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Preface

Business and its relationship to society has experienced many dramatic changes in the twenty-first century. Social responsibility has become much more important to companies due to the major economic challenges that faced companies in the early part of the century as well as the more recent global recession that is taking many years for recovery. During this time, many stakeholders lost trust in business, and throughout the world regulatory agencies tightened their grip on business decision-making to attempt to legislate responsible conduct. Many activities considered socially responsible yet voluntary are now viewed as mandatory or are considered best practices. The institutionalization of social responsibility and business ethics is being felt and reflected on by businesses and public policy decision-makers. The Sarbanes-Oxley Act of 2002 and the administrative rulings of the Securities and Exchange Commission have reformed corporate governance, internal controls, financial reporting, executive compensation, business ethics, and organizations’ relations to stakeholders. In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act revamped many aspects of financial compliance due to a loss of trust in our banking system. The Consumer Financial Protection Bureau was established to protect consumers in areas such as loans, credit cards, and financial transparency.

In this text, we demonstrate and help the instructor prove that social responsibility is a theoretically grounded yet highly actionable and practical field of interest. The relationship between business and society is inherently controversial and complex, yet the intersection of its components, such as corporate governance, workplace ethics, community needs, and technology, is experienced in every organization. For this reason, we developed this text to effectively assist decision-making and inspire the application of social responsibility principles to a variety of situations and organizations.

Because of this transformation of corporate responsibility, the fifth edition of Business and Society: A Strategic Approach to Social Responsibility is designed to fully reflect these changes. We have been diligent in this revision about discussing the most current knowledge and describing best practices related to social responsibility. The innovative text, cutting-edge cases, and comprehensive teaching and learning package for Business and Society ensure that business students understand and appreciate concerns about philanthropy, employee well-being, corporate governance, consumer protection, social issues, and sustainability.
Business and Society is a highly readable and teachable text that focuses on the reality of social responsibility in the workplace. We have revised the fifth edition to be the most practical and applied business and society text available. A differentiating feature of this book is its focus on the role that social responsibility takes in strategic business decisions. We demonstrate that studying social responsibility provides knowledge and insights that positively contribute to organizational performance and professional success. This text prepares students for the social responsibility challenges and opportunities they will face throughout their careers. We provide the latest examples, stimulating cases, and unique learning tools that capture the reality and complexity of social responsibility. Students and instructors prefer this book because it presents examples, tools, and practices needed to develop and implement a socially responsible business strategy. Finally, this book makes the assumption that students will be working in an organization trying to improve social responsibility and not just critics of business.

**IMPORTANT CHANGES TO THE FIFTH EDITION**

The fifth edition has been completely revised to include new examples, vignettes, and cases. Each chapter of the text has been updated to include recent social responsibility issues related to the economy, ethical decision-making, and concerns about corporate governance. Chapter 4 has been updated to include recent legislation that impacts business, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and amendments to the Federal Sentencing Guidelines for Organizations. In Chapter 5, we have inserted information about how to develop an ethical culture as well as normative considerations in ethical decision-making. Chapter 6 has been expanded to include the institutionalization of business ethics, the importance of ethical leadership, and requirements for becoming an ethical leader in an organization. An important addition to Chapter 9 involves social entrepreneurship and how it impacts the relationships between businesses and their communities.

New opening cases at the start of each chapter address a variety of issues related to the chapter content, including greenwashing, fracking, and childhood obesity. Companies featured in these cases include Target, CarMax, General Motors, and Credit Suisse. Two boxed inserts focus on social responsibility. One relates to ethical challenges in different areas of business, including human resources, marketing, accounting, and finance. Topics discussed in these vignettes include minimum wages, integrated reporting, and cooperative banking. Another boxed insert entitled “Earth in the Balance” focuses on social responsibility related to sustainability issues. These vignettes discuss green initiatives at companies such as Google, Unilever, and SodaStream.
The “Responsible Business Debate” feature at the end of each chapter introduces a real-world issue and presents two competing perspectives. The debate is positioned so that class teams can defend a position and analyze topics, giving students the opportunity to engage in active learning. Topics discussed include controversies over clearance pricing, performance reviews, business’s influence on society, and the use of genetically engineered pesticides. We have also provided 15 cutting-edge cases, all of which are new or significantly updated.

**CONTENT AND ORGANIZATION**

Professors who teach business and society courses come from diverse backgrounds, including law, management, marketing, philosophy, and many others. Such diversity affords great opportunities to the field of business and society and showcases the central role that social responsibility occupies within various academic, professional, work, and community circles. Because of the widespread interest and multiplicity of stakeholders, the philosophy and practice of social responsibility is both exciting and debatable; it is in a constant state of discussion and refinement—just like all important business concepts and practices.

We define social responsibility in Chapter 1, “Social Responsibility Framework,” as the adoption by a business of a strategic focus for fulfilling the economic, legal, ethical, and philanthropic responsibilities expected of it by its stakeholders. To gain the benefits of social responsibility, effective and mutually beneficial relationships must be developed with customers, employees, investors, government, the community, and others who have a stake in the company. We believe that social responsibility must be fully valued and championed by top managers and granted the same planning time, priority, and management attention as any company initiative. Therefore, the framework for the text reflects a process that begins with the social responsibility philosophy, includes the four types of responsibilities, involves many types of stakeholders, and ultimately results in both short- and long-term performance gains. We also provide a strategic orientation, so students will develop the knowledge, skills, and attitudes for understanding how organizations achieve many benefits through social responsibility.

Chapter 2, “Strategic Management of Stakeholder Relationships,” examines the types and attributes of stakeholders, how stakeholders become influential, and the processes for integrating and managing their influence on a firm. The chapter introduces the stakeholder interaction model and examines the impact on global business, corporate reputation, and crisis situations on stakeholder relationships.

Because both daily and strategic decisions affect a variety of stakeholders, companies must maintain a governance structure for ensuring proper control and responsibility for their actions. Chapter 3, “Corporate Governance,” examines the rights of shareholders, the accountability
of top management for corporate actions, executive compensation, and strategic-level processes for ensuring that economic, legal, ethical, and philanthropic responsibilities are satisfied. Corporate governance is an integral element for social responsibility, which, until the recent scandals, had not received the same level of emphasis as issues such as environment and human rights.

Chapter 4, “Legal, Regulatory, and Political Issues,” explores the complex relationship between business and government. Every business must be aware of and abide by the laws and regulations that dictate required business conduct. This chapter also examines how business can participate in the public policy perspective to influence government. A strategic approach for legal compliance, based on the Federal Sentencing Guidelines for Organizations, is also provided.

Chapter 5, “Business Ethics and Ethical Decision-Making,” and Chapter 6, “Strategic Approaches to Improving Ethical Behavior,” are devoted to exploring the role of ethics and ethical leadership in business decision-making. Business ethics relates to responsibilities and expectations that exist beyond legally prescribed levels. We examine the factors that influence ethical decision-making and consider how companies can apply this understanding to improve ethical conduct. We fully describe the components of an organizational ethics program and detail the implementation plans needed for effectiveness.

Chapter 7, “Employee Relations,” and Chapter 8, “Consumer Relations,” explore relationships with two pivotal stakeholders—consumers and employees. These constituencies, although different by definition, have similar expectations of the economic, legal, ethical, and philanthropic responsibilities that must be addressed by business.

Chapter 9, “Community Relations and Strategic Philanthropy,” examines companies’ synergistic use of organizational core competencies and resources to address key stakeholders’ interests and achieve both organizational and social benefits. While traditional benevolent philanthropy involves donating a percentage of sales to social causes, a strategic approach aligns employees and organizational resources and expertise with the needs and concerns of stakeholders. Strategic philanthropy involves both financial and nonfinancial contributions to stakeholders, but it also directly benefits the company.

Due to the internet and other technological advances, communication is faster than ever, information is readily available, people are living longer and healthier lives, and consumer expectations of businesses continue to rise. Chapter 10, “Technology Issues,” provides cutting-edge information on the unique issues that arise as a result of enhanced technology in the workplace and business environment, including its effects on privacy, intellectual property, and health. The strategic direction for technology depends on the government’s and businesses’ ability to plan, implement, and audit the influence of technology on society.

Chapter 11, “Sustainability Issues,” explores the significant environmental issues business and society face today, including air pollution,
global warming, water pollution and water quantity, land pollution, waste management, deforestation, urban sprawl, biodiversity, genetically modified foods, and alternative energy. This chapter also considers the impact of government environmental policy and regulation and examines how some companies are going beyond these laws to address environmental issues and act in an environmentally responsible manner.

Chapter 12, “Social Responsibility in a Global Environment,” is a chapter that addresses the unique issues found in a global business environment. Emerging trends and standards are placed in a global context.

**SPECIAL FEATURES**

**Examples**

Company examples and anecdotes from all over the world are found throughout the text. The purpose of these tools is to take students through a complete strategic planning and implementation perspective on business and society concerns by incorporating an active and team-based learning perspective. Every chapter opens with a vignette and includes examples that shed more light on how social responsibility works in today’s business. In this edition, all boxed features focus on managerial and global dimensions of social responsibility. Chapter opening objectives, a chapter summary, boldfaced key terms, and discussion questions at the end of each chapter help direct students’ attention to key points.

**Experiential Exercises**

Experiential exercises at the end of each chapter help students apply social responsibility concepts and ideas to business practice. Most of the exercises involve research on the activities, programs, and philosophies that companies and organizations are using to implement social responsibility today. These exercises are designed for higher-level learning and require students to apply, analyze, synthesize, and evaluate knowledge, concepts, practices, and possibilities for social responsibility. At the same time, the instructor can generate rich and complex discussions from student responses to exercises. For example, the experiential exercise for Chapter 1 asks students to examine *Fortune* magazine’s annual list of the Most Admired Companies. This exercise sets the stage for a discussion on the broad context in which stakeholders, business objectives, and responsibilities converge.

“What Would You Do?” exercises depict people in real-world scenarios who are faced with decisions about social responsibility in the workplace. One exercise (see Chapter 9) discusses the dilemma of a newly named vice president of corporate philanthropy. His charge over the next year is to develop a stronger reputation for philanthropy and social responsibility with the company’s stakeholders, including employees, customers, and community. At the end of the scenario, students are asked to
help the VP develop a plan for gaining internal support for the office and its philanthropic efforts.

A new debate issue is located at the end of each chapter. The topic of each debate deals with a real-world company or dilemma that is both current and controversial. Many students have not had the opportunity to engage in a debate and to defend a position related to social responsibility. This feature highlights the complexity of ethical issues by creating a dialog on advantages and disadvantages surrounding issues. The debates also help students develop their critical-thinking, research, and communication skills.

Cases

So that students learn more about specific practices, problems, and opportunities in social responsibility, 15 cases are provided at the end of the book. The cases represent a comprehensive collection for examining social responsibility in a multidimensional way. The 15 cases allow students to consider the effects of stakeholders and responsibility expectations on larger and well-known businesses. These cases represent the most up-to-date and compelling issues in social responsibility. All of the cases used in this book are original and have been updated with all developments that have occurred through 2014. Students will find these cases to be pivotal to their understanding of the complexity of social responsibility in practice. The following provides an overview of the 15 cases:

- Case 1: Monsanto Attempts to Balance Stakeholder Interests. This case discusses the challenges and successes that Monsanto has experienced in balancing the interests of different stakeholders. The primary controversy that Monsanto has faced involves the patented and genetically modified nature of its seeds, pesticides, and herbicides.
- Case 2: The Mission of CVS: Corporate Social Responsibility and Pharmacy Innovation. This case examines the corporate social responsibility initiatives of CVS as well as ethical challenges it has faced. Of particular interest is CVS’s decision to drop profitable tobacco products from stores to better align itself as a health services company.
- Case 3: Belle Meade Plantation: The First Non-Profit Winery Engages in Social Entrepreneurship. We discuss the Nashville plantation, Belle Meade’s background, and the challenges it has faced as a nonprofit. To support itself instead of having to rely solely on donations or tour tickets, Belle Meade has become a social entrepreneur by developing and selling wine from the plantation’s vineyards on the premises. Proceeds go to support the plantation. This endeavor in social entrepreneurship has led to the nation’s first non-profit winery.
- Case 4: Multilevel Marketing Under Fire: Herbalife Defends Its Business Model. This case considers the accusations levied against Herbalife by activist investor William Ackman charging Herbalife’s business model as being a pyramid scheme. We differentiate between a pyramid scheme and a multilevel marketing compensation model and apply this to Herbalife’s business.
• Case 5: Hobby Lobby: Balancing Stakeholders and Religious Freedom in Business Decisions. We investigate the landmark decision in *Burwell v. Hobby Lobby* and its impact on the religious rights of closely held private companies. This victory for Hobby Lobby is likely to have major implications for the government’s ability to require certain benefits if they conflict with a closely held company’s religious principles.

• Case 6: Starbucks’ Mission: Social Responsibility and Brand Strength. This case examines Starbucks’ foundation for a socially responsible culture. It also describes how Starbucks strives to meet the needs of different stakeholders and how this stakeholder emphasis has led to the development of successful products and a strong brand image.

• Case 7: Lululemon: Encouraging a Healthier Lifestyle. We demonstrate Lululemon’s success in its mission to help consumers live a healthier lifestyle. Additionally, we look at some of the controversies that have hit Lululemon in recent years, including the remarks and subsequent resignation of Board Chairman and founder Chip Wilson.

• Case 8: Coping with Financial and Ethical Risks at American International Group (AIG). This case covers the scandal involving AIG leading to the most recent recession as well as the controversial actions it took after it received government bailout money. It looks at how AIG has attempted to rebuild its reputation and restore trust.

• Case 9: The Coca-Cola Company Struggles with Ethical Crises. We look at the many ethical issues that have challenged Coca-Cola’s dominancy in the late 1990s to the first decades of the twenty-first century. In particular, we focus on how Coca-Cola has reacted to these crises and its initiatives to become a socially responsible company.

• Case 10: Enron: Questionable Accounting Leads to Collapse. This case describes the well-known example of Enron, one of the biggest bankruptcies of the time that shocked the world with its far-reaching effects. We examine the different players in the Enron crisis as well as the lessons that the Enron debacle can teach the business world.

• Case 11: The Complexity of Intellectual Property. This case takes an in-depth look at different types of intellectual property as well as how common violations occur. The lawsuit between Apple and Samsung is discussed to show that even large well-established companies deal with this issue.

• Case 12: Salesforce.com: Responsible Cloud Computing. We examine the success of Salesforce.com’s cloud computing model. In particular, we focus on its 1-1-1 model to give back to the communities in which it does business.

• Case 13: Mattel Responds to Ethical Challenges. This case goes over Mattel’s corporate social responsibility initiatives with a particular emphasis on its supplier code of conduct. Two major controversies Mattel has faced are discussed. The first is the lead paint and magnet scandal that forced Mattel to undergo a massive recall and damaged its reputation. A more recent example is the intellectual property dispute it has had with rival company MGA over the ownership of the Bratz dolls.
Case 14: Home Depot Implements Stakeholder Orientation. Although Home Depot faced a decrease in customer satisfaction in the past, it has implemented a number of initiatives to restore its ethical reputation with stakeholders. Some major initiatives include its diversity supplier program, its use of wood certified by the Forest Stewardship Council, and its philanthropic involvement with Habitat for Humanity. Above all, Home Depot has adopted a stakeholder orientation that considers how it can best meet the needs of all its various stakeholders.

Case 15: New Belgium Brewing: Engaging in Sustainable Social Responsibility. This case examines the background of New Belgium Brewing and its social responsibility initiatives. Its strong emphasis on sustainability and employee involvement are discussed as examples of how the craft brewery has been able to maintain its corporate values since its founding.

Role-Play Exercises
In addition to many examples, end-of-chapter exercises, and the cases, we provide three role-play exercises in the Instructor’s Manual. The role-play exercises built around a fictitious yet plausible scenario or case support higher-level learning objectives, require group decision-making skills, and can be used in classes of any size. Implementation of the exercises can be customized to the time frame, course objectives, student population, and other unique characteristics of a course. These exercises are aligned with trends in higher education toward teamwork, active learning, and student experiences in handling real-world business issues. For example, the National Farm & Garden exercise places students in a crisis situation involving a product defect that requires an immediate response and consideration of changes over the long term. The Soy-Dri exercise requires students to come up with an action plan for how to deal with customer confusion over the appropriate use of different products. The Shockvolt exercise places students in a situation in which they must determine the ethics and potential legal implications for marketing an energy drink. The role-play simulations (1) give students the opportunity to practice making decisions that have consequences for social responsibility, (2) utilize a team-based approach, (3) recreate the pressures, power, information flows, and other factors that affect decision-making in the workplace, and (4) incorporate a debriefing and feedback period for maximum learning and linkages to course objectives. We developed the role-play exercises to enhance more traditional learning tools and to complement the array of resources provided to users of this text. Few textbooks offer this level of teaching support and proprietary learning devices.
A SUPPLEMENTS PACKAGE

The comprehensive Instructor’s Manual includes chapter outlines, answers to the discussion questions at the end of each chapter, comments on the experiential exercises at the end of each chapter, comments on each case, and a sample syllabus. The role-play exercises are included in the manual along with specific suggestions for using and implementing them in class.

The Test Bank provides multiple choice and essay questions for each chapter and includes a mix of descriptive and application questions.

A PowerPoint slide program is available for easy downloading and provides a recap of the highlights in each chapter.

Visit www.chicagobusinesspress.com to request access to the instructor supplements.

AUTHORS’ PERSONAL WEBSITE

O. C. Ferrell and Linda Ferrell have established a teaching resource website based on their participation in the Daniels Fund Ethics Initiative. Their publicly accessible website contains original cases, debate issues, videos, interviews, and PowerPoint modules on select business and society topics as well as other resources such as articles on ethics and social responsibility education. It is possible to access this website at http://danielsethics.mgt.unm.edu.

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Our goal is to provide materials and resources that enhance and strengthen teaching, learning, and thinking about social responsibility. We invite your comments, concerns, and questions. Your suggestions will be sincerely appreciated and utilized.

O. C. Ferrell
Debbie M. Thorne
Linda Ferrell
CHAPTER ONE

Social Responsibility Framework

Chapter Objectives

● To define the concept of social responsibility
● To trace the development of social responsibility
● To examine the global nature of social responsibility
● To discuss the benefits of social responsibility
● To introduce the framework for understanding social responsibility

Chapter Outline

Social Responsibility Defined
Development of Social Responsibility
Global Nature of Social Responsibility
Benefits of Social Responsibility
Framework for Studying Social Responsibility
NiSource—A Top Firm in Social Responsibility

For NiSource, social responsibility involves actively living its four core values: fairness, honesty, integrity, and trust. NiSource is a Fortune 500 company that owns a portfolio of energy businesses. Headquartered in Merrillville, Indiana, NiSource is involved in natural gas and electric transmission, storage, generation, and distribution in seven states.

The company’s mission reflects its emphasis on social responsibility. It seeks to deliver “safe, reliable, clean and affordable energy” that benefits all stakeholders. As a profitable company complying with all applicable laws, NiSource achieves the economic and legal levels of social responsibility. It also exhibits strong ethical and philanthropic initiatives, leading it to be named one of the “World’s Most Ethical Companies” for the third consecutive year. Its code of ethics encourages employees to take responsibility for the company’s success and ethical conduct.

NiSource demonstrates a strong commitment to employees, customers, the environment, and communities. For instance, NiSource has taken a strong stance on improving employee safety and has become an industry leader in this area. NiSource incentivizes employees by offering them rewards for safe behavior. As a result, vehicle accidents have decreased 47 percent and other safety-related incidents by 62 percent.

NiSource also recognizes the dangers that consumers might face, especially in situations such as potentially hitting an underground utility line when digging in their yards. NiSource invests $2.3 million on public and safety awareness programs for consumers. As part of its awareness campaign, it created the mascot Digger Dog to appeal to children and educate them about calling the number 811 to receive information about the location of utility lines before digging.

Environmental sustainability is a strong component of NiSource’s corporate culture. In 2014 the company completed a project estimated to reduce harmful sulfur dioxide emissions significantly. The company maintains a Board of Directors’ Environmental Health and Safety Committee that evaluates and approves NiSource’s environmental policy, including policies concerning climate change. NiSource also helps its customers save energy by developing energy efficiency programs such as its Customer CHOICE® program. This program allows customers to reduce energy costs by purchasing natural gas from non-utilities suppliers.

Finally, NiSource recognizes its responsibilities toward communities. It has established the NiSource Charitable Foundation to provide funds to nonprofits who it believes contribute toward its mission to help create “strong and sustainable communities.” NiSource has invested $6.8 million toward nonprofit organizations.

NiSource invests resources in social responsibility and has been recognized for its many benefits. Because of its sustainability initiatives, NiSource was named to the Dow Jones Sustainability Index in 2012. It was also named among the top 25 Socially Responsible Dividend Stocks by the Dividend Channel. These awards are beneficial in attracting investors interested in investing in socially responsible companies. This has significantly impacted NiSource’s bottom line—its stock outperformed the Dow Jones and Standard and Poor’s indices with a total shareholder return of 8.5 percent. NiSource clearly proves that social responsibility helps stakeholders and the bottom line.1
Businesses today must cope with challenging decisions related to their interface with society. Consumers, as well as others, are increasingly emphasizing the importance of companies’ reputations, which are often based on ethics and social responsibility. The meaning of the term “social responsibility” goes beyond being philanthropic or environmentally sustainable. Seventy-six percent of Americans think the meaning now extends to how employees are treated and the values a company holds. In an era of intense global competition and increasing media scrutiny, consumer activism, and government regulation, all types of organizations need to become adept at fulfilling these expectations. Like NiSource, many companies are trying, with varying results, to meet the many economic, legal, ethical, and philanthropic responsibilities they now face. Satisfying the expectations of social responsibility is a never-ending process of continuous improvement that requires leadership from top management, buy-in from employees, and good relationships across the community, industry, market, and government. Companies must properly plan, allocate, and use resources to satisfy the demands placed on them by investors, employees, customers, business partners, the government, the community, and others. Those who have an interest or stake in the company are referred to as stakeholders.

In this chapter, we examine the concept of social responsibility and how it relates to today’s complex business environment. First, we define social responsibility. Next, we consider the development of social responsibility, its benefits to organizations, and the changing nature of expectations in our increasingly global economy. Finally, we introduce the framework for studying social responsibility used by this text, which includes such elements as strategic management for stakeholder relations; legal, regulatory, and political issues; business ethics; corporate governance; consumer relations; employee relations; philanthropy and community relations; technology issues; sustainability issues; and global relations.

**SOCIAL RESPONSIBILITY DEFINED**

Business ethics, corporate volunteerism, philanthropic activities, going green, sustainability, corporate governance, reputation management—these are terms you may have heard used, or even used yourself, to describe the various rights and responsibilities of business organizations. You may have thought about what these terms actually mean for business practice. You may also have wondered how businesses engage in these behaviors or contribute to these outcomes. In this chapter, we clarify some of the confusion that exists in the terminology that people use when they talk about expectations for business. To this end, we begin by defining social responsibility.

In most societies, businesses are granted a license to operate and the right to exist through a combination of social and legal institutions. Businesses are expected to provide quality goods and services, abide by
laws and regulations, treat employees fairly, follow through on contracts, protect the natural environment, meet warranty obligations, and adhere to many other standards of good business conduct. Companies that continuously meet and exceed these standards are rewarded with customer satisfaction, employee dedication, investor loyalty, strong relationships in the community, and the time and energy to continue focusing on business-related concerns. Firms that fail to meet these responsibilities can face penalties, both formal and informal, and may have their attention diverted away from core business practice. For example, in 2014 General Motors (GM) instituted a recall of 2.6 million vehicles due to faulty ignition switches. Attorneys filed class action lawsuits against GM, and GM’s case was hurt further because it knew about the faulty ignition switch problem years before the recall. This is likely to put a damper on GM’s reputation. The first female CEO of GM, Mary Barra, had to address these issues to restore customer confidence. However, GM can restore consumer confidence if they acknowledge mistakes, correct the problem, and make proper restitution. The goal is to prevent these negative outcomes in the future.

In contrast, a large multinational corporation may be faced with protestors who use physical means to destroy or deface property. For example, in 2014 Vietnamese protestors attacked Chinese companies to protest the location of a Chinese oil rig in disputed waters. In addition to much physical destruction, the protestors injured 129 people and killed 2. Many foreign-owned factories in Vietnam shut down as a result. After the violence died down, companies still had to allocate resources to remodel their stores and answer criticism.

Finally, a company engaged in alleged deceptive practices may face formal investigation by a government agency. For example, officials at the Justice Department inquired about pricing discussions those in the publishing industry might have had to determine whether price fixing was taking place. This occurred two years after a civil antitrust lawsuit was settled with three book publishers who allegedly conspired with Apple to raise electronic book prices. The Justice Department is concerned that pricing discussions among publishers could lead to future price-fixing in order to keep up with Amazon.com’s domination of the e-book and print book industries. Investigations such as this could lead to legal charges and penalties, perhaps severe enough to significantly alter the company’s products and practices or close the business. For example, The Scooter Store, a company that sold motorized wheelchairs all over the United States, filed for Chapter 11 bankruptcy after a federal investigation determined the company had deceptively overcharged Medicare and Medicaid between $47 million and $88 million over the course of two years. The company was found to have engaged in deceptive tactics, such as continually contacting doctors to prescribe the motorized wheelchairs whether or not a patient was in need of one; claiming the wheelchairs were free in advertisements when taxpayers were paying for them; and contributing to political campaigns to avoid any changes to Medicare and Medicaid. In addition, the city of New Braunfels, Texas, the home of the company’s headquarters,
sued the company for the more than $2 million that was given to them from an economic development fund to build their headquarters. To make matters worse, consumers remarked they made purchases from the company because they claimed their goal was to “Always Do the Right Thing.”

Businesses today are expected to look beyond self-interest and recognize that they belong to a larger group, or society, that expects responsible participation. Therefore, if any group, society, or institution is to function, there must be a delicate interplay between rights (i.e., what people expect to get) and responsibilities (i.e., what people are expected to contribute) for the common good. Research indicates that the most ethical and socially responsible companies are the most profitable. Therefore, responsible conduct and policies yield significant benefits to society as well as shareholders. While the media provides much coverage of misconduct and illegal activities in business, most businesses try to act in an ethical and socially responsible manner.

The term social responsibility came into widespread use in the business world during the 1970s. It has evolved into an emphasis on the following areas: social issues, consumer protection, sustainability, and corporate governance. Social issues are linked with the idea of the “common good.” The common good is associated with the development of social conditions that allow for societal welfare and fulfillment to be achieved. In other words, social issues involve the ethical responsibilities a firm owes to society. Equal rights, gender roles, marketing to vulnerable populations, data protection, and internet tracking are examples of social issues common in business. Social issues can become so significant that they warrant legislation to protect consumers. For the Federal Trade Commission’s Bureau of Consumer Protection, leading consumer protection issues include misleading advertising, product safety, and advertising to children.

Sustainability has also become a growing area of concern in society. In the United States, sustainability is used to refer more to the environmental impact on stakeholders. Green marketing practices, consumption of resources, and greenhouse gas emissions are important sustainability considerations that socially responsible businesses will have to address. Corporate governance will be described in more detail in Chapter 3. It refers to formal systems of accountability, oversight, and control. Corporate governance is becoming an increasingly important topic in light of business scandals over the last 10–15 years. Issues in corporate governance include concerns over executive compensation, internal control mechanisms, and risk management. Figure 1.1 discusses the social responsibility issues that we will be covering in this text.

These four areas of social responsibility tend to conflict with the traditional or neoclassical view of a business’s responsibility to society. The traditional view of social responsibility, articulated in the famous economist Milton Friedman’s 1962 Capitalism and Freedom, asserts that business has one purpose, satisfying its investors or shareholders, and that any other considerations are outside its scope. Although this view still exists
today, it has lost credibility as more and more companies have assumed a social responsibility orientation. Companies see social responsibility as a part of their overall corporate strategy and a benefit that directly increases the bottom line. We define social responsibility as the adoption by a business of a strategic focus for fulfilling the economic, legal, ethical, and philanthropic responsibilities expected of it by its stakeholders. This definition encompasses a wide range of objectives and activities, including both historical views of business and perceptions that have emerged in the last decade. Let’s take a closer look at the parts of this definition.

Social Responsibility Applies to All Types of Businesses

It is important to recognize that all types of businesses—small and large, sole proprietorships and partnerships, as well as large corporations—implement social responsibility initiatives to further their relationships with their customers, their employees, and their community at large. For example, Altered Seasons, a candle retailer in Buffalo, New York, operates on a one-for-one model, where the company gives a meal to the hungry for every candle that it sells. The company’s candles are made from environmentally friendly materials and are manufactured in the United States. Thus, the ideas advanced in this book are equally relevant and applicable across a wide variety of businesses and nonprofits.

Nonprofit organizations are expected to be socially responsible. Relationships with stakeholders—including employees, those that are served, and the community—affect their reputation. For example, the Southern California chapter of the Better Business Bureau was expelled from the organization after evidence emerged in 2010 that it had been operating a pay-for-play scheme. The Better Business Bureau is a nonprofit self-regulatory organization that objectively rates businesses on how they

FIGURE 1.1 Major Emphases of Social Responsibility

treat consumers and handle consumer complaints. Investigations revealed that employees at the Southern California bureau were awarding businesses high rankings only if they paid to become members. The bureau is the largest ever expelled for misconduct.12 This example demonstrates that nonprofit organizations must also develop strategic plans for social responsibility. In addition, government agencies are expected to uphold the common good and act in an ethical and responsible manner.

Although the social responsibility efforts of large corporations usually receive the most attention, the activities of small businesses may have a greater impact on local communities.13 Owners of small businesses often serve as community leaders, provide goods and services for customers in smaller markets that larger corporations are not interested in serving, create jobs, and donate resources to local community causes. Medium-sized businesses and their employees have similar roles and functions on both a local and a regional level. Although larger firms produce a substantial portion of the gross national output of the United States, small businesses employ about half of the private sector workforce and produce roughly half of the private sector output. In addition to these economic outcomes, small business presents an entrepreneurial opportunity to many people, some of whom have been shut out of the traditional labor force. Women, minorities, and veterans are increasingly interested in self-employment and other forms of small business activity.14 It is vital that all businesses consider the relationships and expectations that our definition of social responsibility suggests.

Social Responsibility Needs a Strategic Focus

Social responsibility is an important business concept and involves significant planning and implementation. Our definition of social responsibility requires a formal commitment, or a way of communicating the company’s social responsibility philosophy. For example, Herman Miller, a multinational provider of office, residential, and healthcare furniture and services, established a set of values that create a culture of community both within and outside of the company (shown in Table 1.1). This statement declares Herman Miller’s philosophy and the way it will fulfill its responsibilities to its customers, its shareholders, its employees, the community, and the natural environment. Because this statement takes into account all of Herman Miller’s constituents and applies directly to all of the company’s operations, products, markets, and business relationships, it demonstrates the company’s strategic focus on social responsibility. Other companies that embrace social responsibility have incorporated similar elements into their strategic communications, including mission and vision statements, annual reports, and websites. For example, Hershey Entertainment & Resorts focuses upon

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**TABLE 1.1 Herman Miller, Inc.’s Corporate Culture Values of Community**

- Curiosity and Exploration
- Performance
- Engagement
- Design
- Relationships
- Inclusiveness
- A Better World
- Transparency
- Foundations

four pillars of CSR: (1) the environment and the goal to reduce the ecological footprint; (2) the community and being a positive, productive, and informed partner; (3) the workplace, in fostering one that is safe, inclusive, desirable, and respectful; and (4) a marketplace and guest focus that considers the ethical treatment of all stakeholders.\(^{15}\)

In addition to a company’s verbal and written commitment to social responsibility, our definition requires action and results. To implement its social responsibility philosophy, Herman Miller has developed and implemented several corporate-wide strategic initiatives, including research on improving work furniture and environments, innovation in the area of ergonomically correct products, progressive employee development opportunities, volunteerism, and an environmental stewardship program.\(^{16}\) These efforts have earned the company many accolades, such as being named the “Most Admired” furniture manufacturer in America by *Fortune* magazine, and a place on many prestigious lists, including *Fortune* magazine’s “100 Best Companies to Work for in America,” *Forbes* magazine’s “Platinum List” of America’s 400 best-managed large companies, *Business Ethics* magazine’s “100 Best Corporate Citizens,” *Diversity Inc.* magazine’s “Top 10 Corporations for Supplier Diversity,” and *The Progressive Investor*’s “Sustainable Business Top 20.”\(^{17}\) As this example demonstrates, effective social responsibility requires both words and action.

If any such initiative is to have strategic importance, it must be fully valued and championed by top management. Leaders must believe in and support the integration of stakeholder interests and economic, legal, ethical, and philanthropic responsibilities into every corporate decision. For example, company objectives for brand awareness and loyalty can be developed and measured from both a marketing and a social responsibility standpoint because researchers have documented a relationship between consumers’ perceptions of a firm’s social responsibility and their intentions to purchase that company’s brands.\(^{18}\) Likewise, engineers can integrate consumers’ desires for reduced negative environmental impact in product designs, and marketers can ensure that a brand’s advertising campaign incorporates this product benefit. Finally, consumers’ desires for an environmentally sustainable product may stimulate a stronger company interest in assuming environmental leadership in all aspects of its operations. Home Depot, for example, responded to demands by consumers and environmentalists for environmentally friendly wood products by launching a new initiative that gives preference to wood products certified as having been harvested responsibly over those taken from endangered forests.\(^{19}\) With this action, the company—which has long touted its environmental principles—has chosen to take a leadership role in the campaign for environmental responsibility in the home improvement industry. Although social responsibility depends on collaboration and coordination across many parts of the business and among its constituencies, it also produces effects throughout these same groups. We discuss some of these benefits in a later section of this chapter.
Because of the need for coordination, a large company that is committed to social responsibility often creates specific positions or departments to spearhead the various components of its program. For example, Starbucks has a Global Responsibility Department that focuses on responsible and ethical behaviors regarding the environment, employee relations, customer interactions, suppliers, and communities. The company’s Environmental Starbucks Coffee Company Affairs team works to develop environmentally responsible policies and minimize the company’s “footprint.” CEO Howard Schultz considers the creation of a good work environment a top priority. Some of the results of this philosophy include offering one of the best healthcare programs in the coffee shop industry and the institution of wellness programs. Starbucks also practices conservation with its Starbucks Coffee and Farmer Equity Practices (CAFE), which is a set of socially responsible coffee-buying guidelines. Finally, the company is philanthropic and engages the community on how well the company is doing from their perspective. In the table of contents page of the company’s annual report, CSR (corporate social responsibility) is listed as a key feature.20 A smaller firm may give an executive, perhaps in human resources or the business owner, the ability to make decisions regarding community involvement, ethical standards, philanthropy, and other areas. Regardless of the formal or informal nature of the structure, this department or executive should ensure that social responsibility initiatives are aligned with the company’s corporate culture, integrated with companywide goals and plans, fully communicated within and outside the company, and measured to determine their effectiveness and strategic impact. In sum, social responsibility must be given the same planning time, priority, and management attention that is given to any other company initiative, such as continuous improvement, cost management, investor relations, research and development, human resources, or marketing research.

Social Responsibility Fulfills Society’s Expectations

Another element of our definition of social responsibility involves society’s expectations of business conduct. Many people believe that businesses should accept and abide by four types of responsibility: financial, legal, ethical, and philanthropic (see Table 1.2). To varying degrees, the four types are required, expected, and/or desired by society.21

At Stage 1, businesses have a responsibility to be financially viable so that they can provide a return on investment for their owners, create jobs for the community, and contribute goods and services to the economy. The economy is influenced by the ways organizations relate to their shareholders, their customers, their employees, their suppliers, their competitors, their community, and even the natural environment. For example, in nations with corrupt businesses and industries, the negative effects often pervade the entire society. Transparency International, a German organization dedicated to curbing national and international corruption, conducts an annual survey on the effects of business and government
corruption on a country’s economic growth and prospects. The organization reports that corruption reduces economic growth, inhibits foreign investment, and often channels investment and funds into “pet projects” that may create little benefit other than high returns to the corrupt decision makers. Many of the countries with the highest levels of perceived corruption also report the highest levels of poverty in the world. These countries include Somalia, Chad, Iraq, Haiti, Afghanistan, and Myanmar. Transparency International also notes that some relatively poor countries, including Bulgaria, Colombia, and Estonia, have made positive strides in curbing corruption. However, Canada and Iceland have started to experience higher levels of perceived corruption, yet maintain relatively strong economies. The organization encourages governments, consumers, and nonprofit groups to take action in the fight against corruption. Although business and society may be theoretically distinct, there are a host of practical implications for the four levels of social responsibility, business, and its effects on society.

At Stage 2, companies are required to maintain compliance with legal and regulatory requirements specifying the nature of responsible business conduct. Society enforces its expectations regarding the behavior of businesses through the legal system. If a business chooses to behave in a way that customers, special-interest groups, or other businesses perceive as irresponsible, these groups may ask their elected representatives to draft legislation to regulate the firm’s behavior, or they may sue the firm in a court of law in an effort to force it to “play by the rules.” For example, in 2014 Google was charged with anticompetitive behavior regarding its secret Mobile Application Distribution Agreements (MADAs) that all mobile device manufacturers have had to sign. The MADAs require manufacturers to preload and prominently place Google applications and search engines onto the devices. The antitrust lawsuit claimed that manufacturers should have the freedom to choose which search engines will be placed on their devices and that MADAs are stifling competition because other search engines are prevented from approaching the manufacturers to argue for their inclusion on the devices. Further claims stated that this kind of activity decreases the likelihood of the improvement of search engine functionality.
in general. Lastly, they claimed that if other search engines, such as Bing and Yahoo!, were able to compete against Google in the mobile realm, the prices of the devices for end consumers would dramatically decrease.23

Beyond financial viability and legal compliance, companies must decide what they consider to be just, fair, and right—the realm of ethics, principles, and values. Business ethics refers to the principles and standards that guide behavior in the world of business. Principles are specific and universal boundaries for behavior that should never be violated. Principles such as fairness and honesty are determined and expected by the public, government regulators, special-interest groups, consumers, industry, and individual organizations. The most basic of these principles have been codified into laws and regulations to require that companies conduct themselves in ways that conform to society’s expectations. Ethical issues exist in most managerial decisions. A firm needs to create an ethical culture with values and norms that meet the expectations of stakeholders. Values are enduring beliefs and ideals that are socially enforced. Freedom of speech, for example, is a strong value in the Western world. At the Marriott, values include putting people first, pursuing excellence, embracing change, acting with integrity, and serving our world.24

Many firms and industries have chosen to go beyond these basic laws in an effort to act responsibly. The Direct Selling Association (DSA), for example, has established a code of ethics that applies to all individual and company members of the association. Because direct selling involves personal contact with consumers, there are many ethical issues that can arise. For this reason, the DSA code directs the association’s members to go beyond legal standards of conduct in areas such as product representation, appropriate ways of contacting consumers, and warranties and guarantees. In addition, the DSA actively works with government agencies and consumer groups to ensure that ethical standards are pervasive in the direct selling industry. The World Federation of Direct Selling Associations (WFDSA) also maintains two codes of conduct, one for dealing with consumers and the other for interactions within the industry, that provide guidance for direct sellers around the world in countries as diverse as Argentina, Canada, Finland, Taiwan, and Poland.25

At Stage 4 are philanthropic activities, which promote human welfare and goodwill. By making philanthropic donations of money, time, and other resources, companies can contribute to their communities and society and improve the quality of life. For example, the UPS Foundation has been active in the global community since 1951. The foundation offers programs in philanthropy and humanitarian relief. Donations total approximately $100 million worldwide. In addition to the monetary contributions, 1.4 million annual volunteer hours have also been given. The foundation focuses its efforts on education, disaster preparedness and resiliency, urgent response to unexpected disasters, post-disaster recovery, in-kind disaster relief, skill-based volunteering, partnerships with humanitarian organizations, and thought leadership.26
When these dimensions of social responsibility were first introduced, many people assumed that there was a natural progression from financial viability to philanthropic activities, meaning that a firm had to be financially viable before it could properly consider the other three elements. Today, social responsibility is viewed in a more holistic fashion, with all four dimensions seen as related and integrated, and this is the view we will use in this book. In fact, companies demonstrate varying degrees of social responsibility at different points in time. Figure 1.2 depicts the social responsibility continuum. Companies’ fulfillment of their responsibilities can range from a minimal to a strategic focus that results in a stakeholder orientation. Firms that focus only on shareholders and the bottom line operate from a legal or compliance perspective. Firms that take minimal responsibility view such activities as a “cost of doing business.” Some critics believe that pharmaceutical manufacturers take the minimal approach with respect to the advertising and sale of certain drugs. A court case involving pharmaceutical company GlaxoSmithKline revealed a string of pharmaceutical companies engaging in aggressive and deceptive marketing to encourage doctors to prescribe psychotropic drugs to children. It was found that over the course of 20 years, many companies—including Pfizer, Johnson & Johnson, and Eli Lilly—targeted academic leaders, wrote articles, suppressed data, and seduced doctors with gifts to sell these drugs for pediatric use. Further, the children who were prescribed these drugs were mainly foster children from low-income backgrounds. To date, approximately $13 billion has been paid by the pharmaceutical industry to settle lawsuits related to this issue.

Strategic responsibility is realized when a company has integrated a range of expectations, desires, and constituencies into its strategic direction and planning processes. In this case, an organization considers social responsibility an essential component of its vision, mission, values, and practices. BT, formerly known as British Telecom, is communicating its commitment to strategic responsibility with the theme of “Responsible Business,” where BT is focused on tackling climate change, helping create a more inclusive society, and enabling sustainable economic growth. BT has been reporting on its social responsibility activities for nearly 20 years, which makes the company a leader in accountability disclosure. Finally,
firms may be forced to be more socially responsible by government, non-governmental organizations, consumer groups, and other stakeholders. In this case, any expenditures are considered a “tax” that occurs outside the firm’s strategic direction and resource allocation process. Executives with this philosophy often maintain that customers will be lost, employees will become dissatisfied, and other detrimental effects will occur because of forced social responsibility.

In this book, we will give many examples of firms that are at different places along this continuum to show how the pursuit of social responsibility is never ending. For example, Pacific Gas & Electric (PG&E) was nominated to the 100 Best Corporate Citizens list between 2008 and 2013. It had also been named as one of the United States’ three most sustainable large utilities. PG&E has been considered a leader in the industry for sustainability and has demonstrated a commitment to clean energy and community engagement. However, in 2014 it was dropped from the 100 Best Corporate Citizens list. PG&E was suffering the repercussions from a 2010 gas line explosion. After paying a large settlement to those affected by the disaster, the California Public Utilities Commission levied a $14.35 million fine against PG&E for allegedly sending them incorrect safety information about a gas pipeline and then failing to correct the information for a long period of time. As with most large firms, PG&E must continuously monitor a number of social responsibility issues and determine the most appropriate corporate response and action.

Social Responsibility Requires a Stakeholder Orientation

The final element of our definition involves those to whom an organization is responsible, including customers, employees, investors and shareholders, suppliers, governments, communities, and many others. These constituents have a stake in, or claim on, some aspect of a company’s products, industry, markets, and outcomes and are thus known as stakeholders. We explore the roles and expectations of stakeholders in Chapter 2. Companies that consider the diverse perspectives of these constituents in their daily operations and strategic planning are said to have a stakeholder orientation, meaning that they are focused on stakeholders’ concerns. Adopting this orientation is part of the social responsibility philosophy, which implies that business is fundamentally connected to other parts of society and must take responsibility for its effects in those areas.

R. E. Freeman, a developer of stakeholder theory, maintains that business and society are “interpenetrating systems,” in that each affects and is affected by the other. For the common good to be achieved, cross-institutional and -organizational interactions must move society toward shared partnerships. For example, Kingfisher, the operator of more than 1,130 home improvement retail stores in nine countries, embarked on a new corporate responsibility initiative called “Kingfisher Net Positive.”
The four components to this plan included timber, energy, innovation, and communities. In just over two years, the company has nearly reached its goal of sourcing 100 percent of timber from responsible sources, with 89 percent responsibly sourced. Kingfisher has expanded energy-efficient product lines in its stores to help customers reduce energy consumption. In terms of innovation, the company is focusing on designing products with closed loop systems and determining ways of producing materials from in-store recycling. Finally, the company impacts its communities through education, volunteering, and partnering with other organizations, with 25 percent of Kingfisher stores engaged in these activities.

**DEVELOPMENT OF SOCIAL RESPONSIBILITY**

In 1959, Harvard economist Edward Mason asserted that business corporations are “the most important economic institutions.” His declaration implied that companies probably affect the community and society as much, or perhaps more, in social terms as in monetary, or financial, terms. Employment and the benefits associated with a living wage are necessary to develop a sustainable economy. The opportunity for individuals and businesses to attain economic success is necessary to create a society that can address social issues. Today some question our economic system, but without economic resources little progress can be made in developing society.

Although some firms have more of a social impact than others, companies do influence many aspects of our lives, from the workplace to the natural environment. This influence has led many people to conclude that companies’ actions should be designed to benefit employees, customers, business partners, and the community as well as shareholders. Social responsibility has become a benchmark for companies today. However, these expectations have changed over time. For example, the first corporations in the United States were granted charters by various state governments because they were needed to serve an important function in society, such as transportation, insurance, water, or banking services. In addition to serving as a “license to operate,” these charters specified the internal structure of these firms, allowing their actions to be more closely monitored. During this period, corporate charters were often granted for a limited period of time because many people, including legislators, feared the power that corporations could potentially wield. It was not until the mid 1800s and early 1900s that profit and responsibility to stockholders became major corporate goals.

After World War II, as many large U.S. firms came to dominate the global economy, their actions inspired imitation in other nations. The definitive external characteristic of these firms was their economic dominance. Internally, they were marked by the virtually unlimited autonomy afforded to their top managers. This total discretion meant that these firms’ top managers had the luxury of not having to answer for some
of their actions. In the current business mindset, such total autonomy would be viewed as a hindrance to social responsibility because there is no effective system of checks and balances. In Chapter 3, we elaborate on corporate governance, the process of control and accountability in organizations that is necessary for social responsibility.

In the 1950s, the 130 or so largest companies in the United States provided more than half of the country’s manufacturing output. The top 500 firms accounted for almost two-thirds of the country’s nonagricultural economic activity. U.S. productivity and technological advancements dramatically outpaced those of global competitors, such as Japan and Western Europe. For example, the level of production in the United States was twice as high as that in Europe and quadruple that in Japan. The level of research and development carried out by U.S. corporations was also well ahead of overseas firms. For these reasons, the United States was perceived as setting a global standard for other nations to emulate.

During the 1950s and 1960s, these companies provided benefits that are often overlooked. Their contributions to charities, the arts, culture, and other community activities were beneficial to the industry or to society rather than simply to the companies’ own profitability. For example, the lack of competition meant that companies had the profits to invest in higher quality products for consumer and industrial use. Although the government passed laws that required companies to take actions to protect the natural environment, make products safer, and promote equity and diversity in the workplace, many companies voluntarily adopted responsible practices rather than constantly fighting government regulations and taxes. These corporations once provided many of the services that are now provided by the government in the United States. For example, during this period, the U.S. government spent less than the government of any other industrialized nation on such things as pensions and health benefits, as these were provided by companies rather than by the government. In the 1960s and 1970s, however, the business landscape changed.

Economic turmoil during the 1970s and 1980s changed the role of corporations. Venerable firms that had dominated the economy in the 1950s and 1960s became less important as a result of bankruptcies, takeovers, mergers, or other threats, including high energy prices and an influx of foreign competitors. The stability experienced by the U.S. firms of midcentury dissolved. During the 1960s and 1970s, the Fortune 500 had a relatively low turnover of about 4 percent. By 1990, however, one-third of the companies in the Fortune 500 of 1980 had disappeared, primarily as a result of takeovers and bankruptcies. The threats and instability led companies to protect themselves from business cycles by becoming more focused on their core competencies and reducing their product diversity. To combat takeovers, many companies adopted flatter organizational hierarchies. Flatter organizations meant workforce reduction but also entailed increasing empowerment of lower-level employees.

Thus, the 1980s and 1990s brought a new focus on profitability and economies of scale. Efficiency and productivity became the primary
objectives of business. This fostered a wave of downsizing and restructuring that left some people and communities without financial security. Before 1970, large corporations employed about one of every five Americans, but by the 1990s, they employed only one in ten. The familial relationship between employee and employer disappeared, and along with it went employee loyalty and company promises of lifetime employment. Companies slashed their payrolls to reduce costs, and employees changed jobs more often. Workforce reductions and “job hopping” were almost unheard of in the 1960s but had become commonplace two decades later. These trends made temporary employment and contract work the fastest growing forms of employment throughout the 1990s.1

Along with these changes, top managers were largely stripped of their former freedom. Competition heated up, and both consumers and stockholders grew more demanding. The increased competition led business managers to worry more and more about the bottom line and about protecting the company. Escalating use of the internet provided unprecedented access to information about corporate decisions and conduct, and fostered communication among once unconnected groups, furthering consumer awareness and shareholder activism. Consumer demands put more pressure on companies and their employees. The education and activism of stockholders had top management fearing for their jobs. Throughout the last two decades of the twentieth century, legislators and regulators initiated more and more regulatory requirements every year. These factors resulted in difficult trade-offs for management.

Corporate responsibilities were renewed in the 1990s. Partly as a result of business scandals and Wall Street excesses in the 1980s, many industries and companies decided to pursue and expect more responsible and respectable business practices. Many of these practices focused on creating value for stakeholders through more effective processes and decreased the narrow and sole emphasis on corporate profitability. At the same time, consumers and employees became less interested in making money for its own sake and turned toward intrinsic rewards and a more holistic approach to life and work.2 This resulted in increased interest in the development of human and intellectual capital; the installation of corporate ethics programs; the development of programs to promote employee volunteerism in the community; strategic philanthropy efforts and trust in the workplace; and the initiation of a more open dialog between companies and their stakeholders.

Despite major advances in the 1990s, the sheer number of corporate scandals at the beginning of the twenty-first century prompted a new era of social responsibility. The downfall of Enron, WorldCom, and other corporate stalwarts caused regulators, former employees, investors, non-governmental organizations, and ordinary citizens to question the role and integrity of big business and the underlying economic system. Federal legislators passed the Sarbanes–Oxley Act to overhaul securities laws and governance structures. The new Public Company Accounting Oversight Board was implemented to regulate the accounting and auditing profession after
Enron and WorldCom failed due to accounting scandals. Newspapers, business magazines, and news websites devoted entire sections—often labeled Corporate Scandal, Year of the Apology, or Year of the Scandal—to the trials and tribulations of executives, their companies and auditors, and stock analysts.

In 2007 and 2008, a housing boom in the United States collapsed, setting off a financial crisis. Homeowners could not afford to pay their mortgages. Because of the housing boom, in many cases the mortgages were higher than the houses were worth. People all across the United States began to walk away from their mortgages, leaving banks and other lenders with hundreds of thousands of houses that had decreased in value. Meanwhile, companies such as AIG were using complex financial instruments known as derivatives to transfer the risks of securities such as mortgages, almost as a type of insurance policy. The housing collapse created a number of demands on financial firms who had sold these derivatives to pay their insurance contracts on the defaulted debt securities, but financial firms did not have enough of a safety net to cover so many defaults. The housing collapse created a chain reaction that led to the worst recession since the Great Depression. The government was forced to step in to bail out financial firms in order to keep the economy going and prevent the economy from collapsing further. Many established organizations such as Bear Stearns, Lehman Brothers, and Countrywide went bankrupt or were acquired by other firms at a fraction of what they were originally worth. Table 1.3 describes some of the corporations and banks that collapsed in the financial crisis.

### Table 1.3 Corporations and Banks Involved in the Financial Crisis

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In 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act, the most sweeping legislation since Sarbanes–Oxley. Dodd–Frank is intended to protect the economy from similar financial crises in the future by creating more transparency in the financial industry. This complex law required legislators to develop hundreds of laws to increase transparency and create financial stability. The Dodd–Frank Act will be discussed in more detail in Chapter 4. The financial crisis and the collapse of many well-known institutions has led to a renewed interest in business ethics and social responsibility.

In the last five years, the economy has stabilized and the stock market has recovered. Even though many banks failed during the financial crisis, today banks and the other financial institutions are much larger. The largest five banks are twice as large as they were a decade ago.43 Rather than getting rid of too-big-to-fail financial institutions, they seem to be growing much larger despite recent legislation.

GLOBAL NATURE OF SOCIAL RESPONSIBILITY

Although many forces have shaped the debate on social responsibility, the increasing globalization of business has made it an international concern. A common theme is criticism of the increasing power and scope of business and income differences among executives and employees. Questions of corruption, environmental protection, fair wages, safe working conditions, and the income gap between rich and poor were posed. Many critics and protesters believe that global business involves exploitation of the working poor, destruction of the planet, and a rise in inequality.44 After the financial crisis, global trust in business dropped significantly. More recent polls indicate that trust is rebounding in certain countries, but companies are still vulnerable to the ramifications of distrust. Approximately 54 percent of global consumers indicate they trust business. This is even lower in the United States, where only 49 percent trust business overall.45 In an environment where consumers distrust business, greater regulation and lower brand loyalty are the likely results. We discuss more of the relationship between social responsibility and business outcomes later in this chapter.

The globalization of business has critics who believe the movement is detrimental because it destroys the unique cultural elements of individual countries, concentrates power within developed nations and their corporations, abuses natural resources, and takes advantage of people in developing countries. Multinational corporations are perhaps most subject to criticism because of their size and scope. Thirty-seven of the world’s top 100 economies are not national economies at all; they are corporations like Walmart and Royal Dutch Shell. Table 1.4 shows the top 40 world economies. For example, Toyota Motor’s revenues are roughly the size of the combined revenues of Hungary, Ireland, and New Zealand. Because of the economic and political power they potentially wield, the actions of large, multinational companies are under scrutiny by many stakeholders.
Most allegations by antiglobalization protestors are not extreme, but the issues are still of consequence. For example, the pharmaceutical industry has long been criticized for excessively high pricing, interference with clinical evaluations, some disregard for developing nations, and aggressive promotional practices. Critics have called on governments, as well as public health organizations, to influence the industry in changing some of its practices.46

Advocates of the global economy counter these allegations by pointing to increases in overall economic growth, new jobs, new and more effective products, and other positive effects of global business. Although these differences of opinion provide fuel for debate and discussion, the global economy probably “holds much greater potential than its critics think, and much more disruption than its advocates admit. By definition,
a global economy is as big as it can get. This means that the scale of both
the opportunity and the consequences are at an apex.”47 In responding
to this powerful situation, companies around the world are increasingly
implementing programs and practices that strive to achieve a balance
between economic responsibilities and other social responsibilities. The
Nestlé Company, a global foods manufacturer and marketer, published
the Nestlé Corporate Business Principles in 1998 and has continually
revised them (2002, 2004, and 2010). These principles serve as a manage-
ment tool for decision making at Nestlé and have been translated into
over 50 languages. The updated principles are consistent with the United
Nations’ Global Compact, an accord that covers environmental standards,
human rights, and labor conditions.48 We explore the global context of
social responsibility more fully in Chapter 12.

In most developed countries, social responsibility involves stake-
holder accountability and the financial, legal, ethical, and philanthropic
dimensions discussed earlier in the chapter. However, a key question for
implementing social responsibility on a global scale is: “Who decides on
these responsibilities?” Many executives and managers face the challenge
of doing business in diverse countries while attempting to maintain their
employers’ corporate culture and satisfy their expectations. Some com-
panies have adopted an approach in which broad corporate standards
can be adapted at a local level. For example, a corporate goal of demon-
strating environmental leadership could be met in a number of different
ways depending on local conditions and needs. The Coca-Cola Company
releases sustainability and social responsibility reports for each region in
which it conducts business. In Eurasia and Africa, the company highlights
initiatives and progress achieved regarding women’s empowerment, water
conservation, and improvement of communities. In Greece, the company
contributed toward reforestation and to active lifestyles for youth in the
Netherlands. While some of the sustainability and social responsibility
initiatives are similar among countries, Coca-Cola’s focus on each indi-
vidual region allows them to make the most relevant contributions to their
stakeholders.49

Global social responsibility also involves the confluence of govern-
ment, business, trade associations, and other groups. For example, coun-
tries that belong to the Asia-Pacific Economic Cooperation (APEC) are
responsible for half the world’s annual production and trade volume. As
APEC works to reduce trade barriers and tariffs, it has also developed
meaningful projects in the areas of sustainable development, clean technol-
ologies, workplace safety, management of human resources, and the health
of the marine environment. This powerful trade group has demonstrated
that financial, social, and ethical concerns can be tackled simultaneously.50
Like APEC, other trade groups are also exploring ways to enhance eco-
nomic productivity within the context of legal, ethical, and philanthropic
responsibilities.

Another trend involves business leaders becoming “cosmopolitan
citizens” by simultaneously harnessing their leadership skills, worldwide
business connections, access to funds, and beliefs about human and social rights. Bill Gates, the founder of Microsoft, is no longer active day-to-day in the company, as he and his wife spearhead the Bill and Melinda Gates Foundation to tackle AIDS, poverty, malaria, and the need for educational resources. Golfer Jack Nicklaus and his business partner Jack Milstein designed a line of golf balls whose proceeds are designated to children’s health care.\(^5^1\) Dave Goldberg, CEO of SurveyMonkey, created a survey platform called Audience, which donates money to a charity of the surveyors’ choice after completing the survey. Over $1 million has been infused into charities, including Teach for America, the Boys and Girls Club, and the Humane Society.\(^5^2\) Patagonia donates 1 percent of its profits to environmental organizations. These business leaders are acting as agents to ensure the economic promises of globalization are met with true concern for social and environmental considerations. In many cases, such efforts supplant those historically associated with government responsibility and programs.\(^5^3\)

In sum, progressive global businesses and executives recognize the “shared bottom line” that results from the partnership among business, communities, government, customers, and the natural environment. In a Nielsen survey of more than 28,000 citizens in 56 countries, 76 percent of the respondents indicated that they consult others online regarding the social responsibility of companies before they make a purchase. The top three issues that are most important to consumers include environmental sustainability, advancements in STEM (science, technology, engineering, mathematics) education, and relieving hunger and poverty.\(^5^4\) Thus, our concept of social responsibility is applicable to businesses around the world, although adaptations of implementation and other details on the local level are definitely required. In companies around the world, there is also the recognition of a relationship between strategic social responsibility and benefits to society and organizational performance.

**BENEFITS OF SOCIAL RESPONSIBILITY**

The importance of social responsibility initiatives in enhancing stakeholder relationships, improving performance, and creating other benefits has been debated from many different perspectives.\(^5^5\) Many business managers view such programs as costly activities that provide rewards only to society at the expense of the bottom line. Another view holds that some costs of social responsibility can be recovered through improved performance. If social responsibility is strategic and aligned with a firm’s mission and values, then improved performance can be achieved. It is hard to measure the reputation of a firm, but it is important to build trust and achieve success. Moreover, ample research evidence demonstrates that companies that implement strategic social responsibility programs are more profitable.

Some of the specific benefits include increased efficiency in daily operations, greater employee commitment, higher product quality, improved
decision making, increased customer loyalty, as well as improved financial performance. In short, companies that establish a reputation for trust, fairness, and integrity develop a valuable resource that fosters success, which then translates to greater financial performance (see Figure 1.3). This section provides evidence that resources invested in social responsibility programs reap positive outcomes for both organizations and their stakeholders.

**Trust**

Trust is the glue that holds organizations together and allows them to focus on efficiency, productivity, and profits. According to Stephen R. Covey, author of *The 7 Habits of Highly Effective People*, “Trust lies at the very core of effective human interactions. Compelling trust is the highest form of human motivation. It brings out the very best in people, but it takes time and patience, and it doesn’t preclude the necessity to train and develop people so their competency can rise to that level of trust.” When trust is low, organizations decay and relationships deteriorate, resulting in infighting, playing politics within the organization, and general inefficiency. Employee commitment to the organization declines, product quality suffers, employee turnover skyrockets, and customers turn to more trustworthy competitors. Any stakeholder that loses trust can create a missing link necessary for success.

In a trusting work environment, however, employees can reasonably expect to be treated with respect and consideration by both their peers and their superiors. They are also more willing to rely and act on the decisions and actions of their coworkers. Thus, trusting relationships between managers and their subordinates and between peers contribute to greater decision-making efficiencies. Research by the Ethics Resource
Center indicates that this trust is pivotal for supporting an ethical climate. Employees of an organization with a strong ethical culture are much more likely to report misconduct but are much less likely to observe misconduct than employees in firms with a weak ethical culture. Table 1.5 shows five indicators of trust, support, and transparency that have a strong impact on whether employees will report ethical issues. As the table demonstrates, a key factor that inspires trust and transparency in organizations involves support from senior leadership.

Trust is also essential for a company to maintain positive long-term relationships with customers. A study by Cone Communications reported that 42 percent of consumers have boycotted or refused to purchase from companies that have demonstrated irresponsible behavior in the last 12 months. For example, after the Deepwater Horizon oil spill in 2010, certain groups and individual citizens aggressively boycotted BP due to the vast environmental damage in the Gulf of Mexico. Communities and regulators that lose trust in a company can damage the firm’s reputation and relationships with other stakeholders.

**Customer Loyalty**

The prevailing business philosophy about customer relationships is that a company should strive to market products that satisfy customers’ needs through a coordinated effort that also allows the company to achieve its own objectives. It is well accepted that customer satisfaction is one of the most important factors for business success. Although companies must continue to develop and adapt products to keep pace with consumers’ changing desires, it is also crucial to develop long-term relationships with customers. Relationships built on mutual respect and cooperation facilitate the repeat purchases that are essential for success. By focusing on customer satisfaction, a business can continually strengthen its customers’ trust in the company, and as their confidence grows, this in turn increases the firm’s understanding of their requirements.

In a Cone survey of consumer attitudes, 89 percent of consumers indicated they would be likely to switch to brands associated with a good cause if price and quality were equal. These results show that consumers take for granted that they can buy high-quality products at low prices;
therefore, companies need to stand out as doing something—something that demonstrates their commitment to society. A study by Harris Interactive Inc. and the Reputation Institute reported that one-quarter of the respondents had boycotted a firm’s products or lobbied others to do so when they did not agree with the firm’s policies or activities. Another way of looking at these results is that irresponsible behavior could trigger disloyalty and refusals to buy, whereas good social responsibility initiatives could draw customers to a company’s products. For example, many firms use cause-related marketing programs to donate part of a product’s sales revenue to a charity that is meaningful to the product’s target market. Among the best known cause-related marketing programs is Avon’s “pink ribbon.”

Employee Commitment

Employee commitment stems from employees who are empowered with training and autonomy. Sir Richard Branson, founder of the Virgin Group, has one of the most committed groups of employees in business for these reasons, as well as many others. He has created a culture wherein he personally asks employees for their input, writes their ideas down, and incorporates them when relevant. He is a very visible and approachable authority and inspires a “passion of commitment” for customer service. Virgin Airlines is ranked as the highest in quality for domestic airlines. In the end, empowered employees keep customers happy and coming back for more. For instance, service quality is positively related to employee loyalty. This, in turn, leads to higher customer satisfaction and customer loyalty. Evidence also suggests that corporate social responsibility initiatives are a good way to retain and attract employees.

When companies fail to provide value for their employees, loyalty and commitment suffer. A survey by Gallup found low levels of employee loyalty and commitment worldwide. The study, which surveyed thousands of employees in 142 countries, found that only 13 percent of workers indicated feeling engaged in their jobs. Employees spend many of their waking hours at work; thus, an organization’s commitment to goodwill and respect of its employees usually results in increased employee loyalty and support of the company’s objectives.

Shareholder Support

Investors look at a corporation’s bottom line for profits or the potential for increased stock prices. To be successful, relationships with stockholders and other investors must rest on dependability, trust, and commitment. But investors also look for potential cracks or flaws in a company’s performance. Companies perceived by their employees as having a high degree of honesty and integrity had an average three-year total return to shareholders of 101 percent, whereas companies perceived as having
a low degree of honesty and integrity had a three-year total return to shareholders of just 69 percent. After hackers broke into Target’s databases and stole customers’ credit card numbers and other information, stock fell 46 percent. Target has been criticized for its lack of sufficient internal controls.

Many shareholders are also concerned about the reputation of companies in which they invest. Investors have even been known to avoid buying the stock of firms they view as irresponsible. For example, Warren Buffett sold 25 percent of his holdings in General Motors after a series of recalls was initiated following a federal investigation. The investigation concluded that the company was at fault in several injuries and deaths resulting from negligence of a faulty ignition switch. Many socially responsible mutual funds and asset management firms are available to help concerned investors purchase stock in responsible companies. These investors recognize that corporate responsibility is the foundation for efficiency, productivity, and profits. In contrast, investors know that fines or negative publicity can decrease a company’s stock price, customer loyalty, and long-term viability. Consequently, many chief executives spend a great deal of time communicating with investors about their firms’ reputations and financial performance and trying to attract them to their stock.

The issue of drawing and retaining investors is a critical one for CEOs, as roughly 50 percent of investors sell their stock in companies within one year, and the average household replaces 80 percent of its common stock portfolio each year. This focus on short-term gains subjects corporate managers to tremendous pressure to boost short-term earnings, often at the expense of long-term strategic plans. The resulting pressure for short-term gains deprives corporations of stable capital and forces decision makers into a “quarterly” mentality.

Conversely, those shareholders willing to hold onto their investments are more willing to sacrifice short-term gains for long-term income. Attracting these long-term investors shields companies from the vagaries of the stock market and gives them flexibility and stability in long-term strategic planning. In the aftermath of the Enron scandal, however, trust and confidence in financial audits and published financial statements were severely shaken. Membership in grassroots investment clubs declined, retail stock investments declined, and investors called for increased transparency in company operations and reports. Gaining investors’ trust and confidence is vital for sustaining a firm’s financial stability.

**The Bottom Line: Profits**

Social responsibility is positively associated with return on investment, return on assets, and sales growth. A company cannot continuously be socially responsible and nurture and develop an ethical organizational culture unless it has achieved financial performance in terms of profits. Businesses with greater resources—regardless of their staff size—have
the ability to promote their social responsibility along with serving their customers, valuing their employees, and establishing trust with the public. As mentioned before, the stock returns of the world’s most ethical companies are often higher than that of companies listed on the S&P 500.

Many studies have identified a positive relationship between social responsibility and financial performance. For example, a survey of the 500 largest public corporations in the United States found that those that commit to responsible behavior and emphasize compliance with codes of conduct show better financial performance. A managerial focus on stakeholder interests can affect financial performance, although the relationships between stakeholders and financial performance vary and are very complex. A meta analysis of 25 years of research identified 33 studies (63 percent) demonstrating a positive relationship between corporate social performance and corporate financial performance, 5 studies (about 10 percent) indicating a negative relationship, and 14 studies (27 percent) yielding an inconclusive result or no relationship. Research on the effects of legal infractions suggests that the negative effect of misconduct does not appear until the third year following a conviction, with multiple convictions being more harmful than a single one.

In summary, a company with strong efforts and results in social responsibility is generally not penalized by market forces, including the intention of consumers to purchase the firm’s products. Social responsibility efforts and performance serve as a reputational lever that managers may use to influence stakeholders. A high-performing company may also receive endorsements from governmental officials or other influential groups, and these are more believable than company messages. A company with a strong social responsibility orientation often becomes quite proactive in managing and changing conditions that yield economic benefits, including avoiding litigation and increased regulation. Finally, corporate social performance and corporate financial performance are positively correlated. These findings subjugate the belief that social responsibility is just a “cost factor” for business and has no real benefits to the firm.

National Economy

An often asked question is whether business conduct has any bearing on a nation’s overall economic performance. Many economists have wondered why some market-based economies are productive and provide a high standard of living for their citizens, whereas other market-based economies lack the kinds of social institutions that foster productivity and economic growth. Perhaps a society’s economic problems can be explained by a lack of social responsibility. Trust stems from principles of morality and serves as an important “lubricant of the social system.” Many descriptions of
market economies fail to take into account the role of such institutions as family, education, and social systems in explaining standards of living and economic success. Perhaps some countries do a better job of developing economically and socially because of the social structure of their economic relationships.

Social institutions, particularly those that promote trust, are important for the economic wellbeing of a society. Society has become economically successful over time “because of the underlying institutional framework persistently reinforcing incentives for organizations to engage in productive activity.” In some developing countries, opportunities for political and economic development have been stifled by activities that promote monopolies, graft, and corruption and by restrictions on opportunities to advance individual, as well as collective, wellbeing.

L. E. Harrison offers four fundamental factors that promote economic wellbeing: “(1) The degree of identification with others in a society—the radius of trust, or the sense of community; (2) the rigor of the ethical system; (3) the way authority is exercised within the society; and (4) attitudes about work, innovation, saving, and profit.”

Countries with institutions based on strong trust foster a productivity-enhancing environment because they have ethical systems in place that reduce transaction costs and make competitive processes more efficient and effective. In market-based systems with a great degree of trust, such as Germany, Sweden, Switzerland, Canada, and the United Kingdom, highly successful enterprises can develop through a spirit of cooperation and the ease in conducting business.

Superior financial performance at the firm level within a society is measured as profits, earnings per share, return on investment, and capital appreciation. Businesses must achieve a certain level of financial performance to survive and reinvest in the various institutions in society that provide support. But, at the institutional or societal level, a key factor distinguishing societies with high standards of living from those with lower standards of living is whether the institutions within the society are generally trustworthy. The challenge is to articulate the process by which institutions that support social responsibility can contribute to firm-level superior financial performance.

A comparison of countries that have high levels of corruption and underdeveloped social institutions with countries that have low levels of corruption reveals differences in the economic wellbeing of the country’s citizens. Transparency International, an organization discussed earlier, publishes an annual report on global corruption that emphasizes the effects of corruption on the business and social sectors. Table 1.6 lists the countries with the most and least corrupt public sectors, as perceived by Transparency International. Eighteen countries are perceived to be more ethical than the United States. As stated several times in this chapter, conducting business in an ethical and responsible manner generates trust and leads to relationships that promote higher productivity and a positive cycle of effects.
Chapter 1 Social Responsibility Framework

Chapter 1 Social Responsibility Framework

The framework we have developed for this text is designed to help you understand how businesses fulfill social expectations. It begins with the social responsibility philosophy, includes the four levels of social responsibilities, involves many types of stakeholders, and ultimately results in both short and long-term performance benefits. As we discussed earlier, social responsibility must have the support of top management—both in words and in deeds—before it can become an organizational reality. Like many organizations, Cummins Engine Company has faced a number of challenges over the past several decades. Cummins is currently the world leader in the design and manufacture of diesel engines and was the largest employer in Columbus, Indiana, for many years. Cummins’s drive to build positive relationships with employees, customers, and community led Business Ethics to rank the firm on the magazine’s list of the “100 Best Corporate Citizens.” The company received the highest possible rating for its corporate governance practices from Governance Metrics International (GMI), even during the global recession of 2009. In addition, Ethisphere named the company as one of the “World’s Most Ethical Companies” for seven years in a row.85

Once the social responsibility philosophy is accepted, the four aspects of corporate social responsibility are defined and implemented through programs that incorporate stakeholder input and feedback. Cummins, like other companies, is aware of the potential costs associated with addressing social responsibility issues and stakeholder requirements. When social responsibility programs are put into action, they have both immediate and delayed outcomes.

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### TABLE 1.6 Perceptions of Countries as Least/Most Corrupt

<table>
<thead>
<tr>
<th>Least Corrupt Country</th>
<th>Most Corrupt Country</th>
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<td>1. Somalia</td>
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<td>1. New Zealand</td>
<td>1. North Korea</td>
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<tr>
<td>3. Finland</td>
<td>1. Afghanistan</td>
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<tr>
<td>3. Sweden</td>
<td>4. Sudan</td>
</tr>
<tr>
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<td>5. South Sudan</td>
</tr>
<tr>
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<td>6. Libya</td>
</tr>
<tr>
<td>7. Switzerland</td>
<td>7. Iraq</td>
</tr>
<tr>
<td>8. The Netherlands</td>
<td>8. Uzbekistan</td>
</tr>
<tr>
<td>9. Australia</td>
<td>8. Turkmenistan</td>
</tr>
<tr>
<td>9. Canada</td>
<td>8. Syria</td>
</tr>
</tbody>
</table>

Figure 1.4 depicts how the chapters of this book fit into our framework. This framework begins with a look at the importance of working with stakeholders to achieve social responsibility objectives. The framework also includes an examination of the influence on business decisions and actions of the legal, regulatory, and political environment; business ethics; and corporate governance. The remaining chapters of the book explore the responsibilities associated with specific stakeholders and issues that confront business decision makers today, including the process of implementing a social responsibility audit.

**Strategic Management of Stakeholder Relationships**

Social responsibility is grounded in effective and mutually beneficial relationships with customers, employees, investors, competitors, government, the community, and others who have a stake in the company. Increasingly, companies are recognizing that these constituents both affect and are affected by their actions. For this reason, many companies attempt to
address the concerns of stakeholder groups, recognizing that failure to do so can have serious long-term consequences. For example, the Better Business Bureau of the Alaska, Oregon, and Western Washington region revoked the membership of 12 businesses in a period of three months for not meeting the organization’s standards.86 Chapter 2 examines the types of stakeholders and their attributes, how stakeholders become influential, and the processes for integrating and managing stakeholders’ influence on a firm. It also examines the impact of corporate reputation and crisis situations on stakeholder relationships.

**Corporate Governance**

Because both daily and strategic decisions affect a variety of stakeholders, companies must maintain a governance structure to ensure proper control of their actions and assign responsibility for those actions. In Chapter 3, we define corporate governance and discuss its role in achieving strategic social responsibility. Key governance issues addressed include the rights of shareholders, the accountability of top management for corporate actions, executive compensation, and strategic-level processes for ensuring that financial, legal, ethical, and philanthropic responsibilities are satisfied.

**Legal, Regulatory, and Political Issues**

In Chapter 4, we explore the complex relationship between business and government. Every business must be aware of and abide by the laws and regulations that dictate acceptable business conduct. This chapter also examines how business can influence government by participating in the public policy process. A strategic approach for legal compliance is also provided.

**Business Ethics and Strategic Approaches to Improving Ethical Behavior**

Because individual values are a component of organizational conduct, these findings raise concerns about the ethics of future business leaders. Chapters 5 and 6 are devoted to exploring the role of ethics in business decision making. These chapters explore business responsibilities that go beyond the conduct that is legally prescribed. We examine the factors that influence ethical decision making and consider how companies can apply this understanding to increase their ethical conduct. We also examine ethical leadership and how it contributes to an ethical corporate culture.

**Employee Relations**

In today’s business environment, most organizations want to build long-term relationships with a variety of stakeholders, but particularly with employees—the focus of Chapter 7. Employees today want fair treatment,
excellent compensation and benefits, and assistance in balancing work and family obligations. This is increasingly important as employee privacy issues have become a major concern in recent years. Raytheon developed a computer program called SilentRunner that can detect patterns of data activity that may reflect employee fraud, insider trading, espionage, or other unauthorized activity. Critics, however, question whether the use of such software contributes to an environment of trust and commitment. Research has shown that committed and satisfied employees are more productive, serve customers better, and are less likely to leave their employers. These benefits are important to successful business performance, but organizations must be proactive in their human resources programs if they are to receive them.

Consumer Relations

Chapter 8 explores companies’ relationships with consumers. This constituency is part of a firm’s primary stakeholder group, and there are a number of financial, legal, ethical, and philanthropic responsibilities that companies must address. Chapter 8 therefore considers the obligations that companies have toward their customers, including health and safety issues, honesty in marketing, consumer rights, and related responsibilities.

Community and Philanthropy

Chapter 9 examines community relations and strategic philanthropy, the synergistic use of organizational core competencies and resources to address key stakeholders’ interests and to achieve both organizational and social benefits. Whereas traditional benevolent philanthropy involves donating a percentage of sales to social causes, a strategic approach aligns employees and organizational resources and expertise with the needs and concerns of stakeholders, especially the community. Strategic philanthropy involves both financial and nonfinancial contributions (employee time, goods and services, technology and equipment, and facilities) to stakeholders and reaps benefits for the community and company.

Technology Issues

In Chapter 10, we examine the issues that arise as a result of enhanced technology in the business environment, including the effects of new technology on privacy, intellectual property, and health. The strategic direction for technology depends on government as well as on business’s ability to plan the implementation of new technology and to assess the influence of that technology on society.

Thanks to the internet and other technological advances, we can communicate faster than ever before, find information about just about anything, and live longer, healthier lives. However, not all of the changes
that occur as a result of new technologies are positive. For example, because shopping via the internet does not require a signature to verify transactions, online credit card fraud is significantly greater than fraud through mail-order catalogs and traditional storefront retailers. A major identity theft ring in New York affected thousands of people. Members of the theft ring illegally obtained the credit records of consumers and then sold them to criminals for about $60 per record. The criminals used the credit records to obtain loans, drain bank accounts, and perform other fraudulent activities.88

**Sustainability Issues**

In Chapter 11, we dedicate an entire chapter to issues of sustainability, including the interdependent nature of economic development, social development, and environmental impact. Sustainability has become a watchword in business and community circles, and this chapter explores the ways in which companies define and develop goals, implement programs, and contribute to sustainability concerns. The Dow Jones Sustainability Index (DJSI) makes an annual assessment of companies’ economic, environmental, and social performance, based on more than 50 general and industry specific criteria. The DJSI includes 2,500 companies from 20 countries and is used by investors who prefer to make financial investments in companies engaged in socially responsible and sustainable practices.89

**Global Social Responsibility**

Finally, in order for many businesses to remain competitive, they must continually evolve to reach global markets and anticipate emerging world trends. Chapter 12 delves into the complex and intriguing nature of social responsibility in a global economy. Building on key concepts discussed throughout the book, we examine the forces that make overseas business plans and activities of paramount concern to host countries, local and national governments, nongovernmental organizations, and other members of society. The chapter covers a wide range of challenges and opportunities, such as outsourcing, environmental protection, living wages, labor standards, and trade restrictions.

We hope this framework provides you with a way of understanding the range of concepts, ideas, and practices that are involved in an effective social responsibility initiative. So that you can learn more about the practices of specific companies, a number of cases are provided at the end of the book. In addition, every chapter includes an opening vignette and other examples that shed more light on how social responsibility works in today’s businesses. Every chapter also includes a real-life scenario entitled “What Would You Do?” a contemporary
Today, many consumers are using sustainability criteria in their purchase decisions. This has had a major impact on the automotive industry. Automobile makers such as Ford are investigating new ways to increase the sustainability of their vehicles. Vehicles have started evolving into lighter versions of themselves as lighter materials increase fuel efficiency.

Although automobile makers have a market incentive to increase the fuel-efficiency of vehicles, they also have a legal incentive. In the United States it has been mandated that vehicles must reach 35.5 miles per gallon (mpg) by 2016. The government plans to extend this to 54.5 mpg by 2025. In Europe, cars must reduce emissions 40 percent 2007 levels by 2021. This is requiring automakers to be innovative in investigating ways to make their vehicles lighter. Materials for these lighter cars include aluminum, carbon fiber, and high-strength steel, which can decrease a vehicle’s weight by 200 pounds. Automakers are optimistic that developing these lighter vehicles will cut fuel emissions in half.

Unfortunately, these criteria create a challenge for carmakers developing electric vehicles (EVs). Although EVs reduce greenhouse gas emissions, the batteries needed for the EV are often expensive and heavy. EV maker Tesla Motor is dealing with these issues by using less costly, lighter batteries. Its Giga Factory is estimated to produce 30 gigawatt hours worth of batteries each year—what is needed to power approximately 400,000 vehicles. BMW is spending nearly $3 billion to completely reinvent the car. It is producing a new brand of light hybrid luxury vehicle with a carbon-neutral supply chain. Its i3 EV utilizes light carbon-fiber thread and aluminum to make it incredibly lightweight for a car, at 2,680 pounds. This enables it to get 81 mpg.

Automakers are also increasing their use of sustainable materials in their vehicles’ interiors. The i3, for instance, has an interior made from eucalyptus. Another EV firm called Fisker is using reclaimed wood for the interior of its sedans. These often lighter materials contribute to a more fuel-efficient vehicle. The Ford Fusion’s use of kenaf leaves instead of oil-based resins in its doors reduces door bolsters by 25 percent.

All of these changes will entail challenges, not only for automakers but also for consumers. While consumers might desire more socially responsible and sustainable products, many do not like to sacrifice convenience or cost. It is estimated that repair costs for vehicles made of aluminum will increase due to the lightness of the materials. In countries such as Germany, consumers enjoy driving quickly on the roads, requiring vehicles that use a lot of gas. More fuel-efficient vehicles may be more limited in speed. Both businesses and consumers will have to make trade-offs in the quest for a more sustainable industry. However, these trade-offs have the potential to significantly reduce the negative impact of vehicle emissions on the environment.

debate issue, and another exercise to help you apply concepts and examine your own decision-making process. As you will soon see, the concept of social responsibility is both exciting and controversial; it is in a constant state of development—just like all important business concepts and practices.

A recent survey of thought leaders in the area of social responsibility found that a majority believes social responsibility has made steady progress into conventional business thinking. Much like the social responsibility continuum introduced in this chapter, the thought leaders described several stages of commitment to corporate social responsibility. These stages range from light, where companies are concerned about responding to complaints, to deep, where companies are founded on a business model of improving social or environmental circumstances. Many companies fall somewhere in between, with a focus on complying with new standards and surviving in a climate of increasing social responsibility expectations. We encourage you to draw on current news events and your own experiences to understand social responsibility and the challenges and opportunities it poses for your career, profession, role as a consumer, leadership approach, and the business world.

**SUMMARY**

The term *social responsibility* came into widespread use during the last several decades, but there remains some confusion over the term’s exact meaning. This text defines social responsibility as the adoption by a business of a strategic focus for fulfilling the economic, legal, ethical, and philanthropic responsibilities expected of it by its stakeholders.

All types of businesses can implement social responsibility initiatives to further their relationships with their customers, their employees, and the community at large. Although the efforts of large corporations usually receive the most attention, the actions of small businesses may have a greater impact on local communities.

The definition of social responsibility involves the extent to which a firm embraces the social responsibility philosophy and follows through with the implementation of initiatives. Social responsibility must be fully valued and championed by top managers and given the same planning time, priority, and management attention as is given to any other company initiative.

Many people believe that businesses should accept and abide by four types of responsibilities: financial, legal, ethical, and philanthropic. Companies have a responsibility to be financially or economically viable so that they can provide a return on investment for their owners, create jobs for the community, and contribute goods and services to the economy. They are also expected to obey laws and regulations that specify what is responsible business conduct. Business ethics refers to
the principles and standards that guide behavior in the world of business. Philanthropic activities promote human welfare or goodwill. These responsibilities can be viewed holistically, with all four related and integrated into a comprehensive approach. Social responsibility can also be expressed as a continuum.

Because customers, employees, investors and shareholders, suppliers, governments, communities, and others have a stake in or claim on some aspect of a company’s products, operations, markets, industry, and outcomes, they are known as stakeholders. Adopting a stakeholder orientation is part of the social responsibility philosophy.

The influence of business has led many people to conclude that corporations should benefit their employees, their customers, their business partners, and their community as well as their shareholders. However, these responsibilities and expectations have changed over time. After World War II, many large U.S. firms dominated the global economy. Their power was largely mirrored by the autonomy of their top managers. Because of the relative lack of global competition and stockholder input during the 1950s and 1960s, there were few formal governance procedures to restrain management’s actions. The stability experienced by midcentury firms dissolved in the economic turmoil of the 1970s and 1980s, leading companies to focus more on their core competencies and reduce their product diversity. The 1980s and 1990s brought a new focus on efficiency and productivity, which fostered a wave of downsizing and restructuring. Concern for corporate responsibilities was renewed in the 1990s. In the 1990s and beyond, the balance between the global market economy and an interest in social justice and cohesion best characterizes the intent and need for social responsibility. Despite major advances in the 1990s, the sheer number of corporate scandals at the beginning of the twenty-first century prompted a new era of social responsibility.

The increasing globalization of business has made social responsibility an international concern. In most developed countries, social responsibility involves economic, legal, ethical, and philanthropic responsibilities to a variety of stakeholders. Global social responsibility also involves responsibilities to a confluence of governments, businesses, trade associations, and other groups. Progressive global businesses recognize the “shared bottom line” that results from the partnership among businesses, communities, governments, and other stakeholders.

The importance of social responsibility initiatives in enhancing stakeholder relationships, improving performance, and creating other benefits has been debated from many different perspectives. Many business managers view such programs as costly activities that provide rewards only to society at the expense of the bottom line. Others hold that some costs of social responsibility can be recovered through improved performance. Although it is true that some aspects of social responsibility may not accrue directly to the bottom line, we believe that organizations benefit indirectly over the long run from these
activities. Moreover, ample research and anecdotal evidence demonstrate that there are many rewards for companies that implement such programs.

The process of social responsibility begins with the social responsibility philosophy, includes the four responsibilities, involves many types of stakeholders, and ultimately results in both short and long-term performance benefits. Once the social responsibility philosophy is accepted, the four types of responsibility are defined and implemented through programs that incorporate stakeholder input and feedback.

Responsible Business Debate

How to Regulate Global Business

**Issue:** Are less formal systems and agreements likely to be more successful than a formal legal and regulatory system?

A key lesson learned from recent business scandals is that responsible, transparent, and ethical leadership is needed in order for companies to develop and maintain a long-term commitment to social responsibility for the benefit of multiple stakeholders. This is especially true of multinational corporations (MNCs) because of the power and influence these businesses and their executives represent. MNCs operate in multiple environments and contexts where laws, rules, expectations, and mores are divergent. In addition, the enforcement and monitoring mechanisms to oversee these expectations range from the barely existent to well-resourced government agencies.

The failure to have a global legal and regulatory scheme has resulted in environmental disasters, child labor, financial fraud, antitrust violations, tainted food products, and other problems. For example, in 2008 Mattel paid a $12 million settlement to 39 U.S. states for shipping Chinese-made toys containing unsafe amounts of lead. The country’s largest toy maker also agreed to new standards for lead content in its toys. Apple Inc. was later criticized for workplace disasters and worker suicides at one of its Chinese suppliers, Foxconn. To save on manufacturing costs, many U.S. companies make products where wages are lower and regulatory standards often differ.

Despite the new coverage of corporate wrongdoing and questionable decision-making, there are many firms making the commitment to social responsibility through self-regulation. Over 12,000 participants in 145 countries are signatories to the United Nation’s (UN) Global Compact, signaling their agreement to 10 principles on human rights, anticorruption, environment, and labor. The Global Reporting Initiative (GRI) provides a framework for companies developing social responsibility reports that discuss key standards, are comparable to peers, and capture performance over time. The new ISO 26000 standards assist in voluntary organizational self-analysis, media review, investor due diligence, and other reviews of social responsibility efforts.

**There Are Two Sides to Every Issue**

1. Defend the need for a legal and regulatory system that would oversee international and multinational business operations. How would the system be developed? How would the system enact its responsibility for enforcing legal and regulatory standards?
2. Defend the efficacy of assurance systems and agreements, such as the UN Global Compact and ISO 26000 standards. Why are these less formal systems and agreements likely to be more successful than a formal legal and regulatory system?
KEY TERMS

- social responsibility (p. 14)
- stakeholders (p. 7)

DISCUSSION QUESTIONS

1. Define social responsibility. How does this view of the role of business differ from your previous perceptions? How is it consistent with your attitudes and beliefs about business?
2. If a company is named to one of the “best in social responsibility” lists, what positive effects can it potentially reap? What are the possible costs or negative outcomes that may be associated with being named to one of these lists?
3. What historical trends have affected the social responsibilities of business? How have recent scandals affected the business climate, including any changes in responsibilities and expectations?
4. How would you respond to the statement that this chapter presents only the positive side of the argument that social responsibility results in improved organizational performance?
5. On the basis of the social responsibility model presented in this chapter, describe the philosophy, responsibilities, and stakeholders that make up a company’s approach to social responsibility. What are the short and long-term outcomes of this effort?
6. Consider the role that various business disciplines, including marketing, finance, accounting, and human resources, have in social responsibility. What specific views and philosophies do these different disciplines bring to the implementation of social responsibility?

EXPERIENTIAL EXERCISE

Evaluate Fortune magazine’s annual list of the most admired companies found on the magazine’s website (www.fortune.com). These companies as a group have superior financial performance compared to other firms. Go to each company’s website and try to assess its management commitment to the welfare of stakeholders. If any of the companies have experienced legal or ethical misconduct, explain how this may affect specific stakeholders. Rank the companies on the basis of the information available and your opinion on their fulfillment of social responsibility.

WHAT WOULD YOU DO?

Jamie Ramos looked out her window at the early morning sky and gazed at the small crowd below. The words and pictures on their posters were pretty tame this time, she thought. The last protest group used pictures of tarred lungs, corpses, and other graphic photos to show the effects of smoking on a person’s internal organs. Their words were also hateful, so much so that employees at the Unified Tobacco headquarters were afraid to walk in and out of the main building. Those who normally took smoking breaks on the back patio decided to skip the break and eat something instead at the company-subsidized cafeteria. By midday, Unified hired extra security to escort employees in and out of the building and to ensure that protestors followed the state guideline of staying at least 15 feet from the company’s entrance. The media picked up on the story—and the photos—and it caused quite a stir in the national press.

At least this protest group seemed fairly reasonable. Late yesterday, a state court provided a reduced judgment to the family of a lifelong smoker, now deceased. This meant that Unified was going to owe millions less than originally expected. The length and stress of the lawsuit had taken its toll, especially on top management, although all employees were certainly affected. After two years of being battered in the media, learning of a huge settlement, and then continuing on with the appeals process, emotions were wearing thin with the continued criticism.
Jamie wondered what this day would bring. As the manager of community relations, her job was to represent Unified in the community, manage the employee volunteer program, create a quarterly newsletter, serve as a liaison to the company’s philanthropic foundation, develop solid relationships, and serve on various boards related to social welfare and community needs. The company’s foundation donated nearly $1.5 million a year to charities and causes. Over one-quarter of its employees volunteered ten hours a month in their communities.

Jamie reported to a vice-president and was pleased with the career progress she had made since graduating from college eight years earlier. Although some of her friends wondered out loud how she could work for a tobacco company, Jamie was steadfast in her belief that even a tobacco firm could contribute something meaningful to society. She had the chance to affect some of those contributions in her community relations role.

Jamie’s phone rang and she took a call from her vice-president. The VP indicated that, although the protestors seemed relatively calm this time, he was not comfortable with their presence. Several employees had taped signs in office windows telling the protestors to “Go away.” Other VPs had dropped by his office to discuss the protest and thought that the responsibility for handling these issues fell to his group. He went on to say that he needed Jamie’s help, and the assistance of a few others, in formulating a plan to (1) deal with the protest today and (2) strengthen the strategy for communicating the company’s message and goodwill in the future. Their meeting would begin in one hour, so Jamie had some time to sketch out her recommendations on both issues. What would you do?
# Chapter Objectives

- To provide an overview of the need for an organizational ethics program
- To consider crucial keys to development of an effective ethics program
- To demonstrate the elements of a corporate culture.
- To examine leadership and its importance to an ethical corporate culture.
- To discuss the requirements for ethical leadership.

# Chapter Outline

- Scope and Purpose of Organizational Ethics Programs
- Codes of Conduct
- Ethics Officers
- Ethics Training and Communication
- Establishing Systems to Monitor and Enforce Ethical Standards
- Continuous Improvement of the Ethics Program
- Institutionalization of Business Ethics
- Ethical Leadership
- Requirements for Ethical Leadership
As concerns about the environment grow among consumers and stakeholder groups, more companies are trying to portray themselves in an eco-friendly light. This can lead to a form of deception called greenwashing, which occurs when companies market products as environmentally friendly when they are actually not. It is a way for companies to appeal to green consumers while avoiding the costs of developing truly “green” products.

Businesses accused of greenwashing can be exposed as misleading the public and face the possibility of negative publicity and resulting sales declines. In the United States, firms that label or advertise products as organic or environmentally friendly are supposed to abide by the Federal Trade Commission’s revised “Green Guides,” which provides guidelines to help companies make sure that their green claims are truthful. Those found to be misleading consumers risk fines, negative publicity and the possibility of consumer reimbursement.

Both the Federal Trade Commission and consumer advocates are beginning to hold companies to stricter standards. The FTC levied a $450,000 fine against AJM Packaging Corporation for violating a 1994 order not to represent its products or packaging as being biodegradable without reliable evidence to back it up. A lawsuit was filed against PepsiCo because critics found synthetic vitamins in the drink despite its claims to be all-natural. PepsiCo paid to settle the lawsuit and agreed not to use the all-natural label.

The problem is that terms such as “natural” and “green” can be hard to define. Is a product eco-friendly if most, but not all, of its components are made from sustainable materials? What about companies that still give off carbon emissions but which have improved their products over the years? The automobile industry faces this problem as vehicles continue to negatively impact the environment. Even hybrids, electric vehicles, and fuel-efficient cars impact the environment. Norway actually banned all green claims in car advertising after concerns about greenwashing in the auto industry.

To not become a victim of greenwashing, ask the right questions. When buying green, investigate what materials the products use and how the company obtained those materials. Always look for evidence to back up a green product’s claims. Also, beware of ambiguous claims. For instance, the phrase “lower carbon emissions” in and of itself does not explain much if it does not have a point of comparison. Third-party certification including the Forest Stewardship Council and Green Globes offer some assurance that certified products adhere to certain green guidelines. With greenwashing incidents increasing, consumers need to use caution and verify that the products they buy are truly eco-friendly.
A strategic approach to ethical decisions will contribute to both business and society. This chapter provides a framework that is consistent with research, best practices, and regulatory requirements for improving ethical conduct within the organization. Some companies have not implemented effective business ethics programs, but they should because ethics and compliance programs create good systems to manage organizational misconduct. Our framework for developing effective ethics programs is consistent with the ethical decision-making process described in Chapter 5. In addition, the strategic approach to an ethics program presented here is consistent with the Federal Sentencing Guidelines for Organizations, the Sarbanes-Oxley Act, and the Dodd-Frank Act described in Chapter 4. These legislative reforms require managers to assume responsibility and ensure that ethical standards are implemented properly on a daily basis. Ethics programs include not only the need for top executive leadership but also responsibility by boards of directors for corporate governance.

Unethical and illegal business conduct occurs, even in organizations that have ethics programs. For example, although Enron had a code of ethics and was a member of the Better Business Bureau, the company was devastated by unethical activities and corporate scandal. Many business leaders believe that personal moral development and character are all that is needed for corporate responsibility. There are those who feel that ethics initiatives should arise inherently from a company’s culture and that hiring good employees will limit unethical behavior within the organization. Many executives and board members do not understand how organizational ethical decisions are made nor how to develop an ethical corporate culture. Customized ethics programs may help many organizations provide guidance for employees from diverse backgrounds to gain an understanding of acceptable behavior within the organization. Many ethical issues in business are complex and include considerations that require organizational agreement regarding appropriate action. Top executives and boards of directors must provide leadership, a system to resolve these issues, and support for an ethical corporate culture.

In this chapter, we provide an overview of why businesses need to develop an organizational ethics program. Next, we consider the factors that are crucial for the development of such a program: a code of conduct, an ethics officer and appropriate delegation of authority, effective ethics training, a system to monitor and support ethical compliance, and continual efforts to improve the ethics program. Next we discuss the institutionalization of business ethics through mandated and voluntary programs. We discuss the importance of ethical leadership to a company’s ethics program. Finally, we examine the requirements of ethical leadership and its impact on organizational culture, including the different forms of communication an ethical leader must master.
Chapter 6  Strategic Approaches to Improving Ethical Behavior

SCOPE AND PURPOSE OF ORGANIZATIONAL ETHICS PROGRAMS

Usually, an organization is held accountable for the conduct of its employees. Companies must assess their ethical risks and develop values and compliance systems to avoid legal and ethical mistakes that could damage the organization. The Federal Sentencing Guidelines for Organizations hold corporations responsible for conduct engaged in as an entity. Some corporate outcomes cannot be tied to one individual or even a group, and misconduct can result from a collective pattern of decisions supported by a corporate culture. Therefore, corporations can be held accountable, fined, and even ordered to close their doors when they are operating in a manner inconsistent with major legal requirements. Organizations are sensitive to avoid infringing on employees’ personal freedoms and ethical beliefs. In cases where an individual’s personal beliefs and activities are inconsistent with company policies on ethics, conflict may develop. If the individual feels that ethics systems in the organization are deficient or directed in an inappropriate manner, some type of open conflict resolution may be needed to deal with the differences.

Understanding the factors that influence how individuals make decisions to resolve ethical issues, as discussed in Chapter 5, can help companies encourage ethical behavior and discourage undesirable conduct. Fostering ethical decisions within an organization requires eliminating unethical behavior and improving the firm’s ethical standards. Some people will always do things in their own self-interest regardless of organizational goals or accepted standards of conduct. For example, major league baseball players know that use of steroids is prohibited, yet some players still choose to use them in order to gain an edge. Yankee superstar Alex Rodriguez tested positive for steroid use while playing for the Texas Rangers. At the time, there were no penalties for such drug use, but today they are on the Major League Baseball list of banned substances, with definite penalties for use. Alex Rodriguez was banned from the 2014 season and ordered to forfeit his compensation and any bonuses for that year as a result of testing positive again for performance enhancing drugs. Eliminating inappropriate or abnormal behavior through screening techniques and enforcement of the firm’s ethical standards can help improve the firm’s overall ethical conduct.

Organizations can foster unethical corporate cultures not because individuals within them are bad but because the pressures to succeed create opportunities that reward unethical decisions. In the case of an unethical corporate culture, the organization must redesign its ethical standards to conform to industry and stakeholder standards of acceptable behavior. Most businesses attempt to improve ethical decision making by establishing and implementing a strategic approach to improving organizational ethics. Companies such as Texas Instruments, Starbucks, and Levi’s take a strategic approach to organizational ethics but monitor their programs on a continuous basis and make improvements when problems occur.
To be socially responsible and promote legal and ethical conduct, an organization should develop an organizational ethics program by establishing, communicating, and monitoring ethical values and legal requirements that characterize its history, culture, industry, and operating environment. Without such programs and uniform standards and policies of conduct, it is difficult for employees to determine what behaviors are acceptable within a company. As discussed earlier, in the absence of such programs and standards, employees generally will make decisions based on their observations of how their coworkers and managers behave. A strong ethics program includes a written code of conduct, an ethics officer to oversee the program, careful delegation of authority, formal ethics training, auditing, monitoring, enforcement, and periodic revision of program standards. Without a strong customized program, problems are much more likely to arise. Figure 6.1 outlines what employees identified as the causes of organizational misconduct.

Trust in top management and business is low. An analysis of trustworthy companies revealed three characteristics that CEOs have implemented that resulted in trust and confidence in business. These include involving those directly affected by company decisions in the decision-making process, being transparent and consistent in actions, and nurturing relationships. This is a recurring theme among primary stakeholders. Consumers are looking for clear, creative, and constructive leadership from CEOs that demonstrates trust is a priority.

**FIGURE 6.1** Employee Assessment of the Causes of Misconduct

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are seeking to bend the rules or steal for their own personal gain</td>
<td>49%</td>
</tr>
<tr>
<td>Believe policies and procedures are easy to bypass or override</td>
<td>57%</td>
</tr>
<tr>
<td>Lack resources to get the job done without cutting corners</td>
<td>57%</td>
</tr>
<tr>
<td>Lack understanding of the standards that apply to their jobs</td>
<td>59%</td>
</tr>
<tr>
<td>Fear losing their jobs if they do not meet targets</td>
<td>59%</td>
</tr>
<tr>
<td>Believe they will be rewarded for results, not the means used to achieve them</td>
<td>59%</td>
</tr>
<tr>
<td>Believe that the code of conduct is not taken seriously</td>
<td>60%</td>
</tr>
<tr>
<td>Feel pressure to do “whatever it takes” to meet business targets</td>
<td>64%</td>
</tr>
</tbody>
</table>

No universal standards exist that can be applied to organizational ethics programs in all organizations, but most companies develop codes, values, or policies for guidance about business conduct. The majority of companies that have been in ethical or legal trouble usually have stated ethics codes and programs. Often, the problem is that top management, as well as the overall corporate culture, has not integrated these codes, values, and standards into daily decision making. For example, founder and former Chesapeake Energy CEO Aubrey McClendon had been accused of several ethics violations, including near insider trading incidents and collusion with another energy company. Media outlets and shareholders called attention to the misdeeds through frequent articles and a lawsuit called for his resignation. After several years of accusations, McClendon stepped down as CEO, and the company is on its way to restoring its reputation. If a company’s leadership fails to provide the vision and support needed for ethical conduct, then an ethics program will not be effective. Ethics is not something to be delegated to lower-level employees while top managers break the rules. Excellent leaders must lead by example and reinforce the integrity of the organizational culture.

No matter what their specific goals, ethics programs are developed as organizational control systems, the aim of which is to create predictability and consistency in employee behavior. There are two types of organizational control systems. A compliance orientation creates order by requiring that employees identify with and commit to specific required conduct. It uses legal terms and statutes that teach employees the rules and penalties for noncompliance. The other type of system is a values orientation, which strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of principles such as respect and responsibility. The goal is to create an environment where employees are compelled and willing to support an ethical organizational culture. More than half of employees in the KPMG Forensic Ethics Survey stated that they had observed misconduct that could cause ‘a significant loss of public trust if discovered.’ The industries in which this type of misconduct increased the most include electronics, chemicals and diversified industrials, consumer markets, and aerospace and defense. The goal of an effective ethics program is to get employees to report wrongdoing when they become aware of it and seek guidance when they are uncertain as to how to respond in ambiguous circumstances.

Research into compliance- and values-based approaches reveals that both types of programs can interact or work toward the same end, but a values orientation tends to have a stronger influence on employees. Values-based programs increase employees’ awareness of ethics at work, their integrity, their willingness to deliver bad news to supervisors, and the perception that better decisions are made. Compliance-based programs are linked to employees’ awareness of ethical issues at work and their perception that decision making is better because of the expectations of its employees.
To meet the public’s escalating demands for ethical decision making, companies need to develop plans and structures for addressing ethical considerations. Some directions for the improvement of ethics have been mandated through regulations, but companies must be willing to have a values and ethics implementation system in place that exceeds the minimum regulatory requirements. In addition, companies that have experienced reputational damage in the past are much further along compared to their peers in establishing ethics and compliance programs.6

**CODES OF CONDUCT**

Because people come from diverse family, educational, and business backgrounds, it cannot be assumed that they know how to behave appropriately when they enter a new organization or job. Most companies begin the process of establishing organizational ethics programs by developing **codes of conduct** (also called codes of ethics), which are formal statements that describe what an organization expects of its employees. Table 6.1 depicts elements of an effective ethics and compliance program (such as codes and training). Codes of ethics address risk areas that organizations face and which employees may experience in the workplace.

**TABLE 6.1 Elements of an Effective Ethics Program**

<table>
<thead>
<tr>
<th></th>
<th>Standards and Codes</th>
<th>Used to prevent and detect criminal conduct by expressing what the right thing is, how it can be accomplished, and the expectations to which the employee is held. They should be communicated and written in a concise, clear language in codes of ethics.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Leadership and the Ethics Officer</td>
<td>The company’s board of directors usually oversees the implementation of the program, and a senior executive or committee of executives should be given overall responsibility for its compliance. Many ethics officers report to the chief executive and interact with the board of directors on a regular basis.</td>
</tr>
<tr>
<td>3</td>
<td>Communication and Effective Training</td>
<td>The company must effectively implement the program through education and training. Training should be focused on industry-specific areas of risk, and should not merely recite the law, but should explicitly explain the company’s policies and ask employees to think through complex “gray areas” they may encounter in their day-to-day tasks.</td>
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<td>4</td>
<td>Monitoring and Disclosure</td>
<td>The ethics and compliance program should be implemented. Employees should be asked about the “unwritten rules” within the company to determine whether the program’s goals match its actual operation. Employees must be provided with effective mechanisms through which to anonymously or confidentially report potential misconduct or seek guidance on compliance issues, protect such individuals against retaliation, and adequately follow up on their reports.</td>
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(Continued)
Chapter 6  Strategic Approaches to Improving Ethical Behavior

Table 6.2  Developing and Implementing a Code of Ethics

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<tbody>
<tr>
<td>1.</td>
<td>Consider areas of risk and state values as well as conduct necessary to comply with laws and regulations. Values and principles are an important buffer in preventing serious misconduct.</td>
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<tr>
<td>2.</td>
<td>Identify values and principles that specifically address current ethical issues.</td>
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<td>3.</td>
<td>Consider values and principles that link the organization to a stakeholder orientation. Attempt to find overlaps in organizational and stakeholder values.</td>
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<td>4.</td>
<td>Make the code understandable by providing examples that reflect values.</td>
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<td>5.</td>
<td>Communicate the code frequently and in language that employees can understand.</td>
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<tr>
<td>6.</td>
<td>Revise the code every year with input from organizational members and stakeholders.</td>
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employees understand the nature of business ethics and the ethical stan-
dards they are expected to follow, TI provides the “Ethics Quick Test”
to help employees when they have doubts about the ethics of specific
situations and behaviors. It urges employees to reflect upon the following
questions and statements:

Is the action legal?
Does it comply with our values?
If you do it, will you feel bad?
How will it look in the newspaper?
If you know it’s wrong, don’t do it!
If you’re not sure, ask.
Keep asking until you get an answer.8

Texas Instruments explicitly states what it expects of its employees and
what behaviors are unacceptable. When such standards of behavior are
not made explicit, employees sometimes base ethical decisions on their
observations of the behavior of peers and management. The use of rewards
and punishments to enforce codes and policies controls the opportunity
to behave unethically and increases employees’ acceptance of ethical
standards.

As we stated, codes of conduct may address a variety of situations,
from internal operations to sales presentations and financial disclosure
practices. Research has found that corporate codes of ethics often have
five to seven core values or principles, in addition to more detailed descrip-
tions and examples of appropriate conduct.9 The six values that have
been suggested as desirable to appearing in the codes of ethics include: (1)
trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and
(6) citizenship. These values will not be effective without distribution,
training, and the support of top management in making the values a part
of the corporate culture. Employees need specific examples of how the
values can be implemented and guide ethical decision making.

Codes of conduct will not resolve every ethical issue encountered in
daily operations, but they help employees and managers deal with ethical
dilemmas by prescribing or limiting specific actions. Many companies have
a code of ethics, but is it communicated effectively? According to the Ethics
Resource Center, the number of companies developing and implementing
effective ethics and compliance programs is increasing each year.10 A code
that is placed on a website or in a training manual is useless if it is not
reinforced on a daily basis. By communicating to employees both what is
expected of them and what punishments they face if they violate the rules,
codes of conduct curtail opportunities for unethical behavior and thereby
improve ethical decision making. Wells Fargo Bank offers a comprehensive
code of conduct that specifies: “If you violate any provision of the Code
or fail to cooperate fully with any inquiries or investigations, you will be subject to corrective action, which may include termination of your employment. Codes of conduct do not have to be so detailed that they take into account every situation, but they should provide guidelines and principles that are capable of helping employees achieve organizational ethical objectives and address risks in an accepted manner.

**ETHICS OFFICERS**

Organizational ethics programs also must have oversight by a high-ranking person known to respect and understand legal and ethical standards. This person is often referred to as an ethics officer but can also be the general counsel, the vice-president of human resource management, or any other officer. Corporate wrongdoings and scandal-grabbing headlines have a profound negative impact on public trust. To ensure compliance with state and federal regulations, many corporations are now appointing chief compliance officers and ethics and business conduct professionals to develop and oversee corporate compliance programs.

Consistent enforcement and necessary disciplinary action are essential to a functional ethics and compliance program. The ethics or compliance officer is usually responsible for companywide disciplinary systems, implementing all disciplinary actions the company takes for violations of its ethical standards. Many companies are including ethics and compliance in employee performance appraisals. During performance appraisals, employees may be asked to sign an acknowledgment that they have read the company’s current guidelines on its ethics policies. The company must also promptly investigate any known or suspected misconduct. The appropriate company official, often the ethics officer, needs to make a recommendation to senior management on how to deal with a particular ethics infraction.

The Ethics and Compliance Officer Association (ECOA) consists of front line managers of ethics programs in dozens of industries worldwide. Ethics and compliance officers are instrumental in managing ethics programs and have the attention of top managers and boards of directors. The ethics officer position has existed for decades, but its importance increased tremendously when the Federal Sentencing Guidelines for Organizations were passed in 1991. The guidelines gave companies that faced federal charges for misconduct the incentive of fine reductions up to 95 percent if they had an effective comprehensive ethics program in place. The financial reporting requirements of the Sarbanes-Oxley Act put more pressure on ethics officers to monitor financial reporting, as well as reporting of sales and inventory movements, to prevent fraud in reporting revenue and profits. While not always deemed to be most effective, it is recommended that ethics officers report directly to the board of directors.

Building an ethics program and hiring an ethics officer to avoid fines alone will not be effective. Only with the involvement of top management and the board can an ethics officer earn the trust and cooperation of all
key decision makers. Ethics officers should be knowledgeable about the industry’s laws and regulations as well as adept at communicating and reinforcing values that build an ethical corporate culture.

**ETHICS TRAINING AND COMMUNICATION**

Instituting a training program and a system of communication to disseminate the firm’s ethical standards is a major step in developing an effective ethics program. Such training can educate employees about the firm’s policies and expectations, relevant laws and regulations, and general social standards. Training programs can make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice. Training also can help empower employees to ask tough questions and make ethical decisions.

Ethics officers provide the oversight and management of most ethics training. Although training and communication should reinforce values and provide learning opportunities about rules, risks, and acceptable behavior, it is only one part of an effective ethics program. The employee’s capacity to exercise judgments that result in ethical decisions must be reinforced and developed. Ethics training should be customized to the specific risk areas they face. If ethical evaluations are not a part of regular performance appraisals, the message employees will receive is that ethics is not an important component of decision making. For ethics training to make a difference, employees must understand why it is conducted, how it fits into the organization, and what their role is in its implementation.

Top corporate executives must communicate with managers at the operations level (e.g., in production, sales, and finance) and enforce overall ethical standards within the organization. Table 6.3 lists the factors crucial to successful ethics training. It is most important to help employees identify ethical issues and give them the means to address and resolve such

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<thead>
<tr>
<th>TABLE 6.3 Factors Crucial to Ethics Training</th>
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<tr>
<td>1. Identify the key ethical risk areas.</td>
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<td>2. Relate ethical decisions to the organization’s values, principles, and culture.</td>
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<td>3. Communicate company codes, policies, and procedures regarding ethical business conduct.</td>
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<td>4. Provide leadership training to model desired behavior.</td>
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<td>5. Provide directions for internal questions and non-retaliatory reporting mechanisms.</td>
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<td>6. Engage in regular training events using a variety of educational tools.</td>
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<td>7. Establish manuals, websites, social media, and other communication to reinforce ethics training.</td>
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<td>8. Evaluate and use feedback to improve training.</td>
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*Source: © O. C. Ferrell 2015.*
issues in ambiguous situations. In addition, employees must be offered direction on seeking assistance from managers or other designated personnel in resolving ethical problems. An effective ethics program can reduce criminal, civil, and administrative consequences, including fines, penalties, judgments, debarment from government contracts, and court control of the organization. An ineffective ethics program that results in many unethical acts may cause negative publicity, a decrease in organizational financial performance, and lowered stakeholder trust. An ethical disaster can be more damaging to an organization than a natural disaster because of the damage that occurs to organizational reputation.

Companies can implement ethical principles in their organizations through training programs. Discussions conducted in ethics training programs sometimes break down into personal opinions about what should or should not be done in particular situations. To be successful, business ethics programs need to educate employees about how to identify and deal with business ethics issues. Employees are then able to base ethical decisions on their knowledge of appropriate actions, from an organizational perspective, rather than on emotions.

Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics. If ethics training is to be effective, it must start with a foundation, a code of ethics, commitment from all levels of the organization, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program.

Most experts agree that one of the most effective methods of ethics training involves resolving ethical dilemmas that relate to actual situations employees may encounter while performing their jobs. For example, Lockheed Martin developed a training game called *Gray Matters*. This training device includes dilemmas that can be resolved by teams. Each member of the team can offer his or her perspective and understand the ramifications of the decision for coworkers and the organization.

Another training device is the behavioral simulation or role-play exercise in which participants are given a short hypothetical ethical issue scenario to review. The participants are assigned roles within the hypothetical organization and are provided with varying levels of information about the issue. They then must interact to provide recommended courses of action representing short-term, midrange, and long-term considerations. The simulation recreates the complexities of organizational relationships and of having to address a situation without complete information. Learning objectives of the simulation exercise include (1) increased awareness by participants of the ethical, legal, and social dimensions of business decision making; (2) development of analytical skills for resolving ethical issues; and (3) exposure to the complexity of ethical decision making in organizations. Simulations help teach students about why ethics is important as well as how to handle ethics conflict situations.
A growing number of small businesses deliver “learning-management” systems software and content to train and certify employees on a variety of topics. In addition to streamlined training, the systems provide real-time records of instruction that increasingly are the first line of defense for companies facing litigation or questions about whether they are accountable for an employee’s actions. The e-learning market is growing very rapidly both in education and business. For multinational companies, the computerized training elements of such systems provide consistency of content and delivery to all locations and allow for customization of languages and to cultures. Some of the goals of an ethics training program might be to improve employee understanding of ethical issues and the ability to identify them, to inform employees of related procedures and rules, as well as to identify the contact person who could help in resolving ethical problems. In keeping with these goals, the purpose of Boeing’s Code of Ethics and Business Conduct program is to:

- Communicate the Boeing Values and standards of ethical business conduct to employees.
- Inform employees of company policies and procedures regarding ethical business conduct.
- Establish company-wide processes to assist employees in obtaining guidance and resolving questions regarding compliance with the company’s standards of conduct and the Boeing Values.
- Establish company-wide criteria for ethics education and awareness programs.  

Ethical decision making is influenced by organizational culture, by coworkers and supervisors, and by the opportunity to engage in unethical behavior. All three types of influence can be affected by ethics training. Full awareness of the philosophy of management, rules, and procedures can strengthen both the organizational culture and the ethical stance of peers and supervisors. Such awareness also arms employees against opportunities for unethical behavior and reduces the likelihood of misconduct. Thus, the existence and enforcement of company rules and procedures limit unethical practices in the organization. The primary goals of ethics training are to make employees aware of the risks associated with their jobs, industry, and stakeholders; provide an understanding of the culture and expectations within the organization; create accountability for individual actions; and inform employees not only of the behavior that is unacceptable but also that which is acceptable and supported in the organization.

**ESTABLISHING SYSTEMS TO MONITOR AND ENFORCE ETHICAL STANDARDS**

Ethics and compliance programs also involve comparing employee ethical performance with the organization’s ethical standards. Ethics programs can be measured through employee observation, internal audits, surveys, reporting systems, and investigations. An effective ethics program uses
a variety of resources to effectively monitor ethical conduct. Sometimes, external auditing and review of company activities are helpful in developing benchmarks of compliance and identifying areas for improvement.

**Systems to Monitor and Enforce Ethical Standards**

Many companies set up ethics assistance lines, also known as ‘hotlines’, to provide support and give employees the opportunity to ask questions or report concerns. The most effective ethics hotlines operate on an anonymous basis and are supported 24 hours a day, 365 days a year. Approximately 52 percent of the employees who report concerns indicated using their company’s hotline to do so. In addition, 15 percent use the company’s website to report misconduct and 32 percent use other traditional methods such as face-to-face reporting to supervisors or managers, email, fax, and direct mail.16

It is interesting that most of the issues reported do not relate to serious ethical and legal issues. Nearly 70 percent of the issues raised on help lines relate to human resources and complaints such as coworker abuse, failure of management to intervene in such abuse, and inappropriate language. Other top issues reported include business integrity at 17 percent; environment, health, and safety at 7 percent; misuse or misappropriation of assets at 6 percent; and accounting, auditing, and financial reporting at 3 percent.17

A help line or desk is characterized by ease of accessibility and simple procedures, and it serves as a safety net that facilitates monitoring and reporting. Companies such as Global Compliance provide automated case management systems which collect, categorize, and provide alerts to the appropriate manager for dealing with ethics issues in the organization. Companies are increasingly using case management services and software to track employees and issues throughout their entire organization. These programs provide reports of employee concerns, complaints, or observations of misconduct. Systems such as these allow the company to track investigations, analysis, resolutions, documentation, emerging/declining issues, and the time required for resolution.

**Observation and Feedback**

To determine whether a person is performing his or her job adequately and ethically, observation might focus on how the person handles an ethically charged situation. For example, during role-plays in the training sessions of salespeople and managers, ethical issues can be introduced into the discussion, and the decisions can be videotaped and outcomes evaluated by managers.

Questionnaires that survey employees’ ethical perceptions of their company, their superiors, their coworkers, and themselves, as well as ratings of ethical or unethical practices within the firm and industry, can serve as benchmarks in an ongoing assessment of ethical performance.
Then, if unethical behavior is perceived to increase, management will have a better understanding of what types of unethical practices may be occurring and why. A change in the ethics training within the company may be necessary. In addition, organization-wide risk management systems identify new and emerging risks employees face and to which management must respond.

Appropriate action involves rewarding employees who comply with company policies and standards and punishing those who do not. When employees comply with organizational standards, their efforts may be acknowledged and rewarded through public recognition, bonuses, raises, or some other means. Conversely, when employees deviate from organizational standards, they may be reprimanded, transferred, docked, suspended, or even fired.

**Whistle-blowing**

Interpersonal conflict ensues when employees think they know the right course of action in a situation, yet their work group or company promotes or requires a different, possibly unethical decision. In such cases, employees usually follow the organizational values. If they conclude that they cannot discuss what they are doing or what should be done with their coworkers or immediate supervisors, these employees may go outside the organization to publicize and correct the unethical situation. **Whistle-blowing** means exposing an employer’s wrongdoing to outsiders, such as the media or government regulatory agencies.

Whistle-blowers have provided pivotal evidence documenting corporate wrongdoing at a number of companies. Since the institution of the Whistleblower Protection Act, many employees are coming forward to reveal company misdeeds to government authorities. Bradley Birkenfeld of UBS reported a tax evasion scheme to the Internal Revenue Service and was awarded $104 million for the revelation. Another whistleblower, Keith Edwards, was awarded over $63 million for providing information regarding J. P. Morgan’s plan to hide findings from internal reviews about faulty mortgage loans from the government. Despite these large monetary rewards, the fortunes of whistleblowers are peppered with negative pushback. Most are labeled traitors, many lose their jobs, and some find it difficult to gain new employment afterward.

Critics have stated that the potential for large monetary sums related to whistleblowing encourage employees to come forward regardless of whether their claims are valid. However, a survey by the Ethics Resource Center showed that only 14 percent of employees are motivated by such incentives. Rather, the majority of external reporting is a result of other factors such as lack of trust in company authorities, experience of retaliation from prior internal reporting, and the fear of losing one’s job. Because of the risks involved in being a whistleblower, Table 6.4 provides a checklist of questions an employee should ask before blowing the whistle.
Chapter 6 Strategic Approaches to Improving Ethical Behavior

**TABLE 6.4 Questions to Ask Before Engaging in External Whistle-Blowing**

1. Have I exhausted internal anonymous reporting opportunities within the organization?
2. Have I examined company polices and codes that outline acceptable behavior and violations of standards?
3. Is this a personal issue that should be resolved through other means?
4. Can I manage the stress that may evolve from exposing potential wrongdoing in the organization?
5. Can I deal with the consequences of resolving an ethical or legal conflict within the organization?

Source: © O. C. Ferrell 2014.

**CONTINUOUS IMPROVEMENT OF THE ETHICS PROGRAM**

Improving the system that encourages employees to make more ethical decisions is not very different from implementing other types of business strategies. Implementation means putting strategies into action. Implementation in ethics and compliance means the design of activities to achieve organizational objectives using available resources and given existing constraints. Implementation translates a plan for action into operational terms and establishes a means by which organizational ethical performance will be monitored, controlled, and improved.

A firm’s ability to plan and implement ethical business standards depends in part on the organization’s structuring of resources and activities to achieve its ethical objectives in an effective and efficient manner. Some U.S. companies are setting up computer systems that encourage whistle-blowing. For instance, Marvin Windows (one of the world’s largest custom manufacturers of wood windows and doors) was concerned about employees feeling comfortable reporting violations of safety conditions, bad management, fraud, or theft. It established an anonymous system that allows for reporting in native country languages. This system is used to alert management to potential problems in the organization and facilitate an investigation. Systems such as these help alleviate employee concerns when reporting observed misconduct.

Once a company determines that its ethical performance has not been satisfactory, the company’s management may want to reorganize the way certain ethical decisions are made. For example, a decentralized organization may need to centralize key decisions, if only for a time, so that top-level managers can ensure improved organizational decision-making. Centralization may reduce the opportunity for lower-level managers and employees to make unethical decisions. Top management can then focus on improving the corporate culture and infusing more ethical values throughout the organization by providing rewards for positive behavior and sanctions for negative behavior. Dell Computer is an example of a
centralized organization, possibly because of its focus on manufacturing processes. In other companies, decentralization of important decisions may be a better way to attack ethical problems so that lower-level managers, familiar with the forces of the local business environment and local culture and values, can make more decisions. Coca-Cola is a more decentralized company due to its use of independent distributors and unique localized cultures. Whether the ethics function is centralized or decentralized, the key need is to delegate authority in such a way that the organization can achieve ethical performance.

**INSTITUTIONALIZATION OF BUSINESS ETHICS**

To successfully implement an ethics program, managers should be aware of the core, legally mandated, and voluntary elements of organizational business practices. All three should be incorporated into an organization’s ethics program. This generates an ethical culture that successfully controls and manages ethical risks. Institutionalization involves the legal and social forces that provide organizational rewards and punishments based upon stakeholder assessments of an organization’s behavior. In business ethics, institutionalization is associated with the establishment of laws, regulations, norms, and organizational programs. A refusal to conform to what is believed to be ethical conduct is often perceived to be an ethical issue and a concern to stakeholders. Institutions involve obligations, structures, and social expectations that reward and limit ethical decisions. Federal agencies, for instance, are institutions that mandate laws for appropriate conduct. They may even recommend core practices for developing an ethical organizational culture.

**Voluntary, Core Practices, and Mandatory Dimensions of Ethics Programs**

Table 6.5 summarizes the three elements of institutionalization. Voluntary practices are the beliefs, values, and voluntary responsibilities of an organization. All organizations engage in some level of voluntary activities to

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<th><strong>Voluntary boundary</strong></th>
<th>A management-initiated boundary of conduct (beliefs, values, voluntary policies, and voluntary responsibilities)</th>
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<tr>
<td><strong>Core practice</strong></td>
<td>A highly appropriate and common practice that helps ensure compliance with legal requirements, industry self-regulation, and societal expectations</td>
</tr>
<tr>
<td><strong>Mandated boundary</strong></td>
<td>An externally imposed boundary of conduct (laws, rules, regulations, and other requirements)</td>
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Source: Adapted from the "Open Compliance Ethics Group (OCEG) Foundation Guidelines," v1.0, Steering Committee Update, December 2005, Phoenix, AZ.
help different stakeholders. These responsibilities often manifest themselves through **philanthropy**, which occurs when businesses give back to communities and causes. Home Depot strongly supports the nonprofit organization Habitat for Humanity and encourages employees to volunteer. Evidence suggests that a sense of the law and ethical behavior increases voluntary responsibility activities. Research has also confirmed that when a company’s core practices support ethical and legal responsibilities, they enhance economic performance.24

**Core practices** are recognized best practices that are often encouraged by regulatory forces and industry trade associations. As we mentioned in the previous chapter, the Better Business Bureau provides guidance for managing customer conflicts and reviewing advertising disputes. Core practices are appropriate practices often common to the industry. They guarantee compliance with legal requirements and social expectations. Core practices align the expectations of the consumer with a business to create satisfying exchanges.25

Although core practices are not enforced on a legal basis, businesses can face consequences for not engaging in them when misconduct occurs. For example, the Federal Sentencing Guidelines for Organizations provide incentives for firms that effectively implement core practices. If misconduct occurs, firms that have demonstrated best practices may be able to avoid serious penalties. However, if the board took no initiative to oversee ethics and compliance in the organization, its failure could increase the level of punishment the company experiences. In institutionalizing core practices, the government allows organizations to structure their own methods and takes action only if violations occur. **Mandated boundaries** are externally imposed boundaries of conduct, such as laws, rules, regulations, and other requirements. Laws regulating business competition are examples of mandated boundaries.

Organizations manage stakeholder expectations for ethical conduct through corporate governance mechanisms, compliance, risk management, and voluntary activities. Government initiatives and stakeholder demands have helped to institutionalize these drivers of an ethical organizational culture. For instance, the governing authority of an organization structures corporate governance to provide oversight, checks, and balances to ensure the organization meets its ethical objectives. Compliance represents areas that must follow laws and regulations. Risk management examines the chance that misconduct may occur based on the type of business and the risk areas it commonly faces. Voluntary activities often involve the values and responsibilities organizations adopt in contributing to stakeholder expectations.

**ETHICAL LEADERSHIP**26

A company’s leaders provide the blueprint for an organization’s corporate culture.27 If organizational leaders do not display ethical conduct, the corporate culture will evolve on its own to exhibit the organization’s norms.
Most people believe that financial statements such as income statements and balance sheets provide the entire picture of a firm’s financial standing. In reality, however, this is not the case. It has been estimated that about 80 percent of a firm’s value is not found on the balance sheet. One of the least understood areas involves sustainability. For instance, how much does violating an environmental law truly cost a firm, not only monetarily but also in terms of its reputation? Some socially responsible businesses have adopted a triple bottom line approach in which the organization reports its financial results, its impact on society, and its impact on the planet. Yet even these companies find it difficult to take three different dimensions and add them up to provide an overall report.

A pilot program consisting of about 100 global companies in 25 countries is investigating ways to overcome these challenges. This program, monitored by the International Integrated Reporting Council, seeks to create an integrated reporting model giving investors the opportunity to gain a holistic view of the company’s operations and business strategies. Integrated reporting combines both financial and non-financial information. According to the Chartered Institute of Management Accountants, integrated reporting is meant to examine how organizations “really create value.” Companies testing this program include Microsoft, Unilever, Clorox, and Coca-Cola. Although most of these firms already develop sustainability or social responsibility reports, these reports are separate from the company’s financial information. Such an endeavor requires the active participation of both company financial officers and accountants.

Companies in the pilot program have different ways of reporting, but all focus on the true cost of capital and resources. For instance, U.K. global support and construction firm Interserve developed an integrated report focused upon four dimensions, including financial, natural/environmental, knowledge, and social capital. This reporting system recognizes the value of intangible assets such as knowledge as well as the firm’s societal impact. The point of such reports is not to report more information, but to provide more thorough information so both investors and consumers receive a more complete view of the company. Whereas financial reports focus on short-term numbers, it is hoped that integrated reporting will allow firms to adopt a more long-term orientation by taking an in-depth look at their resources and their impacts.

Proponents of integrated reporting hope that integrated reports will become the primary reports of the organization. In other words, integrated reporting may become the new norm for investor reports such as the annual report. Additionally, the demand for integrated reporting metrics seems to be growing. For instance, stock exchanges such as the Nasdaq are beginning to require more information on a firm’s corporate governance and environmental activities.

and values. Consider the infamous accounting firm Arthur Andersen, once one of the “Big Five” accounting firms (they were reduced to the “Big Four” after Arthur Andersen’s demise). Arthur Andersen, who founded the company, valued ethical behavior. In one situation, he refused to improperly record an accounting entry for a major client. Contrast this to the firm Arthur Andersen a few years before its demise and you can see what could happen when an organization strays from ethical leadership. Without ethical leadership, an organizational culture cannot be maintained for long periods of time.

Organizational leaders are important to ethical decision making because they have the ability to motivate employees and enforce the organization’s norms, policies, and procedures. Ethical leaders make certain that operational goals are achieved in an ethical manner. They do not simply allow employees to follow their individual moral codes, but enforce shared organizational values to support an ethical organizational culture. Ethical leaders also take the responsibility to model acceptable conduct for employees. Ethical leadership is positively related to employee organizational citizenship; conversely, it is negatively related to employee misconduct. In other words, ethical leaders are more likely to have employees that support the organization’s ethical culture and less likely to have employees that deviate from organizational values.

In addition to CEOs and managers, the board of directors is important in whether the organization displays ethical leadership. Legally, the board has a fiduciary duty to stakeholders to manage in the best interests of the organization. However, it is not always easy to determine what is in the best interests of the organization. A good example would be whether to engage in a risky activity that would result in short-term gains but which could cost the organization significantly in the long-run. To determine the appropriate course of action, board members must consider the impact a decision will have on different stakeholders.

So far we have discussed individuals in a position of authority within an organization. However, ethical leadership is not limited to authority figures. It should also be practiced by employees at all levels of the organization. Often, the actions of fellow employees significantly influence the ethical decision making of an individual. Thus, both leaders as well as employees within an organization have the responsibility to demonstrate ethical leadership characteristics when making decisions.

If stakeholders are dissatisfied with an organizational leader, the leader will not remain in that position. Ethical leaders must have the trust and respect of their followers. For instance, the former CEO of Best Buy resigned after an internal audit allegedly discovered he had had an inappropriate relationship with an employee. The nature of the relationship was found to violate Best Buy ethical policies. Ineffective tone at the top generates the perception that managers do not care about the organization’s ethics program or that they feel they are above the ethical requirements that everyone else in the organization must follow.
Just as strong ethical leadership plays a key role in guiding employee behavior, so does a strong corporate culture of support. A KPMG Forensic Integrity Survey asked employees whether the leaders of their companies displayed personal integrity and ethical leadership traits. Approximately 68 percent of employees indicated that leaders emphasized ethics and integrity in the organization. These types of responses are becoming more common as organizations continue strengthening their ethics programs. The results of having an ethical focus are proving to be beneficial toward business operations. Challenges persist, however, and ethical leaders must be vigilant in nurturing the corporate culture of their organizations.

Leadership Power

As we have shown, organizational leaders use their power and influence to shape corporate culture. Power refers to the influence that leaders and managers have over the behavior and decisions of subordinates. An individual has power over others when his or her presence causes them to behave differently. Exerting power is one way to influence the ethical decision-making framework we described in Chapter 5 (especially significant others and opportunity).

The status and power of leaders are directly related to the amount of pressure they can exert on employees to conform to their expectations. A superior in a position of authority can put strong pressure on employees to comply, even when their personal ethical values conflict with the superior’s wishes. For example, a manager might say to a subordinate, “I want the confidential data about our competitor’s sales on my desk by Monday morning, and I don’t care how you get it.” A subordinate who values his or her job or who does not realize the ethical questions involved may feel pressured to do something unethical to obtain the data.

There are five power bases from which one person may influence another: (1) reward power, (2) coercive power, (3) legitimate power, (4) expert power, and (5) referent power. These five bases of power can be used to motivate individuals either ethically or unethically.

Reward Power Reward power refers to a person’s ability to influence the behavior of others by offering them something desirable. Typical rewards might be money, status, or promotion. Consider, for example, a retail salesperson who has two watches (a Timex and a Casio) for sale. Let us assume that the Timex is of higher quality than the Casio but is priced about the same. In the absence of any form of reward power, the salesperson would logically attempt to sell the Timex watch. However, if Casio gave him an extra 10 percent commission, he would probably focus his efforts on selling the Casio watch. This “carrot dangling” and incentives have been shown to be very effective in getting people to change their behavior in the long run. In the short run, however, it is not as effective as coercive power.
Coercive Power Coercive power is essentially the opposite of reward power. Instead of rewarding a person for doing something, coercive power penalizes actions or behavior. As an example, suppose a valuable client asks an industrial salesperson for a bribe and insinuates that he will take his business elsewhere if his demands are not met. Although the salesperson believes bribery is unethical, her boss has told her that she must keep the client happy or lose her chance at promotion. The boss is also imposing a negative sanction if certain actions are not performed. Every year, 20 percent of Enron’s workforce was asked to leave because they were ranked as “needs improvement,” or because of other issues. Employees not wanting to fall into the bottom 20 percent engaged in corruption or exhibited complacency toward corruption.36

Coercive power relies on fear to change behavior. For this reason, it has been found to be more effective in changing behavior in the short run than in the long run. Coercion is often employed in situations where there is an extreme imbalance in power. However, people who are continually subjected to coercion may seek a counterbalance by aligning themselves with other more powerful persons or simply by leaving the organization. In firms that use coercive power, relationships usually break down in the long run. Power is an ethical issue not only for individuals but also for work groups that establish policy for large corporations.

Legitimate Power Legitimate power stems from the belief that a certain person has the right to exert influence and that certain others have an obligation to accept it. The titles and positions of authority that organizations bestow on individuals appeal to this traditional view of power. Many people readily acquiesce to those who wield legitimate power, sometimes committing acts that are contrary to their beliefs and values. Betty Vinson, an accountant at WorldCom, objected to her supervisor’s requests to produce improper accounting entries in an effort to conceal WorldCom’s deteriorating financial condition. She finally gave in to their requests, however, after being told that this was the only way to save the company. She and other WorldCom accountants eventually pleaded guilty to conspiracy and fraud charges.37

Such loyalty to authority figures can also be seen in corporations that have strong charismatic leaders and centralized structures. In business, if a superior tells an employee to increase sales “no matter what it takes” and that employee has a strong affiliation to legitimate power, the employee may try anything to fulfill that order.

Expert Power Expert power is derived from a person’s knowledge (or the perception that the person possesses knowledge). Expert power usually stems from a superior’s credibility with subordinates. Credibility, and thus expert power, is positively related to the number of years a person has worked in a firm or industry, the person’s education, or the honors he or she has received for performance. Expert power can also be conferred on a person by others who perceive him or her as an expert on a specific topic.
A relatively low-level secretary may have expert power because he or she knows specific details about how the business operates and can even make suggestions on how to inflate revenue through expense reimbursements.

Expert power may cause ethical problems when it is used to manipulate others or to gain an unfair advantage. Physicians, lawyers, or consultants can take unfair advantage of uninformed clients, for example. Accounting firms may gain extra income by ignoring concerns about the accuracy of financial data they are provided in an audit.

Referent Power Referent power may exist when one person perceives that his or her goals or objectives are similar to another’s. The second person may attempt to influence the first to take actions that will lead both to achieve their objectives. Because they share the same objectives, the person influenced by the other will perceive the other’s use of referent power as beneficial. For this power relationship to be effective, however, some sort of empathy must exist between the individuals. Identification with others helps to boost the decision maker’s confidence when making a decision, thus increasing his or her referent power.

Consider the following situation: Lisa Jones, a manager in the accounting department of a manufacturing firm, has asked Michael Wong, a salesperson, to speed up the delivery of sales contracts, so the revenue can be reported in the current quarter. Michael protests that he is not to blame for the slow process. In this case, Lisa makes use of referent power. She invites Michael to lunch, and they discuss some of their work concerns. They agree to speed up document processing, and Lisa suggests that Michael start asking for contracts that he expects in the next quarter. He agrees to give it a try, and within several weeks, the contracts are moving faster and revenue has increased in the current quarter. Lisa’s job is made easier, and Michael gets his commission checks a little sooner. (On the other hand, they may be engaging in channel stuffing, which in some cases can be considered revenue fraud.)

The five bases of power are not mutually exclusive. People typically use several power bases to effect change in others. Although power in itself is neither ethical nor unethical, its use can raise ethical issues. Sometimes, a leader uses power to manipulate a situation or a person’s values in a way that creates a conflict with the person’s value structure. For example, a manager who forces an employee to choose between staying home with his sick child and keeping his job is using coercive power, which creates a direct conflict with the employee’s values.

The Role of an Ethical Corporate Culture

Top management sets the tone for the ethical culture of an organization. If executives and CEOs do not explicitly address ethics issues, a culture may emerge where unethical behavior is sanctioned and rewarded. To be most successful, ethical standards and expected behaviors should be integrated throughout every organizational process from hiring, training, compensating, and rewarding to firing. This requires ethical leadership.
An ethical organizational culture is important to employees. A fair, open, and trusting organizational climate supports an ethical culture and can be attributed to lower turnover and higher employee satisfaction. Southwest Airlines has a very strong organizational culture that has remained consistent from the days of its key founder Herb Kelleher. All Southwest employees have heard the stories of Kelleher engaging employees and emphasizing loyalty, teamwork, and the creation of a fun environment. Kelleher strove to treat employees like family. Today, Southwest continues that legacy and culture. Pilots willingly support the ‘Adopt a Pilot’ program that allows students in classrooms countrywide to adopt a Southwest pilot for its four-week educational and mentoring program.38

Some leaders assume that hiring or promoting good, ethical managers will automatically produce an ethical organizational climate. This ignores the fact that an individual may have limited opportunity to enforce his or her own personal ethics on management systems and informal decision making that occurs in the organization. The greatest influence on employee behavior is that of peers and coworkers.39 Many times, workers do not know what constitutes specific ethical violations such as price fixing, deceptive advertising, consumer fraud, and copyright violations. The more ethical the culture of the organization is perceived to be, the less likely it is that unethical decision making will occur. Over time, an organization’s failure to monitor or manage its culture may foster questionable behavior. FedEx maintains a strong ethical culture and has woven its values and expectations throughout the company. FedEx’s open-door policy specifies that employees may bring up any work issue or problem with any manager in the organization.40

**Requirements of Ethical Leadership**41

Ethical leaders develop their skills through years of training, experience, and learning. In identifying what makes an effective leader, there is no clear consensus of the exact skills needed. However, there are certain skills that seem to be common to ethical organizational leaders. To be an ethical organizational leader, individuals should model corporate values, place the organization’s own interests above their own, understand their employees, develop tools for reporting, and recognize the limitations of organizational rules and values.42 Additionally, ethical leaders should never ignore issues of misconduct.

Ethical leaders do not live in a vacuum but are constantly interacting with others to encourage them to develop ethical leadership skills. Perhaps the best ethical leaders recognize their own limitations and establish strong support networks within the organization to help them in the decision making process. In so doing, they motivate employees toward reaching their full potential and emphasize their importance to the organization.43 They also establish incentives for those in the organization who train new leaders.44 Developing effective ethical leaders should be a never-ending process within an organization.
Archie Carroll developed a list of characteristics called the “7 Habits of Highly Moral Leaders,” based on Stephen Covey’s *The 7 Habits of Highly Effective People.* We have adapted Carroll’s work to develop “The 7 Habits of Strong Ethical Leaders.” These characteristics include (1) having a strong personal character, (2) having a passion to do what is right, (3) being proactive, (4) considering stakeholder interests, (5) modeling the organization’s values, (6) being transparent and actively involved in organizational decision making, and (7) being a competent manager who takes a holistic view of the firm’s ethical culture. Ethical leadership requires holistic thinking—one that is willing to take on the challenging issues organizations face every day. Strong ethical leaders have the knowledge and courage to put together important information in order to make the most ethical decision. Various stakeholder demands and conflicts make this a major challenge, but ethical leaders are up to the task. Above all, ethical leaders abide by their principles. This might even require the leader to leave the organization if he or she feels that the culture is too unethical to change.

Additionally, effective ethical leaders are so passionate about the organization and its success that they place the organizations’ interests above their own. It also requires them to align employees behind a shared vision. Ethical leaders are concerned with the legacy of their companies, desiring for the company’s success to continue long after they are gone. For example, Milton Hershey’s legacy has continued at Hershey Foods long after his death, and the firm’s ethical culture remains a role model for other companies.

Ethical leaders must be proactive in anticipating, planning, and acting to avoid potential ethical crises. They shoulder the important responsibility of developing effective ethics programs to guide employees in their ethical decision making. Ethical leaders understand social needs and develop core practices of ethical leadership. Vice Chairman Tom Mendoza at NetApp tells managers to let him know when an employee is “doing something right.” Mendoza then calls the employees to thank them. His personal “thank you” calls average approximately 10–20 calls per day. Recognizing employee accomplishments in promoting ethical conduct is a great way to make employees feel appreciated and reinforce an ethical organizational culture.

Finally, ethical leaders should be role models. If leaders do not model the values that they advocate, then those values become little more than window dressing. Behavioral scientist Brent Smith claims that leaders acting as role models are the primary influence on individual ethical behavior. On the other hand, leaders whose decisions go against the organization’s values signal to employees that the organization’s ethical values are meaningless. Whole Foods is an example of a company that strongly supports its core values. In addition to providing quality products, Whole Foods establishes employee well-being through the creation of a transparent workplace. To reduce the power gap between executives and employees, a salary cap has been placed on executive compensation. Each Whole Foods store donates at least 5 percent of profits to its communities. Table 6.6 displays Whole Foods’ core values.
Chapter 6  Strategic Approaches to Improving Ethical Behavior

### TABLE 6.6 Whole Food’s Core Values

- Sell the highest quality natural and organic products
- Satisfy, delight, and nourish our customers
- Support team member happiness and excellence
- Create wealth through profits and growth
- Serve and support our global and local communities
- Practice and advance environmental stewardship
- Create ongoing win-win partnerships with our suppliers
- Promote the health of our stakeholders through healthy eating education


### Benefits of Ethical Leadership

Perhaps the most important influence of ethical leadership is its impact on organizational culture. Because ethical leaders communicate and oversee the implementation of an organization’s values, they make certain that employees are familiarized with core beliefs. Some may provide incentives for ethical conduct, such as rewards for making ethical decisions. These incentives have a positive impact on ethical conduct among employees. Teaching employees to value integrity is a key component in creating an ethical organization.

Research has shown that ethical leadership tends toward higher employee satisfaction and commitment. Employees seem to like working for ethical companies and are more likely to stay with ethical organizations. This saves the firm money and leads to higher productivity. Employees at The Container Store are provided with 263 hours of training, receive higher pay than at competing stores, and are shown appreciation through events like We Love Our Employees Day. This strong organizational culture has resulted in a turnover rate of 10 percent for The Container Store. This is compared to 100 percent for other retailers in the industry.

In addition to employee satisfaction and productivity, ethical leadership also creates strong connections with stakeholders external to the organization. Studies have revealed that customers are willing to pay higher prices for products from companies they consider to be ethical. Consumer trust for businesses still has a long way to go after the latest recession, and organizations that can establish trust are likely to receive a large and loyal customer following.

Ethical leadership also impacts an organization’s long-term value. Evidence shows that the ethical commitment of organizational members is positively associated with the organization’s value on the stock market. This is because reputation has a profound influence on whether an investor will even invest. Investors consider the risk of an investment as a major
factor in their decision, and because social responsibility programs are negatively related to long-term risks, ethical conduct is likely to improve reputation and consequently lower the risks of investment. As we already discussed in the previous chapters, from a regulatory standpoint, organizations demonstrated as having strong ethics programs are more likely to see reduced penalties if misconduct should happen. By creating strong relationships with a variety of stakeholders, ethical leaders are able to develop major competitive advantages for their organizations.

**Leadership Styles**

Leadership styles impact not only how a leader leads but also how employees accept and/or adhere to organizational norms and values. Clearly, leadership styles that reinforce the development of organizational values are beneficial. These styles of leadership affect the organization’s communication and oversight of values, norms, and ethics codes. The challenge that leaders face is earning employee trust. This trust is imperative if a leader hopes to guide employees into ethical decision making. Trustworthy leaders tend to be seen as ethical stewards. Employees often look to their organizational leaders to determine how to respond to a situation, even when that response may be ethically questionable.

Effective ethical leadership requires the leader to understand the organization’s vision and values, ethical challenges, and the risks involved in accomplishing organizational objectives. One of the biggest assumptions is that those who fail in ethical leadership do not have an ethical character. This is a fallacy. In reality, there are a number of examples of people implicated in misconduct who appeared to have good character. Rajat Gupta, who was convicted for passing on insider trading tips, has been recognized for his strong philanthropic endeavors and exceptional kindness.

Ethical leaders must learn from their experiences and gain knowledge about appropriate practices. They display transparency in their leadership and have the ability to understand both current ethical issues as well as to anticipate future issues. These leaders often adopt a stakeholder orientation approach to management. It is also important to note that even the most ethical leaders are human; they will make ethical mistakes, but how they acknowledge these mistakes is what often separates them from other leaders.

One important characteristic that many ethical leaders appear to possess is emotional intelligence, or the skills to manage themselves and their relationships with others effectively. Emotionally intelligent leaders are characterized by self-awareness, self-control, and relationship building. They see their efforts as achieving “something greater than themselves.” Warren Buffett and Howard Schultz are examples of emotionally intelligent leaders. These leaders are able to motivate employees to support a common vision, making them feel that their efforts matter in the successful operation of the organization. Because emotionally intelligent leaders exhibit self-control and self-awareness, they are more proficient in tackling...
stressful and challenging situations. Because of the impact of emotional intelligence on the success of the organization, some employers have begun viewing emotional intelligence as more important than IQ.69

Daniel Goleman examined leadership styles based upon emotional intelligence. He came up with the following six styles:70

1. The coercive leader requires complete obedience and focuses on achievement, initiative, and self-control. This style can be highly effective during times of crisis but tends to be detrimental to long-term performance.
2. The authoritative leader motivates employees to follow a shared vision, embraces change, and creates a strongly positive performance climate.
3. The affiliative leader values people and their needs. This leader depends upon friendship and trust to encourage flexibility and innovation.
4. The democratic leader values participation and teamwork to develop collaborative decisions. This style focuses heavily on communication and creating a positive work climate.
5. The pacesetting leader sets high standards of performance. This style works well for achieving quick results from motivated, achievement-oriented employees but can have negative results due to its stringent performance standards.
6. The coaching leader creates a positive work climate by developing skills to promote long-term success, delegating responsibility, and assigning challenging assignments.

Using Goleman’s research, Richard Boyatzis and Annie McKee came up with the idea of a resonant leader. Resonant leaders are mindful of their emotions, believe that goals can be achieved, and display a caring attitude toward other employees. This leads to resonance within the organization, enhancing collaboration and the ability of employees to work toward shared goals.71 Resonant leaders are highly effective in creating an ethical corporate culture as well as strong relationships with employees.

The most successful leaders tend to adapt their styles based upon the situation. Leadership style relies heavily on how the leader measures risks as well as his or her desire to attain a positive corporate culture. Like other leadership characteristics, many emotional intelligence skills can be learned. Starbucks places great importance on emotional intelligence. New employees at the company undergo a training program called the “Latte Method” to learn how to detect negative emotions from their customers and the best ways of responding to them.72

Two dominant leadership styles in an organization are transactional and transformational. Transactional leadership attempts to create employee satisfaction through negotiating for levels of performance or “bartering” for desired behaviors. Transformational leadership, in contrast, tries to raise the level of commitment of employees and creates greater trust and motivation.73 Transformational leaders attempt to promote activities and behavior through a shared vision and common learning experiences. Both transformational and transactional leaders can positively influence the organizational climate.
Transformational leaders communicate a sense of mission, stimulate new ways of thinking, and enhance as well as generate new learning experiences. Transformational leadership considers the employees’ needs and aspirations in conjunction with organizational needs. Therefore, transformational leaders have a stronger influence on coworker support and the building of an ethical culture than transactional leaders. Transformational leaders also build a commitment and respect for values that provide agreement on how to deal with ethical issues. Transformational ethical leadership is best suited for higher levels of ethical commitment among employees and strong stakeholder support for an ethical climate. A number of industry trade associations, such as the American Institute of Certified Public Accountants, Defense Industry Initiative on Business Ethics and Conduct, and the Ethics and Compliance Officer Association, are assisting companies in providing transformational leadership. Research suggests that organizations with transformational leadership are more likely to be involved in corporate social responsibility (CSR) activities.

Transactional leadership focuses on ensuring that the required conduct and procedures are implemented. The “barter” aspects of negotiations to achieve the desired outcomes result in a dynamic relationship between lenders and employees where reactions, conflicts, and crises influence the relationship more than ethical concerns. Transactional leaders produce employees who achieve a negotiated level of required ethical performance or compliance. As long as employees and leaders find the exchange mutually rewarding, the compliance relationship is likely to be successful. However, transactional leadership is best suited to quickly changing ethical climates or reacting to ethical problems or issues. After a major leadership scandal at Tyco resulted in the conviction of CEO Dennis Kozlowski and the removal of its board members, the need for quick action to pull up the struggling company was apparent. Without a quick turnaround—both in leadership and in the company’s ethical conduct—Tyco may not have survived. Eric Pillmore was hired to be the senior vice president of corporate governance at Tyco. Pillmore had to institute ethics and corporate governance decisions quickly to aid in the turnaround. He helmed a new ethics program that changed leadership policies and gave him direct communications with the board of directors.

Other leadership experts are classifying leaders into a new category based on how they model organizational values. Authentic leadership includes individuals who are passionate about the organization, display corporate values in their daily behavior at work, and establish enduring relationships with stakeholders. Kim Jordan, CEO of craft brewery New Belgium Brewing (NBB), is an example of an authentic leader. Jordan constantly attempts to embody NBB’s mission to “operate a profitable company which makes our love and talent manifest.” Jordan has also successfully aligned employees at NBB toward a shared goal of providing high quality products, improving sustainability, and embracing a stakeholder orientation.
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Authentic leadership can also be learned. In fact, authentic leaders often learn by observing the successful leadership habits of other strong leaders. Authentic leaders possess principle-centered power, meaning that they can handle difficult situations and are extremely dedicated toward their organizations. They also exhibit organizational core values and incorporate these values into daily operations. This type of leadership should be the aim for all ethical leaders in an organization.

**Leader-Follower Relationships**

Communication is the key toward establishing strong relationships between organizational leaders and employees. Leader–follower congruence takes place when leaders and their followers (employees) share the same organizational vision, ethical expectations, and objectives. It is important for ethical leaders to get employees to adopt shared organizational goals and values. If employees feel that the organizational leaders are unapproachable, this will create a major obstacle toward the achievement of the organization’s vision and objectives.

On the other hand, leaders may take the opposite approach by micromanaging employees. Managing employees too closely will make them feel stifled and give them the feeling that the management does not trust them. Micromanagement in organizations is associated with lower morale, decreased productivity, and greater tendency to leave the company. These disadvantages can be avoided when ethical leaders use communication to develop respectful relationships with employees. These more positive relationships tend to increase job satisfaction and employee commitment.

Because organizational leaders are often managers or executives, they may not work very much with lower-level employees. This could create a sense of isolation in which the leader feels cut off from other employees. The more isolated organizational leaders are, the less connected they will be with employees—and the less likely they will be to detect organizational misconduct. Instead, ethical leaders must frequently interact with employees. This takes the form of not only speaking with employees but also listening to them and encouraging them to provide feedback. Often employees tend to want to avoid discussing ethical issues in the workplace. To get past this hesitation, ethical leaders must proactively communicate the firm’s ethical values and develop a transparent workplace in which employees can feel comfortable expressing concerns. We discuss communication in more detail in the next section. When organizational leaders and employees are on the same page, they are able to advance the organization’s goals and culture more effectively.

**Ethical Leadership Communication**

The development of an ethical culture is impossible without strong communication in the organization. If an organizational leader communicates through highly controlling speech that tolerates little criticism, employees will be reluctant to bring up any ethical issues or problems. However,
Table 6.7 Communication Skills for Becoming an Ethical Leader

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<tr>
<td>1.</td>
<td>Tell employees the truth about their conduct.</td>
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<tr>
<td>2.</td>
<td>Listen to employee concerns about ethical issues they observe.</td>
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<tr>
<td>3.</td>
<td>Engage in direct personal communication about appropriate conduct.</td>
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<tr>
<td>4.</td>
<td>Use coaching to provide expectations about behavior.</td>
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<td>5.</td>
<td>Include performance feedback on ethical evaluations.</td>
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<td>6.</td>
<td>Be sure your feedback on ethical conduct is correct.</td>
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<tr>
<td>7.</td>
<td>Always ask for feedback from employees.</td>
</tr>
<tr>
<td>8.</td>
<td>Continue to develop your leadership skills.</td>
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</table>

Ethical leaders understand the importance of frequent communication and interaction with employees. Table 6.7 shows how leaders can use communication to become better leaders.

An ethical culture must contain both transparency and strong mechanisms for reporting. Ethical leaders in the organization must create a transparent environment where ethics is frequently discussed. This helps remove the idea that discussing issues is a “taboo” topic. Reporting occurs when organizational leaders and their employees communicate. Most of the time, employees report to the leaders. However, ethical leaders should also be responsible for reporting crucial information to employees to promote an ethical workplace and advance organizational goals.

Reporting can be either formal or informal. Formal reports occur in contexts such as conferences and meetings. An important tool for formal reporting is an anonymous ethics hotline employees can use to report concerns. Informal reporting is no less important. It happens when ethical leaders interact with their employees on a less formal basis to keep them apprised of organizational policies, expectations, and decisions. Informal discussions are incredibly important in identifying ethical risk areas as concerns are frequently expressed through casual conversations. Ethical leaders must recognize the importance of both formal and informal communication mechanisms.

Just as individuals can learn leadership skills, they can also learn how to communicate effectively. Effective communication skills are often developed and honed through training and experience. Organizational communication necessary for the establishment of an ethical culture includes the following: interpersonal communication, small group communication, nonverbal communication, and listening. Table 6.8 summarizes the four categories of communication.

**Interpersonal Communication.** Interpersonal communication is the most common form of communication. It occurs when two or more people communicate with one other. A meeting between an employee and her supervisor is an example of interpersonal communication. Interpersonal communication (versus small group communication) is more intimate because fewer people are involved. This type of communication should
TABLE 6.8 Four Categories of Communication

<table>
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<th>Communication</th>
<th>Description</th>
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<tbody>
<tr>
<td>Interpersonal</td>
<td>When two or more people communicate with one another</td>
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<tr>
<td>Small Group</td>
<td>Communication that occurs in small groups</td>
</tr>
<tr>
<td>Nonverbal</td>
<td>Expressed through body language, actions, expressions, tone of voice, proximity, volume, rhythm, or any other way that is not oral or written</td>
</tr>
<tr>
<td>Listening</td>
<td>Actively listening to the other person’s verbal or nonverbal behavior</td>
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To occur often within an organization because it gives ethical leaders a greater chance to uncover ethical risk areas, create better employee relationships, and encourage feedback about the organization’s ethical climate. For interpersonal communication to be effective, ethical leaders must show the employee respect and dignity to maintain a positive relationship—even during disciplinary procedures. Respecting the employee demonstrates that the leader cares about what the employee has to say. On the other hand, this does not mean that ethical leaders should ignore or compromise unethical employee conduct. It is less about placating an employee and more about showing him or her dignity as a person.

It is not uncommon for employees to feel intimidated by their superiors due to power differences. An ethical leader can use communication to reassure employees as well as balance the interests of all relevant stakeholders. A good way to reduce perceived power distances is for the ethical leader to be open and respectful to the employee instead of judgmental. This approach helps make employees feel more comfortable about bringing up ethical concerns.

Communication is not always black-and-white. Like many ethical issues, there are times when the ethical leader will have different options on what to communicate, with some being more or less ethical than others. For instance, lying to a customer is clearly unacceptable, but white lies that do not damage stakeholders (such as complimenting an employee on a haircut despite the fact that it looks awful) may be permissible in some instances. Additionally, as the Rajat Gupta example from earlier demonstrates, communication that is not thought out carefully can have serious consequences. For Rajat Gupta, giving his friend Raj Rajaratnam from The Galleon Group nonpublic information directly violated the law. Ethical leaders will encounter numerous situations in which they must consider the ethical consequences of communication with stakeholders. Ethical leaders who strongly support ethical interpersonal communication can empower employees while promoting the organization’s ethical objectives.

Small Group Communication. Small group communication is becoming increasingly important to ethical decision making. Because ethical decision making does not occur in a silo, small group communication is often necessary to investigate and select the most ethical course of action.
group communication has an advantage over interpersonal communication because it increases collaboration, explores more options, and allows employees to participate more in ethical decision making. Small groups generate a variety of perspectives on a particular issue, enabling ethical leaders to look at an issue from a number of different angles. This diversity of perspectives can lead to better solutions than if the leader had tried to arrive at the outcome individually.

Small groups also help to create checks and balances through accountability. An effective team holds individual members accountable for their contributions. For effective small group communication to take place, all small group members should feel comfortable with contributing input, understand the organization’s ethical values, be trained in ethical communication, know how to listen to the input of other members, try to understand the other person’s point of view, demonstrate a readiness to seek common agreement, investigate different alternatives, and commit to choosing the most ethical solution.91

However, ethical leaders should also recognize the limitations of small group communication. Sometimes routine group decision making can cause the group to overlook possibilities. It is also not uncommon for teams to experience groupthink or group polarization. Group polarization is the tendency to decide on a more extreme solution than an individual might choose on his or her own. A small group, for instance, might choose to pursue a riskier decision than would normally be chosen.92 Groupthink is when group members feel pressured to conform to the group consensus, even if they personally disagree with it. This could result in a less-than-optimal ethical decision.

**Nonverbal Communication.** Non-spoken communication is a dimension of ethical communication that is just as important as spoken forms. Nonverbal communication is expressed through body language, actions, expressions, tone of voice, proximity, volume, rhythm, or any other way that is not oral or written. Nonverbal communication is important because it provides clues to an individual’s emotional state.93 Paralanguage, which includes the way we talk, can indicate whether a person is angry, sad, happy, etc. Often nonverbal communication is more trustworthy than spoken communication. For instance, although a person might say one thing, if his or her body language communicates something else, then the nonverbal communication is often a better indicator of what the person really means. This is because nonverbal communication is harder to control than the spoken word as it occurs in the subconscious.

Nonverbal communication helps to clarify ambiguous or confusing language, alerting the communicator about whether the recipient understands the communication. Because nonverbal communication provides important insights into a person’s feelings, ethical leaders should pay careful attention to their employees’ nonverbal cues. Sometimes permission to engage in unethical activities is granted by an expression or nodding of the head. They should also be careful to monitor their own nonverbal cues so they do not give off the wrong impression to employees.
Listening. Ethical communication is not limited to speaking or communicating nonverbally. It also involves actively listening to the other person’s verbal or nonverbal behavior. Communication between stakeholders cannot occur without listening. Organizational leaders who fail to listen can overlook ethical issues and fail to stop them before they snowball into a crisis. In fact, many employees have cited the failure to listen as one of their top complaints in the workplace, so listening to employee concerns is crucial in advancing an ethical organizational culture. Without listening ethical leaders cannot learn important information from employee reports necessary in understanding the ethical climate of the firm.

On the other hand, listening to employees increases morale as well as their willingness to participate in the ethical decision making process. Effective listening skills creates a sense of credibility and trustworthiness. This supports a transparent organizational culture in which ethical concerns can be discussed freely. Because ethical leaders act as role models, their ability to listen encourages employees to do the same, further promoting the acceptance of the organization’s ethical values.

SUMMARY

A strategic approach to ethical decisions will contribute to both business and society. To be socially responsible and promote legal and ethical conduct, an organization should develop an organizational ethics program by establishing, communicating, and monitoring ethical values and legal requirements that characterize its history, culture, industry, and operating environment. Most companies begin the process of establishing an organizational ethics program by developing a code of conduct, a formal statement that describes what the organization expects of its employees. A code should reflect senior management’s desire for organizational compliance with values, rules, and policies that support an ethical climate. Codes of conduct help employees and managers address ethical dilemmas by prescribing or limiting specific activities.

Organizational ethics programs must be overseen by high-ranking persons reputed for their legal and ethical standards. Often referred to as ethics officers, these persons are responsible for assessing the needs and risks to be addressed in an organization-wide ethics program, developing and distributing a code of conduct, conducting training programs for employees, establishing and maintaining a confidential service to answer questions about ethical issues, making sure the company is in compliance with government regulations, monitoring and auditing ethical conduct, taking action on possible violations of the organization’s code, and reviewing and updating the code. Instituting a training program and a system to communicate and educate employees about the firm’s ethical standards is a major step in developing an effective ethics program.

Ethical compliance involves comparing the employee’s ethical performance with the organization’s ethical standards. Ethical compliance can be measured through employee observation, internal audits, reporting
systems, and investigations. An internal system for reporting misconduct is especially useful. Employees who conclude that they cannot discuss current or potential unethical activities with co-workers or superiors and go outside the organization for help are known as whistle-blowers.

Consistent enforcement and necessary disciplinary action are essential to a functional ethical compliance program. Continuous improvement of the ethics program is necessary. Ethical leadership and a strong corporate culture in support of ethical behavior are required to implement an effective organizational ethics program.

Ethical leadership is particularly important to the organization’s ethical culture. The most effective leaders are able to adapt their leadership styles—reward, coercive, legitimate, expert, and referent power—to the type of situation. These styles also have a major impact on the organization’s corporate culture. Emotional intelligence is also an important component of ethical leadership.

There are many requirements for ethical leadership, including a passion for doing right, being competent and proactive, taking a holistic view of the ethics program, considering stakeholder interests, and acting as a role model. Ethical leadership leads to several benefits for the organization, including higher employee satisfaction and productivity as well as the promotion of ethical values. Leaders have different methods of leading. These methods, including transactional, transformational, and authentic, have different impacts on the organization’s ethical culture. To promote an ethical culture, it is necessary for leaders to have strong positive relationships with the employees. An important way of maintaining these relationships is through communication. Ethical leaders should master interpersonal, small group, and nonverbal communication as well as listening. Being an effective communicator helps the ethical leader to develop positive employee relationships, uncover ethical issues, address employee concerns, and include employees in the ethical decision-making process.

Responsible Business Debate

Enron: The Capitalist Manifesto?

**Issue:** Was it greed, corporate culture, or something else that caused the downfall of Enron?

“Greed is good,” said Gordon Gekko in the movie Wall Street—a mind-set that permeated the financial firms of Wall Street for decades. If this phrase is the capitalist manifesto, Enron is the archetype of this philosophy. The company marked both the height and the beginning of the end of that kind of corporate mentality.

Ken Lay, former CEO of Enron, has become the ultimate symbol of unethical conduct. He was the key executive involved in a massive fraud that destroyed thousands of jobs, life savings, as well as billions in shareholder value. Lay was put on trial and found guilty of “consciously avoiding knowing about wrongdoing” at Enron. Yet even after his conviction, Lay maintained that “with 30,000 employees in 30 countries and 200 executives at the vice president level,” the corruption...
had existed without his knowledge. Most experts believe that ethical corporate cultures are a top-down phenomenon, and after the fall of Enron, most people felt Lay had to be held responsible.

Enron whistle blower Sherron Watkins asserted that Lay was indeed some distance from the fraud, and that Jeff Skilling, also CEO for a short time, was the one who had created a strong culture of greed where bad behavior was rewarded as long as it delivered profits for the company. Aggressive business practices included finding loopholes in regulation, extreme pressure to perform, periodic firing of the lowest performing employees, paying huge salaries and bonuses to those who did perform well (regardless of what ethical corners they may have cut), and bribing lawyers, bankers, accountants, and other so-called gatekeepers.

A culture of greed evolved where everyone took risks and expected a big reward. And yet, until his death Key Lay claimed the firm had strong values of respect, integrity, communication, and excellence, including a detailed code of ethics. How could these two corporate cultures—the greedy one created by Skilling and the ethical one Lay believed Enron had—exist in the same company? In the end, Lay stated internal controls were not effective and that he believed the frauds of Andy Fastow, the former CFO, were what brought down the company. Sherron Watkins, although a key whistleblower, did not blame Lay. She thought that Jeff Skilling's charismatic and intimidating leadership had been the central problem. Watkins believes that if Skilling had been out of the picture, the fraud would not have happened. The Enron disaster created more new regulatory legislation and incited an ongoing debate about the nature of capitalism and what is an effective business ethics program.

There Are Two Sides To Every Issue:
1. Ethical misconduct was caused by the corporate culture at Enron.
2. Ethical misconduct at Enron was caused by Ken Lay's and Jeff Skilling's leadership.


KEY TERMS

- codes of conduct (p. 190)
- ethics officer (p. 193)
- whistle-blowers (p. 198)
- voluntary practices (p. 200)
- philanthropy (p. 201)
- core practices (p. 201)
- mandated boundaries (p. 201)
- emotional intelligence (p. 210)

DISCUSSION QUESTIONS

1. How can an organization be socially responsible and promote legal and ethical conduct?
2. What are the elements that should be included in a strong ethics program?
3. What is a code of conduct and how can a code be communicated effectively to employees?
4. How and why are a training program and a communications system important in developing an effective ethics program?
5. What does ethical compliance involve and how can it be measured?
6. What role does leadership play in influencing organizational behavior?
7. Describe some of the skills needed to be an ethical leader.
8. List some of the benefits of ethical leadership.
9. Compare transformational leadership and transactional leadership.
10. Describe the four different types of communication.
Robert Rubine flipped through his messages and wondered which call he should return first. It was only 3:30 p.m., but he felt as though he had been through a week’s worth of decisions and worries. Mondays were normally busy, but this one was anything but normal. Robert’s employer, Medic-All, is in the business of selling a wide array of medical supplies and equipment. The company’s products range from relatively inexpensive items, like bandages, gloves, and syringes, to more costly items, such as microscopes, incubators, and examination tables. Although the product line is broad, it represents the “basics” required in most healthcare settings. Medic-All utilizes an inside sales force to market its products to private hospitals, elder care facilities, government healthcare institutions, and other similar organizations. The company employs 275 people and is considered a small business under government rules.

The inside sales force has the authority to negotiate on price, which works well in the highly competitive market of medical supplies and equipment. The salespeople are compensated primarily on a commission basis. The sales force and other employees receive legal training annually. All employees are required to sign Medic-All’s code of ethics each year and attend an ethics training session. Despite the importance of the inside sales force, Medic-All has experienced a good deal of turnover in its sales management team. A new lead manager was hired about four months ago. Robert oversees the sales division in his role as vice president of marketing and operations.

Late Friday afternoon last week, Robert received word that two employees in the company’s headquarters were selling products to the government at a higher price than they were selling them to other organizations. Both employees have been on the job for over two years and seem to be good performers. A few of their sales colleagues have complained to the lead sales manager about the high quarterly commissions that the two employees recently received. They insinuated that these commissions were earned unfairly by charging government-run hospitals high prices. A cursory review of their accounts showed that, in many instances, the government was paying more than other organizations. Under procurement rules, the government is supposed to pay a fair price, one that other cost-conscious customers would pay. When asked about the situation, the two employees said that the price offered was based on volume, so the pricing always varied from customer to customer.

Robert took the information to his boss, the president. The two of them discussed how these employees received legal and ethics training, signed the company code of ethics, and should have been knowledgeable about rules related to government procurement. The president said that these two salespeople sounded like “rogue employees,” who committed acts without the approval of the management to increase their commissions. The president also said that the company had already experienced a good deal of turnover in its sales management team. A new lead manager was hired about four months ago. Robert oversees the sales division in his role as vice president of marketing and operations.

The president and Robert then discussed many issues and scenarios, such as how to deal with the two salespeople, whether to continue the investigation and inform the government, what strategies to put in place for preventing similar problems in the future, how to protect the firm’s good name, whether the company could face suspension from lucrative government business, and others. What would you do?

EXPERIENTIAL EXERCISE
Visit the website of the Ethics and Compliance Officer Association (http://www.theecoa.org). What is the association’s current mission and membership composition? Review the website to determine the issues and concerns that comprise the ECOA’s most recent programs, publications, and research. What trends do you find? What topics seem most important to ethics officers today?

WHAT WOULD YOU DO?

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The Mission of CVS: Corporate Social Responsibility and Pharmacy Innovation

INTRODUCTION

In 1963, brothers Stanley and Sidney Goldstein founded the first Consumer Value Store (CVS) with partner Ralph Hoagland in Lowell, Massachusetts. The store originally sold health and beauty supplies. It was widely successful, and grew to include 17 stores in one year. By 1967, CVS began offering pharmacy in-store departments, and in less than a decade it was acquired by the retail holding corporation Melville Corporation. This marked the beginning of CVS's expansion across the east coast through new store openings or mergers and acquisitions. It soon reached the milestone of exceeding $100 million in sales in 1974.

As the company grew, it faced intense competition, which it responded to through a differentiation strategy. CVS focused on its core offerings of health and beauty products, placing stores in shopping malls to generate more foot traffic. This strategy worked well for the company, causing it to hit $1 billion in sales by 1985. The company celebrated their 25th year in 1988 with 750 stores and $1.6 billion in sales. The acquisition of People's Drug stores enabled CVS to establish its presence more widely along the coast and spurred the launch of PharmaCare, a pharmacy benefit management (PBM) company providing services to employers and insurers. In 1996 the Melville Corporation restructured, and CVS became independent as a publicly traded company on the New York Stock Exchange.

This new surge of investment allowed the company to expand widely across the nation into the Midwest and South. CVS’s acquisition of 2,500 Revco stores became the largest acquisition in U.S. retail pharmacy history. With the rise of the Internet, CVS seized upon the opportunity to launch CVS.com in 1999 (and Caremark.com after the 2007 acquisition). This became the first fully integrated online pharmacy in the United States. In another first for the U.S. pharmacy retail industry, the company introduced the ExtraCare Card loyalty program in 2001. The company’s 40th anniversary in 2003 was marked with increasing westward expansion, 44 million loyalty card holders, and more than 4,000 stores in approximately 30 states. In the following five years, the company’s acquisitions allowed CVS to gain leadership in key markets, begin a mail order business, and open its 7,000th retail location. It would also undergo a name change to CVS/Caremark after acquiring Caremark Rx, a prescription benefits management organization.

The two most important acquisitions in the history of CVS include MinuteClinic walk-in health clinics (in 2005) and Caremark Rx, Inc., (in 2007), a pharmacy benefits management company. To date, MinuteClinic has facilitated over 18 million patient visits in 800 clinics across 27 states, putting them in prime position to reach their 2017 goal of operating 1,500 clinics in 35 states. CVS/Caremark, as it was renamed after the acquisition, became the second largest pharmacy in the United States after Walgreen’s, introducing new services such as online prescription refills. By 2011, the company had more than $100 billion in revenue, 7,500 retail pharmacies, 31 retail specialty pharmacies, 12 specialty mail order pharmacies, 18 onsite pharmacies, and a pharmacy benefit management business.

CVS purchases and stocks products that meet the highest quality standards as well as its own line of products whose specifications and performance are annually tested and reviewed to ensure compliance with applicable consumer safety laws. In addition, the company has instituted its own Cosmetic Safety Policy that cosmetic products on the shelves must meet. CVS employs 200,000 people in over 7,600 locations across 46 states, the District of Columbia, Puerto Rico, Brazil, and Northern Ireland. Corporate headquarters are located in Woonsocket, Rhode Island. In one year, CVS filled and managed 1.6 billion prescriptions, provided services to 63 million PBM clients, and surpassed $126 billion in net revenues. The company is proud to note their number 13 spot on the Fortune 100 list. It has also paid dividends to shareholders for 69 consecutive

*This case was prepared by Yixing Chen, Christine Shields, and Michelle Urban for and under the direction of O. C. Ferrell and Linda Ferrell © 2014. It was prepared for classroom discussion rather than to illustrate either effective or ineffective handling of an administrative, ethical, or legal decision by management. All sources used for this case were obtained through publicly available material.
quarters, with dividend increases for 11 consecutive years. Today, CVS is one of the largest pharmacy health care providers and pharmacies in the United States, and is comprised of four business functions: CVS/Caremark, MinuteClinic, PBM Services, and Retail Pharmacy.

The following case will explain some of the legal and ethical challenges CVS/Caremark has encountered, including a settlement with the Federal Trade Commission (FTC) and U.S. Department of Health & Human Services (HHS) regarding violations of the Health Insurance Portability and Accountability Act (HIPAA) Privacy Rule, deceptive business practices, and unseemly conduct by a manager resulting in a death. Our examination will also include how CVS/Caremark responded to such allegations, and how they have worked to redefine the company as a healthcare provider. We will analyze the company’s ethical structure, including their recent decision to stop selling cigarettes, as well as an overview of some criticisms the company has received during their transition. The conclusion offers some insights into the future challenges CVS will likely experience.

ETHICAL CHALLENGES
Like most large companies, CVS must frequently address ethical risk areas and maintain socially responsible relationships with stakeholders. Although CVS has excelled in social responsibility, it has suffered from ethical lapses in the past. The next section addresses some of CVS’s most notable ethical challenges, some of which resulted in legal repercussions.

HIPAA Privacy Case of 2009
As a company grows and achieves widespread influence, it also inherits a responsibility to act ethically and within the law. In 2009, CVS/Caremark was accused of improperly disposing of patients’ health information. It was alleged that company employees threw prescription bottle labels and old prescriptions into the trash without destroying sensitive patient information, making it possible for the information to fall into public hands. This is a violation of the HIPAA Privacy Rule, which requires companies operating in the health industry to properly safeguard the information of their patients. The allegations initiated investigations by the Office of Civil Rights (OCR) and the FTC, marking the first such collaborative investigation into a company’s practices. These investigations revealed other issues as well, including a failure of company policies and procedures to completely address the safe handling of sensitive patient information, lack of proper employee training on disposal of sensitive information, and negligence in establishing repercussions for violations of proper disposal methods. This was in spite of the fact that CVS materials reassure clients that their privacy is a top priority for the pharmacy. This claim, in addition to the investigative findings, prompted the FTC to allege that CVS was making deceptive claims and had unfair security practices, both of which are violations of the FTC Act.

CVS settled the case with the U.S. Department of Health & Human Services (HHS), which oversees the enforcement of the HIPAA Privacy Rule, for $2.25 million regarding improper disposal of patients’ health information. The settlement also mandated that the company implement a Corrective Action Plan with the following seven guidelines: (1) revise and distribute policies regarding disposal of protected health information; (2) discipline employees who violate them; (3) train workforce on new requirements; (4) conduct internal monitoring; (5) involve a qualified, independent third-party to assess company compliance with requirements and submit reports to HHS; (6) establish internal reporting procedures requiring employees to report all violations of these new privacy policies; and (7) submit compliance reports to HHS for three years. The company also settled with the FTC by signing a consent order, requiring the company to develop a comprehensive program that would ensure the security and confidentiality of information collected from customers. In so doing, the company agreed to a biennial audit from an independent third party. This audit is meant to ensure that CVS’s program meets the FTC’s standards for its security program. CVS is forbidden by law from misrepresenting its security practices.

Deceptive Business Practices
In addition to privacy challenges, CVS/Caremark has been accused of deceptive business practices. A 2008 civil lawsuit involving 28 states was filed against the personal benefits management division of
CVS/Caremark, which acts as the prescription drug claim intermediary between employers and employees. It also maintains relationships with drugstores and manufacturers. The allegations of the lawsuit included urging doctors to switch patients to name brand prescriptions under the notion that it would save them money. Furthermore, these switches were encouraged without informing doctors of the financial burden it would impose on patients, and employer healthcare plans were not informed that this activity would benefit CVS/Caremark. This could be seen as a conflict of interest at the expense of customers. Due to these allegations, the suit called for a revision in how the division gives information to consumers. In the end, CVS/Caremark signed a consent decree without admitting fault and paid a settlement of $38.5 million to reimburse states for the legal costs and patients overcharged due to the switch in prescription. In a similar matter, a multiyear-long FTC investigation concluded (in 2009) that the company had misled consumers regarding prices on certain prescriptions in one of its Medicare plans. The switch harmed elderly customers as they were billed for up to ten times the amount they anticipated. CVS/Caremark settled with the FTC for $5 million to reimburse customers for the change in price.

**Overdistribution of Oxycodone**

In 2012, CVS faced challenges with another federal agency—the Drug Enforcement Administration (DEA). The DEA suspended the company’s license to sell controlled substances at two Florida locations, only a few miles apart from one another. These locations were found to have ordered a total of 3 million oxycodone pills in 2011. The average order for a U.S. pharmacy in the same year is 69,000 pills. Intensifying the matter, abuse of narcotics (pain pills) is prevalent in the area. Florida state legislation had been implemented in response to the issue as local clinics became known as “pill mills” for their liberal distribution of prescriptions for pain pills.

CVS responded to the DEA’s investigation by notifying some of the area doctors that they would not fill prescriptions written for oxycodone (Schedule II narcotics). However, they also requested a temporary restraining order against the DEA, which would disable the temporary suspension of selling the drugs. The DEA suspension decreased the amount of such narcotics being distributed to the two CVS locations by 80 percent in a period of three months, limiting their ability to make a profit. When the matter came before a federal judge, he ruled that the company was at fault for lack of proper oversight in distributing the drug and other narcotics. The ruling further implied company negligence as such a large amount of pills should have been noticed as a blatant abnormality.

Later that year, the DEA completely revoked the licenses of the two locations to sell controlled substances—the first time this has occurred with a national retail pharmacy chain. CVS claims that they have improved their procedures regarding its distribution of controlled substances; however, the DEA’s claims explicitly included negligence on the part of pharmacists in light of obvious “questionable circumstances.” These circumstances included the fact that several customers were coming to Florida from out of state to fill prescriptions. Many lacked insurance and paid in cash, a red flag that can suggest illegal use of drugs. This was in addition to the heavy pill problem in the area which had already prompted state legislation.

Testimonies from employees indicated company negligence as they had knowledge of the top prescribing doctors in the area and awareness that daily oxycodone quotas were being depleted—sometimes within 30 minutes of the pharmacy opening. Pharmacists also indicated that they set aside pills for those patients they considered to have a real need for them because they had strong suspicions that most of the people purchasing the pills were abusers. They did not feel at liberty to refuse prescriptions to customers, however, because they are not trained to diagnose illnesses. In 2013, CVS announced a review of its database of healthcare providers to find abnormalities in narcotic prescriptions. They found and notified at least 36 providers to whom they would no longer fill orders due to high prescription rates.

Another incident in 2014 involving the disappearance of 37,000 pain pills in four California stores brought the DEA and CVS together again. These stores have a history of not being able to account for several pain prescription drugs. This incident carries up to 2,973 violations of the Federal Controlled Substances Act and could cost the company up to $29 million in penalties. In 2012, the DEA investigated missing pills in a store wherein an employee admitted taking
approximately 20,000 pills. This piqued the curiosity of investigators, who found three retail locations that each had thousands of pills missing.

**Death of a Shoplifter**

In 2010, a man accused of shoplifting toothpaste was chased out of a CVS store by a manager. Video surveillance footage showed an altercation between the two. Six bystanders came to the manager’s assistance, one of whom was seen kicking and punching the perpetrator while the manager held him around the neck. Within seconds, the man was heard saying he could not breathe and died shortly thereafter. Police investigated the incident and have not filed charges despite the medical examiner’s classification of the death as a homicide. The manager claimed that the shoplifter punched him, so he retaliated in self defense. The victim’s mother is filing a civil lawsuit against the manager and claiming CVS is liable for her son’s death. Whether or not CVS is found culpable, the tragedy cast a shadow over CVS and how it handles shoplifters.

**MOVING TOWARD A HEALTHCARE COMPANY**

Despite the ethical challenges CVS has experienced, it is trying to reposition itself as a socially responsible organization that places priority on consumer health. Being a quality healthcare company not only offers reputational benefits, but financial advantages as well. Changes in both the economic and healthcare landscape are creating new opportunities for CVS to provide different programs and redefine itself. Trends including the declining number of primary care physicians, the 16 million baby boomers who are becoming eligible for Medicare benefits, and the more than 30 million newly insured Americans under the Affordable Care Act (ACA) offer CVS an attractive market in which to expand. For example, CVS has refocused its efforts on supplying the growing need for chronic disease management that consumes costly resources when patients do not adhere to physician recommended medications and monitoring methods to maintain health. Innovative programs such as Pharmacy Advisor and Maintenance Choice, developed in collaboration with researchers from Harvard University and Brigham and Women’s Hospital, help patients stay on their medications. Research shows that regular interaction between patient and pharmacist increases the likelihood that patients will adhere to their medication regimen. Many patients who take regular prescriptions often think that they are well enough to cease taking their medication. However, when the symptoms of their ailments reappear, the costs are great, both financially and medically. CVS’s programs allow the company to inform patients about the benefits and risks of these effects through education and awareness. The entire industry also benefits from this knowledge by preventing more costly medical procedures due to medication non-adherence, which occurs when patients skip or incorrectly take their dosage requirements. This is estimated to cost between $5 and $10 for every $1 spent on adherence programs. These services are key components of CVS’s competitive advantage, allowing them to provide the best possible patient care. They were also proactive in preparing patients for Health Care Reform. For instance, CVS/Caremark partnered with the Centers for Medicare and Medicaid Services to raise awareness about new services available to Medicare patients under the ACA.

To help people keep up with these and other changes in healthcare, CVS has established its presence on social media and mobile devices. The company introduced a mobile application for customers to conveniently refill prescriptions, while their Facebook and Twitter pages provide helpful health tips. Customers benefit from using CVS’s digital tools for savings and new user experience. CVS’s iPad application allows individuals to have a 3D digital pharmacy experience reminiscent of shopping in store. Those who are unable to physically visit the store, or prefer the convenience of shopping from home, are able to partake in the CVS experience through the company’s technology. With over 10 million registered users, many are saving money and time filling and refilling prescriptions as well as having instant access to essential drug information.

MinuteClinics are one of the major contributors to CVS’s rebranding efforts. These clinics are the first in healthcare retail history to be accredited by the Joint Commission, the national evaluation and certifying agency for healthcare organizations and programs in the United States. This accreditation signifies the clinic’s commitment to and execution in providing safe, quality healthcare that meets nationally set standards.
In addition to healthcare services, MinuteClinics provide smoking cessation and weight loss programs that contribute positively to people's health. These clinics are also the first retail clinic provider to launch a partnership with the National Patient Safety Foundation for its health literacy program to help improve patient education and community health.

Under the ACA, healthcare organizations are eligible to become members of the Accountable Care Organizations (ACO) program. This program ensures that members are accountable in providing quality healthcare to the sick as well as meeting certain standards to provide health-conscious programs such as those related to smoking cessation and weight loss. Accountability is measured by positive outcomes, resulting in cost savings, which in turn is divided up among members to continue these effective programs and services. There are at least 123 ACOs in the United States, and more than 360 ACOs have been established as Medicare providers since the ACA went into effect—covering over 5.3 million patients.

REVEALING CVS’S NEW DIRECTION: TOBACCO-FREE CVS

In order to be consistent with their transition from pharmacy to healthcare company, CVS has made some landmark decisions aimed toward helping individuals lead healthier lives. In 2014, CVS announced that it would no longer sell tobacco products. The revenues generated from selling tobacco products are about $2 billion annually, so this bold decision sends a strong message to stakeholders regarding the values of the company. A company that is consistent in their actions will gain a good reputation, which will attract more customers and generate revenue. This decision also gives CVS an advantage in terms of the ACA. As the ACA changes the healthcare landscape, companies are racing to get a stronghold in the new system to be listed as a preferred pharmacy. CVS/Caremark’s alignment in defining itself as a healthcare provider will likely result in stronger relationships with doctors and hospitals, creating an advantage of preference. The goal is that referrals for medication will be done through CVS and serve to boost reputation within all CVS segments. This, in conjunction with its status as an ACO, puts CVS in a competitive position to attract newly insured Americans.

This decision spurred 24 state attorneys general to send letters to other pharmacy retailers, including Walmart Stores, Inc., Walgreen Co., and Rite Aid Corp., highlighting the contradiction of selling deadly products and healthcare services simultaneously. The letter also noted that drug store sales make it easier for younger age groups to begin smoking and more difficult for those trying to quit smoking. Walmart and Walgreen acknowledged the letter, but made no indication that they would stop selling tobacco products. Rite Aid responded by saying they will continue to sell both tobacco products as well as smoking cessation services, as the practice is legal. While this letter does not seem to have much of an influence on retailers, some speculate that it increases the pressure on the $100 billion tobacco industry, which is already facing decreasing sales, rising taxes, and smoking bans. For CVS, the decision will affect their short-term profits and reduce each share by $0.06–$0.09 each. Investors do not seem worried, however, as the long-term benefits will make up the difference.

CRITICISM AGAINST CVS

CVS’s new programs are encroaching on the medical industry by providing services to patients. As customers increasingly choose to visit local pharmacy clinics for aches, pains, or common illnesses, primary physicians are feeling the losses, especially since this sector’s healthcare professionals are dwindling. Choosing a retail pharmacy clinic over a physician’s office benefits the patient with lower costs and savings, which is a threat to traditional doctors’ offices. Some groups are publicizing negative feedback on pharmacy care. For instance, the American Academy of Pediatrics issued a statement warning patients not to visit such clinics because they cannot offer the specialized care children need. Some groups argue that programs such as CVS’s MinuteClinic do not offer the same caliber of service and care as a doctor. However, as stated above, CVS holds itself to a very high standard for care in trying to help patients be healthy. It continues to be accredited by the Joint Commission.

CVS MinuteClinics do recognize their limitations, however. Their website offers information to visitors regarding when they should and should not visit the clinics. For example, the website recommends that patients with severe symptoms such as chest pain, shortness of breath and difficulty breathing, poisoning, temperatures above 103 degrees Fahrenheit (for adults) and 104 (for children), and ailments requiring controlled substances should seek care elsewhere. MinuteClinics
staff nurse practitioners and physician assistants who are able to provide services for minor wounds, common illnesses, wellness tests and physicals, etc. Other information regarding insurance and pricing are also available on the website.

**STAKEHOLDER ORIENTATION**

CVS's mission to be a pharmacy innovation company is guided by five values: innovation, collaboration, caring, integrity, and accountability. CVS uses these values to determine their actions and decisions, which offers a glimpse into their ethical culture. The company's goal is to use their assets to reinvent the pharmacy experience and offer innovative solutions that help people on a better path to health. This goal relays to stakeholders that the company cares about their health. CVS/Caremark's business is committed to fostering a culture that encourages creativity and innovation, recognizing that contributions from all members are a high priority. This commitment highlights their value of collaboration with partners and stakeholders, which also serves to hold them accountable for their operating activities—thus strengthening their integrity. Another important factor in their ethical culture is to address enhanced access to care while also lowering its cost.

CEO Larry J. Merlo emphasizes the long-term perspective the company is committed to with each decision and how it will affect each stakeholder group. He states that CVS's priorities remain in customer health, the sustainability of healthcare systems, good stewardship, positive contributions to their communities, and a meaningful workplace for employees. Such a statement from the top leader of the company sets the tone that creates the ethical culture behind CVS. The company's Code of Conduct includes ethical behavior expectations, and they are proud to have good relationships with employee unions who represent approximately 6 percent of their workforce. CVS employs a Chief Compliance Officer, offers regular compliance education and training programs, a confidential 24/7 ethics hotline, and an efficient audit, response, and prevention process that make this program comprehensive. The company also supports the development of employees through professional development training sessions. The purpose of such training is not only to keep employees current on new technologies and processes but to help them advance in their careers within the company.

**Employees**

CVS implemented the Values in Action program for employees, giving them a chance to recognize colleagues through online reward systems. Peers can nominate each other across the company for leadership traits and other commendable accomplishments. Each nomination grants points, which can be redeemed for merchandise, travel, and more. Programs like these let employees know they are valued and empower them in their commitment to CVS. The Values in Action Breakthrough Awards is an annual company-wide broadcast that honors specific individuals exemplifying the company's values in innovation, collaboration, caring, integrity, and accountability.

CVS focuses strongly on compliance and integrity training for employees. The compliance and integrity training for employees is led by a Compliance Officer. Regular compliance education and training programs, a confidential 24/7 ethics hotline, and an efficient audit, response, and prevention process are components that make this program comprehensive. The company also supports the development of employees through professional development training sessions. The purpose of such training is not only to keep employees current on new technologies and processes but to help them advance in their careers within the company.

**Shareholders**

CVS seeks to protect shareholder interests while maintaining broad stakeholder engagement. As a result, CVS carefully designed a comprehensive corporate governance system ranging from board independence to executive compensation. Following a corporate governance framework, a variety of specialized committees has been established with different functions for shareholders. From an information governance standpoint, the oversight committee makes recommendations to enhance the ability of information security. On behalf of the board of directors, the audit committee is in charge of the risk oversight and is responsible for protecting the reputation and core interests of the company.

In order to balance the interests of different groups, senior management created a reformative executive
compensation system. This system is based on financial performance as well as service quality and customer satisfaction. While a pay for performance compensation system is still utilized at CVS, a significant portion of annual executive compensation is delivered into long-term equity rather than short-term. In a move to further align the commitment of CVS to link pay with performance, total shareholder return is added on a three-year incentive plan. Each three-year period is known as a cycle that has a predetermined set of goals for the company/executive to accomplish. At the end of each term, performance is evaluated and the executive will receive compensation based on these results. For example, if the results surpass the goal by 25 percent, the executive pay will increase by a certain predetermined amount. The details will vary for each cycle, but the purpose of the plan is to pay only when the company and its shareholders are benefited from the performance of the executive.

**Communities**

CVS has grown its ethical culture not only to include the company’s functions but the communities around them. Community engagement and philanthropic endeavors, for example, are long-standing commitments CVS has devoted time and resources in developing. Community partnerships have supported veteran hiring, scholarships to future pharmacists, and engaged high school, college, and post-graduate students’ interest in science, technology, engineering, and math (STEM) careers. CVS believes that by helping to further advancements in the best health outcomes, they are investing in their current and future workforce.

CVS donated over $75 million to various organizations and builds strategic partnerships with them to create an awareness of healthy behaviors and educate the community on ways to become insured under the ACA. The company also offers free health screenings and flu shots for the uninsured, prescription discount card programs, and other community programs to supply individuals with the medications they need to maintain health. The discount card program saves customers over 70 percent on medications, resulting in millions of dollars in savings every year. Volunteerism is also supported by CVS, as employees are encouraged to form groups and obtain sponsorship from the company to address needs within their community. The company reported 12 such national groups and 40 regional groups involving over 4,000 employees in 40 states who donated over 2,000 hours to community initiatives.

**Suppliers**

CVS has developed a commitment called Prescription for a Better World, which encompasses their Code of Conduct, Supplier Ethics Policy, Supplier Diversity, and Supplier Audit Program to promote integrity, accountability, and diversity. These programs work to ensure that human rights are respected throughout the entire supply chain. In developing these policies, CVS used principles initiated by the International Labor Organization and the United Nations’ Universal Declaration of Human Rights. The human rights framework guides all suppliers of CVS to avoid unethical and illegal practices such as child labor, human trafficking, discrimination, and dangerous workplace conditions.

The Supplier Audit Program is a risk-based assessment conducted by more than one third party to evaluate workplace conditions, including labor, wages and hours, health and safety, management system and environment, as well as operational, financial and legal risks, to assure that employees’ rights are not being violated. This program was fully expanded to factories in countries considered to be at high risk for such violations, and they are in the process of implementing full social audits for subcontractors in these areas. In addition, CVS works with globally recognized organizations including Worldwide Responsible Accredited Production (WRAP) and Social Accountability International (SAI) to ensure their measurements are relevant and effective. Finally, partnerships with Intertek’s GSV program maintains the company’s certification status with the U.S. Customs-Trade Partnership Against Terrorism (C-TPAT) program to ensure quality of products made in countries such as China.

**Environmental Impact**

Environmental impact is also important to CVS. They record their progress on this front in their annual Corporate Social Responsibility (CSR) Report. They have set a carbon intensity reduction goal of 15 percent by 2018, and through energy efficiency upgrades have been able to address 9 percent of that goal to date. CVS opened their first Leadership in Energy and Environmental Design (LEED) Platinum store, which will serve as a test site to determine the most effective and relevant environmental innovations for the company’s environmental operations goals. They will use this information to set best practices before constructing other stores.
CVS expanded their Energy Management System (EMS), which is designed to ISO (International Organization for Standardization) specifications. This digital system tracks and manages energy use, so that each store can be continually monitored and adjusted according to each location’s condition. They are also in the process of upgrading lighting in the stores to more energy efficient bulbs. Increasing water use was identified as a significant inefficiency, and CVS has responded by eliminating irrigation at retail locations and opting for less water-intensive landscapes. Finally, CVS offers customers ways to recycle and properly dispose of expired, unused, or unwanted medications, which benefits both human and environmental well-being.

**CONCLUSION**

CVS is implementing strategies and allocating resources in the hope of achieving an ethical culture that benefits all stakeholder groups. This helps CVS to maximize ethical decision-making and remain sustainable for years to come. It seems they have learned from previous ethical lapses by being aware of addiction problems within their communities. In 2014, CVS voluntarily opted to stop selling some cold medications in West Virginia and surrounding areas as more methamphetamine labs and corresponding abuse became more prominent throughout the state. The company’s impact on the environment is one of the next big challenges they will have to overcome. As one of the largest pharmacies in the United States, they have a long way to go to reduce their overall footprint. However, they are on the right track, having set goals and implementing action steps to achieve these goals. With the mission of helping people live healthier lives and innovating the pharmacy industry, CVS has a great responsibility in developing a business model allowing them to remain competitive while acting ethically at the same time.

**Questions for Discussion**

1. How has CVS handled its ethical challenges?
2. Evaluate CVS’s decision to no longer sell tobacco products.
3. What is the future of CVS in positioning itself as a healthcare company based on its decision to be socially responsible?

**Sources**


