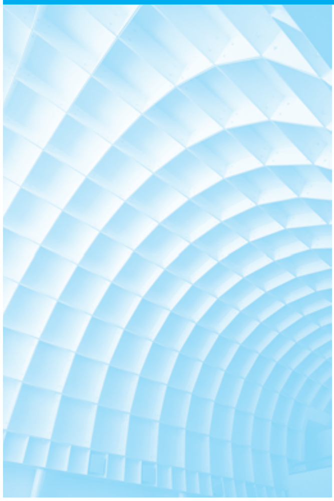
Chapter One



The Study of Business, Government, and Society

ExxonMobil Corporation

ExxonMobil is a colossus. In 2010 it had revenues of $370 billion and net income of $29 billion. To put this in perspective, it had five times the sales of Microsoft; its profits equaled the total sales of Nike. It paid $89 billion in taxes, a sum exceeding the combined revenues of Microsoft and Nike. ExxonMobil employs 84,000 people, most in the 143 subsidiaries it uses for its operations. Its main business is discovering, producing, and selling oil and natural gas, and it has a long record of profiting more at this business than its rivals.

The company cannot be well understood apart from its history. It descends from the Standard Oil Trust, incorporated in 1882 by John D. Rockefeller as Standard Oil of New Jersey. Rockefeller was a quiet, meticulous, secretive manager, a relentless competitor, and a painstaking accountant who obsessed over every detail of strategy and every penny of cost and earnings. He believed that the end of imposing order on a youthful, rowdy oil industry justified the use of ruthless means.

As Standard Oil grew, Rockefeller's values defined the company's culture; that is, the shared assumptions, both spoken and unspoken, that animate its employees. If the values of a founder such as Rockefeller are effective, they become embedded over time in the organization. Once widely shared, they tend to be exceptionally long-lived and stable.[1] Rockefeller emphasized cost control, efficiency, centralized organization, and suppression of competitors. And no set of principles was ever more triumphant. Standard Oil once had more than 90 percent of the American oil market.

Standard Oil's power so offended public values that in 1890 Congress passed the Sherman Antitrust Act to outlaw its monopoly. In 1911, after years of legal battles, the trust was finally broken into 39 separate companies.[2] After the breakup, Standard Oil

[1] See, for example, Edgar H. Schein, *The Corporate Culture Survival Guide,* rev. ed. (San Francisco: Jossey-Bass, 2009), part one.

[2] *Standard Oil Co. of New Jersey v. United States,* 221 U.S. 1 (1911).

of New Jersey continued to exist. Although it had shed 57 percent of its assets to create the new firms, it was still the world's largest oil company. Some companies formed in the breakup were Standard Oil of Indiana (later renamed Amoco), Atlantic Refining (ARCO), Standard Oil of California (Chevron), Continental Oil (Conoco), Standard Oil of Ohio (Sohio), Chesebrough-Pond's (a company that made petroleum jelly), and Standard Oil of New York (Mobil). In 1972 Standard Oil of New Jersey changed its name to Exxon, and in 1999 it merged with Mobil, forming Exxon Mobil.

The passage of time now obscures Rockefeller's influence, but ExxonMobil's actions remain consistent with his nature. It has a centralized, authoritarian culture. Profit is an overriding goal. Every project must meet strict criteria for return on capital. ExxonMobil consistently betters industry rivals in its favorite measure, return on average capital employed.

Unlike Southwest Airlines or Google, where having fun is part of the job, performance pressure at ExxonMobil is so intense that it "is not a fun place to work."[3] As Rockefeller bought competitors, he kept only the best managers from their ranks. Today managers at ExxonMobil face a Darwinian promotion system that weeds out anyone who is not a top performer. "We put them through a big distillation column," said a former CEO, and "only the top of the column stays there."[4] And oil industry competitors still find it a ferocious adversary. The company says simply that it "employs all methods of competition which are lawful and appropriate."[5]

Although ExxonMobil is a powerful corporation, it is no longer the commanding trust of Rockefeller's era. As in the old days, its power is challenged and limited by economic, political, and social forces. Now, however, these forces are more leveling.

Markets are more contested. ExxonMobil pumps only 8 percent of the world's daily output of oil and controls less than 2 percent of petroleum reserves. These figures are far lower than in the 1950s when Exxon was the largest of the Seven Sisters, a group of Western oil firms that dominated global production and reserves, including the huge Middle East oil fields.[6] Now its largest competitors are seven state-owned oil companies, often called the new Seven Sisters, whose output dwarfs that of today's privately owned companies.[7] The biggest, Saudi Aramco, is 3.5 times the size of ExxonMobil in daily crude oil output and has 32 times its reserves.[8] The rise of these state-owned companies reflects a new form of nationalism, one that rejects reliance on foreign firms to exploit natural resources.

[3] Fadel Gheit, a former employee and an oil industry analyst, quoted in Geoff Colvin, "The Defiant One," *Fortune,* April 30, 2007, p. 88.

[4] Lee Raymond, quoted in Tom Bower, *Oil: Money, Politics, and Power in the 21st Century* (New York: Grand Central Publishing, 2009), p. 162.

[5] Exxon Mobil Corporation, Form 10-K 2009, filed with the Securities and Exchange Commission, February 26, 2010, p. 1.

[6] The Seven Sisters were Exxon, Mobil, Shell, British Petroleum, Gulf, Texaco, and Chevron.

[7] The new Seven Sisters are Saudi Aramco (Saudi Arabia), Gazprom (Russia), China National Petroleum Company (China), National Iranian Oil Company (Iran), Petróleos de Venezuela S. A. (Venezuela), Petrobras (Brazil), and Petronas (Malaysia).

[8] Government Accountability Office, *Crude Oil,* GAO-07-283, February 2007, fig. 9; and Ian Bremmer, "The Long Shadow of the Visible Hand," *The Wall Street Journal,* May 22–23, 2010, p. W3.

ExxonMobil is on a treadmill, constantly searching for new oil and natural gas supplies to compensate for declining production in existing fields. Output from a mature field drops 5 to 8 percent a year. To maintain profitability the company pursues new reserves wherever they are, taking political risks and abiding unrest and corruption. Iran and Venezuela have expropriated its assets. In Indonesia, government troops guard its facilities against attacks by rebel forces. In Chad, Angola, Nigeria, and Equatorial Guinea, it has paid dictators for access to oil.

Governments are more active and relations with them, ranging from high-level diplomacy to mundane regulatory compliance, are more complex than in the past. In 2003 the company engaged in a high-stakes game of political intrigue trying to purchase Yukos Oil Company. Yukos was a technologically backward Russian company that controlled oil and gas deposits in Siberia so huge they would double ExxonMobil's reserves. ExxonMobil wanted it badly and offered $45 billion to the Russian capitalists who owned it. Their leader was billionaire Mikhail Khodorkovsky, a political rival of Russia's President Vladimir Putin. Khodorkovsky promised ExxonMobil that he would use his political influence to clear the deal, but when its top managers met with Putin he was guarded and said, "These details are for my ministers. You must deal with them."[9] Soon, Khodorkovsky's private jet was mysteriously delayed from taking off at a Siberian airfield and boarded by masked police, who arrested him on charges of fraud and tax evasion. He has been in jail ever since. Yukos soon merged with a state-owned oil company managed by one of Putin's close allies.

In more ordinary ways, webs of law and regulation dictate ExxonMobil's operations in each country where it does business. In the United States alone approximately 200 federal departments, commissions, agencies, offices, and bureaus, only a handful of which existed in Rockefeller's day, impose rules on the company. If the founder were alive, he might find this tight supervision unrecognizable—even incredible. For example, in 2009 the company paid a $600,000 fine to settle charges that 85 migratory birds in five states died of hydrocarbon exposure after landing in production and wastewater ponds. It agreed to a $2.5 million bird protection program. It will put nets over ponds and install electronic systems that turn on flashing lights and noisemakers when they detect incoming flights of birds.[10]

ExxonMobil also faces a demanding social environment. As a leader in the world's largest industry, it is closely watched by environmental, civil rights, labor, and consumer groups—some of which are actively hostile. For years the company agitated environmentalists by rejecting the scientific case for global warming. Alone among major oil companies, it refused to make significant investments in renewable energy. Its former CEO called such investments "a complete waste of money."[11]

In 2006 a new CEO, Rex Tillerson, tried to blunt criticism by granting publicly that the world is warming. But he made no changes in strategy. A group of John D. Rockefeller's heirs, believing that ExxonMobil no longer represented the "forward-looking" spirit of its great founder, wrote to Tillerson, welcoming him as the new

[9] Quoted in Tom Bower, *Oil: Money, Politics, and Power in the 21st Century,* p. 10.

[10] United States Attorney's Office, District of Colorado, "Exxon-Mobil Pleads Guilty to Killing Migratory Birds in Five States," press release, August 13, 2009.

[11] Lee Raymond, quoted in "The Unrepentant Oilman," *The Economist,* March 15, 2003, p. 64.

leader and requesting a meeting.[12] He would not meet with them. Subsequently, 66 Rockefeller descendants signed an initiative calling on the company to convene a climate change task force. The company refused to talk with the family members, who held only 0.006 percent of its shares.[13]

Besides using ethanol blends in gasoline, ExxonMobil's major investment in alternative energy is a $600 million research project to make biofuels from algae.[14] That investment pales in comparison with its $27 billion in capital and exploration expenditures in 2009 and a $30 billion project nearing completion to liquefy and ship natural gas from Qatar.

As a corporate citizen ExxonMobil funds worldwide programs to benefit communities, nature, and the arts. Its largest contributions, about 50 percent of the total, go to education. Other efforts range from $68 million to fight malaria in Africa to $5,000 for the National Cowgirl Museum in Fort Worth, Texas. In 2009 ExxonMobil gave $196 million to such efforts. This is a large sum from the perspective of an individual. However, for ExxonMobil it was seven-hundredths of 1 percent of its revenues, the equivalent of a person making $1 million a year giving $7 to charity. Does this giving live up to the elegant example of founder John D. Rockefeller, the great philanthropist of his era?

The story of ExxonMobil raises central questions about the role of business in society. When is a corporation socially responsible? How can managers know their responsibilities? What actions are ethical or unethical? How responsive must a corporation be to its critics? This book is a journey into the criteria for answering such questions. As a beginning for this first chapter, however, the story illustrates a range of interactions between one large corporation and many nations and social forces. Such business–government–society interactions are innumerable and complicated. In the chapter that follows we try to order the universe of these interactions by introducing four basic models of the business-government-society relationship. In addition, we define basic terms and explain our approach to the subject matter.

WHAT IS THE BUSINESS–GOVERNMENT–SOCIETY FIELD?

In the universe of human endeavor, we can distinguish subdivisions of economic, political, and social activity—that is, business, government, and society—in every civilization throughout time. Interplay among these activities creates an environment in which businesses operate. The business-government-society (BGS) field is the study of this environment and its importance for managers.

business
Profit-making activity that provides products and services to satisfy human needs.

To begin, we define the basic terms.

Business is a broad term encompassing a range of actions and institutions. It covers management, manufacturing, finance, trade, service, investment, and other activities. Entities as different as a hamburger stand and a giant corporation are businesses. The fundamental purpose of every business is to make a profit by providing products and services that satisfy human needs.

12 Daniel Gross, "There Will Be Blood Orange Juice," *Slate,* April 30, 2008.

13 Jad Mouawad, "Can Rockefeller Heirs Turn Exxon Greener?" *The New York Times,* May 4, 2008, p. B2.

14 "ExxonMobil Invests in Algae for Biofuel," *Nature,* July 2009, p. 449.

government
Structures and processes in society that authoritatively make and apply policies and rules.

society
A network of human relations composed of ideas, institutions, and material things.

idea
An intangible object of thought.

value
An enduring belief about which fundamental life choices are correct.

ideology
A bundle of values that creates a particular view of the world.

institution
A formal pattern of relations that links people to accomplish a goal.

Government refers to structures and processes in society that authoritatively make and apply policies and rules. Like business, it encompasses a wide range of activities and institutions at many levels, from international to local. The focus of this book is on the economic and regulatory powers of government as they affect business.

A *society* is a cooperative network of human relations, organized by flows of power and relatively distinct in its boundaries from other, analogous networks.[15] Every society includes three interacting elements: (1) ideas, (2) institutions, and (3) material things.

Ideas, or intangible objects of thought, include values and ideologies. *Values* are enduring beliefs about which fundamental choices in personal and social life are correct. Cultural habits and norms are based on values. *Ideologies* are bundles of values that create a worldview. They establish the meaning of life or categories of experience by defining what is considered good, true, right, beautiful, and acceptable. Sacred ideologies, or theologies, include the great religions that define human experience in relation to a deity. Secular ideologies, such as democracy, liberalism, capitalism, socialism, or ethics, all of which will be discussed in this book as they relate to business, explain human experience in a visible world, a world ordered by values based on reason, not faith. The two kinds of ideology can overlap, as with ethics, an ideology rooted in both faith and reason. All ideologies have the power to organize collective activity. Ideas shape every institution in society, sometimes coming in conflict as when capitalism's practiced values of exploitation, ruthless competition, self-interest, and short-term gain abrade values of love, mercy, charity, and patience in Christianity.

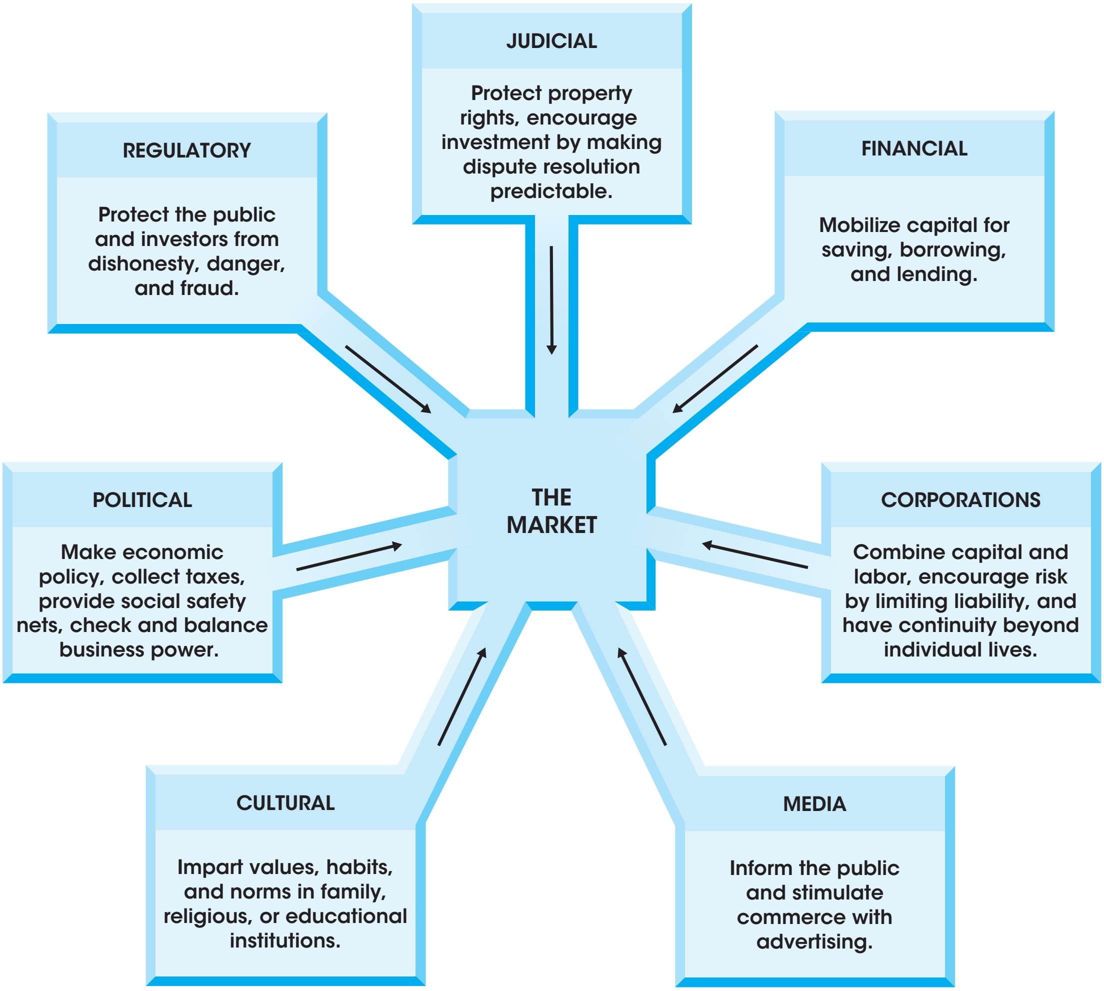
Institutions are formal patterns of relations that link people to accomplish a goal. They are essential to coordinate the work of individuals having no direct relationship with each other.[16] In modern societies, economic, political, cultural, legal, religious, military, educational, media, and familial institutions are salient. There are multiple economic institutions such as financial institutions, the corporate form, and markets. Collectively, we call these business.

As Figure 1.1 shows, markets are supported by a range of institutions. Capitalism has wide variation in nations where it abides because supporting institutions grow from unique historical and cultural roots. In developed nations these institutions are highly evolved and mutually supportive. Where they are weak, markets work in dysfunctional ways. An example is the story of Russia, which introduced a market economy after the fall of communism in the early 1990s. In the old system workers spent lifetimes in secure jobs at state-owned firms. There was no unemployment insurance and, because few workers ever moved, housing markets were undeveloped. A free market economy requires a strong labor market, so workers can switch from jobs in declining firms to jobs in expanding ones. But Russia's labor market was undeveloped. Because the government did not yet

[15] See Michael Mann, *The Sources of Social Power*, vol. I: *A History of Power from the Beginning to A.D. 1760* (New York: Cambridge University Press, 1986), pp. 1–3.

[16] Arnold J. Toynbee, *A Study of History*, vol. XII, *Reconsiderations* (London: Oxford University Press, 1961), p. 270.

FIGURE 1.1 How Institutions Support Markets



provide unemployment benefits to idled workers, there was no safety net. And housing markets were anemic. Company managers, out of basic humanity, were unwilling to lay off workers who would get no benefits and who would find it difficult to move elsewhere.[17] As a result, restructuring in the new Russian economy was torpid. The lesson is that institutions are vital to markets.

Each institution has a specific purpose in society. The function of business is to make a profit by producing goods and services at prices attractive to consumers. A business uses the resources of society to create new wealth. This justifies its existence and is its priority task. All other social tasks—raising an army, advancing knowledge, healing the sick, or raising children—depend on it. Businesses must,

[17] Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: W. W. Norton, 2002), p. 140.

therefore, be managed to make a profit. A categorical statement of this point comes from Peter Drucker: "Business management must always, in every decision and action put economic performance first."[18] Without profit, business fails in its duty to society and lacks legitimacy.

material things Tangible artifacts of a society that shape and are shaped by ideas and institutions.

The third element in society is *material things*, including land, natural resources, infrastructure, and manufactured goods. These shape and, in the case of fabricated objects, are partly products of ideas and institutions. Economic institutions, together with the extent of resources, largely determine the type and quantity of society's material goods.

The BGS field is the study of interactions among the three broad areas defined above. Its primary focus is on the interaction of business with the other two elements. The basic subject matter, therefore, is how business shapes and changes government and society, and how it, in turn, is molded by political and social pressures. Of special interest is how forces in the BGS nexus affect the manager's task.

WHY IS THE BGS FIELD IMPORTANT TO MANAGERS?

To succeed in meeting its objectives, a business must be responsive to both its economic and its noneconomic environment.[19] ExxonMobil, for example, must efficiently discover, refine, transport, and market energy. Yet swift response to market forces is not always enough. There are powerful nonmarket forces to which many businesses, especially large ones, are exposed. Their importance is clear in the two dramatic episodes that punctuate ExxonMobil's history—the 1911 court-ordered breakup and the 1989 *Exxon Valdez* oil spill.

In 1911 the Supreme Court, in a decision that reflected public opinion as well as interpretation of the law, forced Standard Oil to conform with social values favoring open, competitive markets. With unparalleled managerial genius, courage, and perspicacity, John D. Rockefeller and his lieutenants had built a wonder of efficiency that spread fuel and light throughout America at lower cost than otherwise would have prevailed. They never understood why this remarkable commercial performance was not the full measure of Standard Oil. But beyond efficiency, the public demanded fair play. Thus, the great company was dismembered.

In Alaska, one of the company's massive tankers spilled 11 million gallons of crude oil when its captain, having consumed enough vodka "to make most people unconscious," quit the bridge during a critical maneuver. Left alone, an unlicenced third mate ran onto a reef in pristine, picturesque Prince William Sound.[20] The captain was an alcoholic, lately returned to command after a treatment program, but known to have relapsed, drinking in hotels, bars, restaurants, parking lots, and even with Exxon officials. Although the company had a clear policy against

[18] *Management: Tasks-Responsibilities-Practices* (New York: Harper & Row, 1973), p. 40.

[19] For discussion of this distinction see Jean J. Boddewyn, "Understanding and Advancing the Concept of 'Nonmarket,'" *Business & Society,* September 2003.

[20] *In re: the Exxon Valdez,* 270 F.3rd 1238 (2001).

use of alcohol by its crews, managers failed to monitor him. Years later, the United States Supreme Court would call this lapse "worse than negligent but less than malicious."[21]

The disaster brought acute legal, political, and image problems for the firm. It spent $2.4 billion to clean up the spill and another $2.2 billion to settle lawsuits that dragged on for 20 years, Congress passed a law barring its ship from ever again entering the area, and activists told motorists to get their gas from other companies.[22] Today ExxonMobil operates its 650 tankers with extreme care and randomly tests crews for drugs and alcohol. Remarkably, it is now so disciplined that it measures oil spills from its fleet in tablespoons per million gallons shipped. Between 2006 and 2009 it averaged fewer than five tablespoons lost per million gallons shipped.[23]

social contract
An underlying agreement between business and society on basic duties and responsibilities business must carry out to retain public support. It may be reflected in laws and regulations.

Recognizing that a company operates not only within markets but also within a society is critical. If the society, or one or more powerful elements within it, fails to accept a company's actions, that firm will be punished and constrained. Put philosophically, a basic agreement or *social contract* exists between economic institutions and other networks of power in a society. This contract establishes the general duties that business must fulfill to retain the support and acquiescence of the others as it organizes people, exploits nature, and moves markets. It is partly expressed in law, but it also resides in social values.

Unfortunately for managers, the social contract, while unequivocal, is not plain, fixed, precise, or concrete. It is as complex and ambiguous as the economic forces a business faces and no less difficult to comprehend. For example, the public believes that business has social responsibilities beyond making profits and obeying regulations. If business does not meet them, it will suffer. But precisely what are those responsibilities? How is corporate social performance to be measured? To what extent must a business comply with unlegislated ethical values? When meeting social expectations beyond the law conflicts with raising profits, what is the priority? Despite these questions, the social contract codifies the expectations of society, and managers who ignore, misread, or violate it court disaster.

FOUR MODELS OF THE BGS RELATIONSHIP

Interactions among business, government, and society are infinite and their meaning is open to interpretation. Faced with this complexity, many people use simple mental models to impose order and meaning on what they observe. These models are like prisms, each having a different refractive quality, each giving the holder a different view of the world. Depending on the model (or prism) used, a person

[21] *Exxon Shipping Company v. Baker*, 128 S.Ct. 2631 (2008).

[22] The $2.4 billion includes $303 million in voluntary payments to nearby residents for economic losses. The $2.2 billion figure includes criminal and civil fines, civil settlements, interest, and $500 million in punitive damages imposed by a federal jury. The law was a provision in the Oil Protection Act of 1990.

[23] "Changes ExxonMobil Has Made to Prevent Another Accident Like Valdez," at www.exxonmobil.com/Corporate/about_issues_valdez_prevention.aspx, accessed October 1, 2009.

will think differently about the scope of business power in society, criteria for managerial decisions, the extent of corporate responsibility, the ethical duties of managers, and the need for regulation.

The following four models are basic alternatives for seeing the BGS relationship. As abstractions they oversimplify reality and magnify central issues. Each model can be both descriptive and prescriptive; that is, it can be both an explanation of how the BGS relationship does work and, in addition, an ideal about how it should work.

market economy
The economy that emerges when people move beyond subsistence production to production for trade, and markets take on a more central role.

capitalism
An economic ideology with a bundle of values including private ownership of means of production, the profit motive, free competition, and limited government restraint in markets.

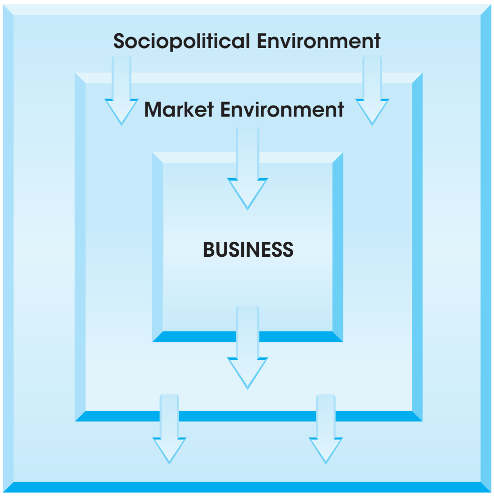
The Market Capitalism Model

The market capitalism model, shown in Figure 1.2, depicts business as operating within a market environment, responding primarily to powerful economic forces. There, it is substantially sheltered from direct impact by social and political forces. The market acts as a buffer between business and nonmarket forces. To appreciate this model, it is important to understand the history and nature of markets and the classic explanation of how they work.

Markets are as old as humanity, but for most of recorded history they were a minor institution. People produced mainly for subsistence, not to trade. Then, in the 1700s, some economies began to expand and industrialize, division of labor developed within them, and people started to produce more for trade. As trade grew, the market, through its price signals, took on a more central role in directing the creation and distribution of goods. The advent of this kind of *market economy*, or an economy in which markets play a major role, reshaped human life.

The classic explanation of how a market economy works comes from the Scottish professor of moral philosophy Adam Smith (1723–1790). In his extraordinary treatise, *The Wealth of Nations*, Smith wrote about what he called "commercial society" or what today we call *capitalism*. He never used that word. It was adopted later by the philosopher Karl Marx (1818–1883), who contrived it as a term of

FIGURE 1.2
The Market Capitalism Model



***Full Production and Full Employment under Our Democratic System of Private Enterprise*, ca. 1944, a crayon and ink drawing by Michael Lenson, an artist working for the Works Progress Administration Federal Art Project. Lenson focuses on the virtues of market capitalism.**
Source: The Library of Congress. © Barry Lenson, used with permission.

pointed insult. But it caught on and soon lost its negative connotation.[24] Smith said the desire to trade for mutual advantage lay deep in human instinct. He noted the growing division of labor in society led more people to try to satisfy their self-interests by specializing their work, then exchanging goods with each other. As they did so, the market's pricing mechanism reconciled supply and demand, and its ceaseless tendency was to make commodities cheaper, better, and more available.

The beauty of this process, according to Smith, was that it coordinated the activities of strangers who, to pursue their selfish advantage, were forced to fulfill the needs of others. In Smith's words, each trader was "led by an invisible hand to promote an end which was no part of his intention," the collective good of society.[25] Through markets that harnessed the constant energy of greed for the public welfare, Smith believed that nations would achieve "universal opulence." His genius was to demystify the way markets work, to frame market capitalism in moral terms, to extol its virtues, and to give it lasting justification as a source of human progress. The greater good for society came when businesses competed freely.

managerial capitalism
A market economy in which the dominant businesses are large firms run by salaried managers, not smaller firms run by owner-entrepreneurs.

In Smith's day producers and sellers were individuals and small businesses managed by their owners. Later, by the late 1800s and early 1900s, throughout the industrialized world, the type of economy described by Smith had evolved into a system of *managerial capitalism*. In it the innumerable, small, owner-run firms that animated Smith's marketplace were overshadowed by a much smaller number of dominant corporations run by hierarchies of salaried managers.[26] These managers

[24] Jerry Z. Muller, *The Mind and the Market: Capitalism in Modern European Thought* (New York: Knopf, 2002), p. xvi.

[25] Adam Smith, *The Wealth of Nations,* ed. E. Cannan (New York: Modern Library, 1937), Book IV, chap. II, p. 423. First published in 1776.

[26] Alfred D. Chandler, Jr., "The Emergence of Managerial Capitalism," *Business History Review,* winter 1984, p. 473.

had limited ownership in their companies and worked for shareholders. This variant of capitalism has now spread throughout the world.

laissez-faire
An economic philosophy that rejects government intervention in markets.

The model incorporates important assumptions. One is that government interference in economic life is slight. This is called *laissez-faire*, a term first used by the French to mean that government should "let us alone." It stands for the belief that government intervention in the market is undesirable. It is costly because it lessens the efficiency with which free enterprise operates to benefit customers. It is unnecessary because market forces are benevolent and, if liberated, will channel economic resources to meet society's needs. It is for governments, not businesses, to correct social problems. Therefore, managers should define company interests narrowly, as profitability and efficiency.

Another assumption is that individuals can own private property and freely risk investments. Under these circumstances, business owners are powerfully motivated to make a profit. If free competition exists, the market will hold profits to a minimum and the quality of products and services will rise as competing firms try to attract more buyers. If one tries to increase profits by charging higher prices, consumers will go to another. If one producer makes higher-quality products, others must follow. In this way, markets convert selfish competition into broad social benefits.

Other assumptions include these: Consumers are informed about products and prices and make rational decisions. Moral restraint accompanies the self-interested behavior of business. Basic institutions such as banking and laws exist to ease commerce. There are many producers and consumers in competitive markets.

The perspective of the market capitalism model leads to these conclusions about the BGS relationship: (1) government regulation should be limited, (2) markets will discipline private economic activity to promote social welfare, (3) the proper measure of corporate performance is profit, and (4) the ethical duty of management is to promote the interests of owners and investors. These tenets of market capitalism have shaped economic values in the industrialized West and, as markets spread, they do so increasingly elsewhere.

There are many critics of capitalism and the market capitalism model. Bernard Mandeville (1670–1733), an intellect predating Adam Smith, argued that markets erode virtue. The envy, avarice, self-love, and ruthlessness that energize them are base values driving out virtues such as love, friendship, and compassion.[27] Karl Marx believed that owners of capital exploited workers and promoted systems of rising inequality. The communist Vladimir Lenin (1870–1924) wrote that industrialists masterminded imperial foreign policies to effect a "territorial division of the whole world among the greatest capitalist powers."[28] Pope John Paul II (1920–2005) feared that markets place too much emphasis on money and material objects and cautioned against a "domination of things over people."[29]

[27] See George Bragues, "Business Is One Thing, Ethics Is Another: Revisiting Bernard Mandeville's *The Fable of the Bees*," *Business Ethics Quarterly*, April 2005.

[28] V. I. Lenin, *Imperialism: The Highest Stage of Capitalism* (New York: International Publishers, 1939), p. 89.

[29] Ioannes Paulus PP.II, Encyclical Letter, *Centesimus annus* (May 1, 1991), no. 33.

Such critics see a long list of flaws that often, perhaps inevitably, appear in markets. Without correction the market amplifies blemishes of human nature and the result is conspiracies, monopolies, frauds, pollution, and dangerous products. Business models arise to satisfy vices such as adultery, gossiping, gambling, smoking, drug use, and prostitution. Calls for corporate social responsibility and more ethical managerial behavior stem from the inevitability of capitalism's flaws. As promised by its defenders, capitalism has created material progress. Yet its dark side is unremitting.

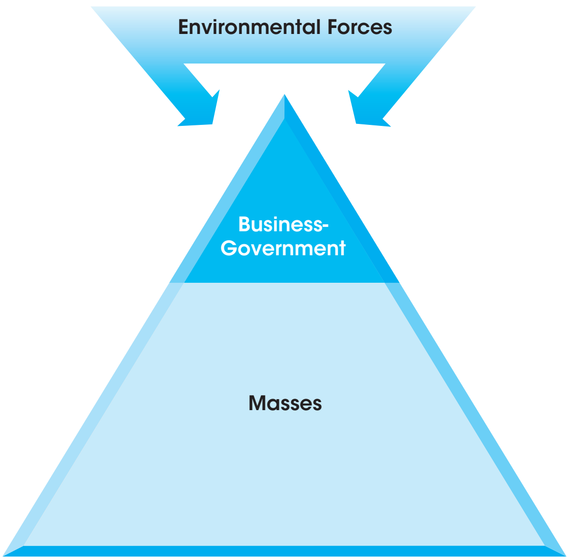
Denunciations of capitalism are pronounced today, but none are new. They carry on a regular attack that winds through the Western intellectual tradition. Adam Smith himself had some reservations and second thoughts. He feared both physical and moral decline in factory workers and the unwarranted idolization of the rich, who might have earned their wealth by unvirtuous methods. In his later years, he grew to see more need for government intervention. But Smith never envisioned a system based solely on greed and self-interest. He expected that in society these traits must coexist with restraint and benevolence.[30]

The ageless debate over whether capitalism is the best means to human fulfillment will continue. Meanwhile, we turn our discussion to an alternative model of the BGS relationship that attracts many of capitalism's detractors.

The Dominance Model

The dominance model is a second basic way of seeing the BGS relationship. It represents primarily the perspective of business critics. In it, business and government dominate the great mass of people. This idea is represented in the pyramidal, hierarchical image of society shown in Figure 1.3.

FIGURE 1.3
The Dominance Model



[30] E. G. West, ed., *The Theory of Moral Sentiments* (Indianapolis: Liberty Classics, 1976), pp. 70–72. Originally published in 1853.

Those who subscribe to the model believe that corporations and a powerful elite control a system that enriches a few at the expense of the many. Such a system is undemocratic. In democratic theory, governments and leaders represent interests expressed by the people, who are sovereign.

Proponents of the dominance model focus on the defects and inefficiencies of capitalism. They believe that corporations are insulated from pressures holding them responsible, that regulation by a government in thrall to big business is feeble, and that market forces are inadequate to ensure ethical management. Unlike other models, the dominance model does not represent an ideal in addition to a description of how things are. For its advocates, the ideal is to turn it upside down so that the BGS relationship conforms to democratic principles.

In the United States the dominance model gained a following during the late nineteenth century when large trusts such as Standard Oil emerged, buying politicians, exploiting workers, monopolizing markets, and sharpening income disparities. Beginning in the 1870s, diverse groups of plain people who found themselves toiling under the directives of rich capitalists rejected the market capitalism model and based a populist reform movement on the critical view of society implied in the dominance model.

populism
A political pattern, recurrent in world history, in which common people who feel oppressed or disadvantaged seek to take power from a ruling elite seen as thwarting fulfillment of the collective welfare.

Populism is a recurrent spectacle in which common people who feel oppressed or disadvantaged in some way seek to take power from a ruling elite that thwarts fulfillment of the collective welfare. In America, the populist impulse bred a sociopolitical movement of economically hard-pressed farmers, miners, and workers lasting from the 1870s to the 1890s that blamed the Eastern business establishment for a range of social ills and sought to limit its power.

This was an era when, for the first time, on a national scale the actions of powerful business magnates shaped the destinies of common people. Some displayed contempt for commoners. "The public be damned," railroad magnate William H. Vanderbilt told a reporter during an interview in his luxurious private railway car.[31] The next day, newspapers around the country printed his remark, enraging the public. Later, Edward Harriman, the aloof, arrogant president of the Union Pacific Railroad, allegedly reassured industry leaders worried about reform legislation, saying "that he 'could buy Congress' and that if necessary he 'could buy the judiciary.'"[32] It was with respect to Harriman that President Theodore Roosevelt once noted, "men of very great wealth in too many instances totally failed to understand the temper of the country and its needs."[33]

[31] "Reporter C.P. Dresser Dead," *The New York Times,* April 25, 1891, p. 7. In fairness to Vanderbilt, the context of the remark is elusive. It came in response to questioning by a reporter who may have awakened Vanderbilt at 2:00 a.m. to ask, perhaps insolently, if he would keep an unprofitable route in service to the public. Vanderbilt's response was magnified far beyond a cross retort to become the age's enduring emblem of arrogant wealth. See "Human Factor Great Lever in Railroading," *Los Angeles Times,* October 20, 1912, p. V15; and Ashley W. Cole, "A Famous Remark," *The New York Times,* August 25, 1918, p. 22 (letter to the editor).

[32] Quoted from correspondence of Theodore Roosevelt in Maury Klein, *The Life & Legend of E.H. Harriman* (Chapel Hill: University of North Carolina Press, 2000), p. 369.

[33] Ibid., p. 363.

This 1900 political cartoon illustrates a central theme of the dominance model, that powerful business interests act in concert with government to further selfish money interests. Although the cartoon is old, the idea remains compelling for many.
Source: © Bettmann/CORBIS

The populist movement in America ultimately fell short of reforming the BGS relationship to a democratic ideal. Other industrializing nations, notably Japan, had similar populist movements. *Marxism,* an ideology opposed to industrial capitalism, emerged in Europe at about the same time as these movements, and it also contained ideas resonant with the dominance model. In capitalist societies, according to Karl Marx, an owner class dominates the economy and ruling institutions. Many business critics worldwide advocated socialist reforms that, based on Marx's theory, could achieve more equitable distribution of power and wealth.

Marxism
An ideology holding that workers should revolt against property-owning capitalists who exploit them, replacing economic and political domination with more equal and democratic socialist institutions.

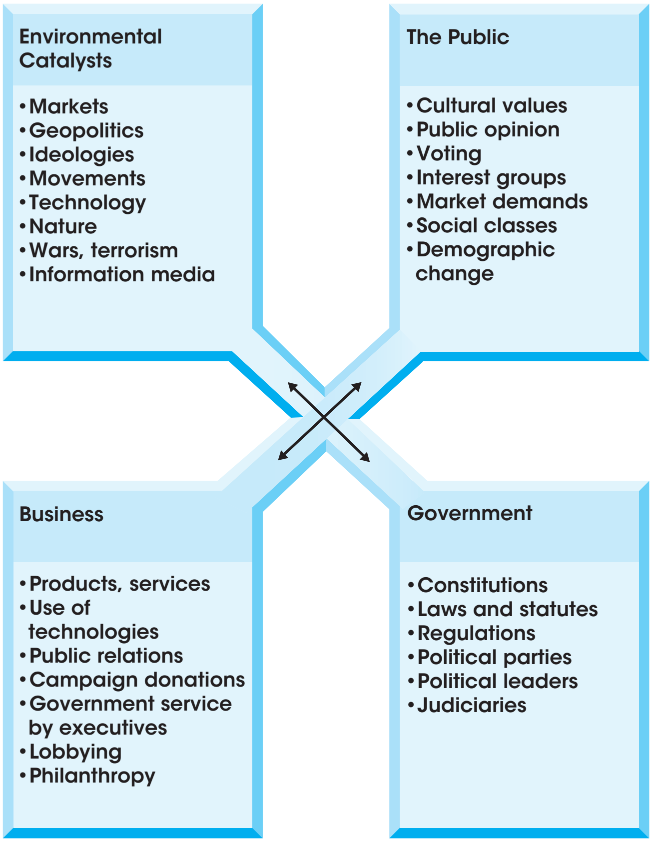
In the United States the dominance model may have been most accurate in the late 1800s when it first arose to conceptualize a world of brazen corporate power and politicians who openly represented industries. However, it remains popular. Ralph Nader, for example, speaks its language.

> Over the past 20 years, big business has increasingly dominated our political economy. This control by corporate government over our political government is creating a widening "democracy gap." The unconstrained behavior of big business is subordinating our democracy to the control of a corporate plutocracy that knows few self-imposed limits to the spread of its power to all sectors of our society.[34]

Nader persists in the rhetoric of the dominance model. Running for president in 2008 he wrote that "the corporations . . . have become our government . . . [and]

[34] "Statement of Ralph Nader," in *The Ralph Nader Reader* (New York: Seven Stories Press, 2000), pp. 3 and 4.

FIGURE 1.4
The Countervailing Forces Model



both parties are moving deeper into the grip of global corporatism,"[35] later adding that "corporate power over our political economy and its control over people's lives knows few boundaries."[36]

The Countervailing Forces Model

The countervailing forces model, shown in Figure 1.4, depicts the BGS relationship as a flow of interactions among major elements of society. It suggests exchanges of power among them, attributing constant dominance to none.

This is a model of multiple forces. The power of each element can rise or fall depending on factors such as the subject at issue, the strength of competing interests, the intensity of feeling, and the influence of leaders. The countervailing forces model generally reflects a way of looking at the BGS relationship in the United States and other Western industrialized nations. It differs from the market capitalism model in opening business directly to influence by nonmarket forces. It differs

[35] Ralph Nader, "It's Not About Me. It's About Our Broken System," *USA Today,* March 5, 2008, p. 11A.

[36] Ralph Nader, "Time for Citizens to Convene," Common Dreams.org, September 28, 2009, at www.commondreams.org.

from the dominance model in rejecting an absolute primacy of business and crediting more power to a combination of forces and interactions rendered paltry by the dominance model.

What overarching conclusions can be drawn from this model? First, business is deeply integrated into an open society and must respond to many forces, both economic and noneconomic. It is not isolated from any part of society, nor is it always dominant. Markets, for example, have the power to organize human activity and can operate very independently of corporate influence. Business exerts power in them, but so do other elements in society. Consumer demand rewards some business decisions, penalizes others, and forces innovation. Governments also shape markets, restricting buyers and sellers as to what products can be exchanged, when, and how.

Second, business is a major force acting on government, the public, and environmental factors. Business often defeats labor, wins political battles, and shapes public opinion. It consumes natural resources. It conditions cultural values, for example, commercialism and materialism, each encouraged by advertising perhaps at the expense of values such as temperance and spirituality. Some believe that among the power groupings in American society business predominates. However, defeats, compromises, and power sharing are highly visible. For example, in the 1970s large corporations fought new environmental regulations only to see a string of major laws, costly to comply with, adopted by Congress.

Third, to maintain broad public support, business must adjust to social, political, and economic forces it can influence but not control. Faulty adjustment invites correction. This is the social contract in action. For more than 50 years American business suppressed labor unions. In keeping with the dominance model, government acted as its constant ally, even sending troops to end strikes forcibly, sometimes violently. Then, during the depression of the 1930s, the public blamed economic problems on corporate greed and excesses, electing President Franklin D. Roosevelt to bring reform. Sympathy for struggling workers was so strong that in 1935 Congress passed the National Labor Relations Act, protecting and easing union organizing, a colossal defeat for business and a bitter lesson about the social contract.

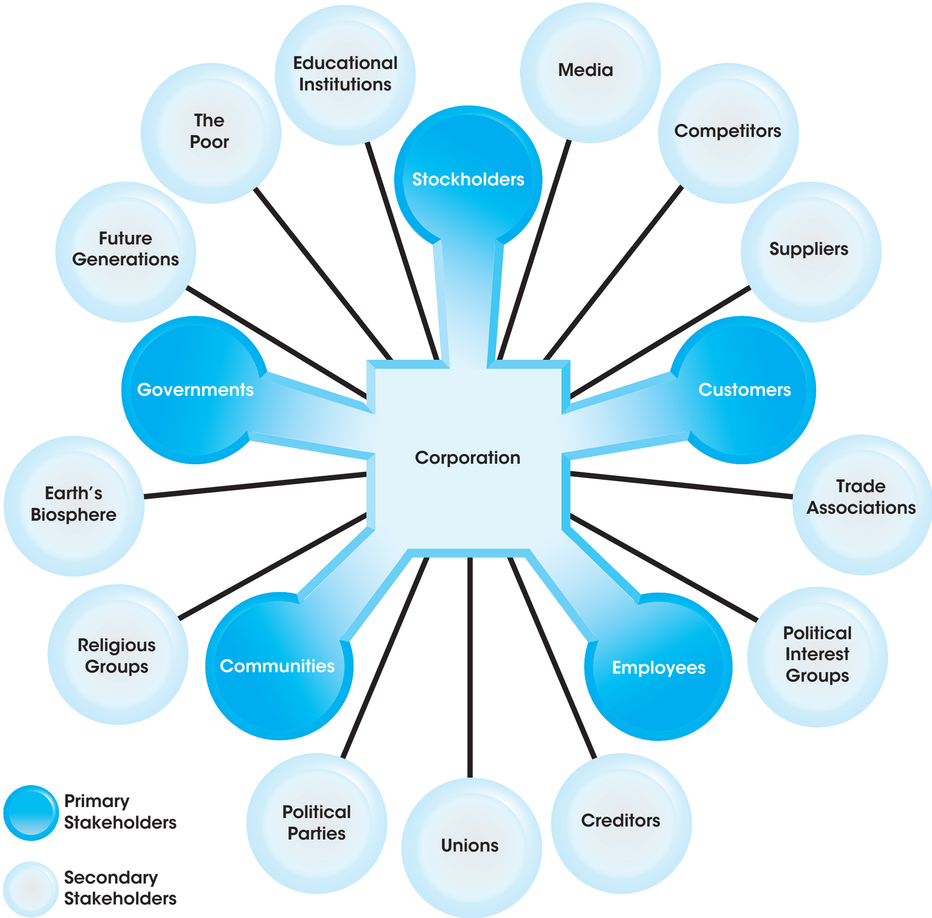
Finally, BGS relationships evolve as changes take place in the ideas, institutions, and processes of society. After the collapse of financial markets in late 2008, for example, the federal government took unprecedented actions, taking large ownership shares in big companies, firing the CEO of General Motors, and dictating executive salaries. Such actions altered the nature of capitalism as practiced in the United States in a way that reduced business power.

stakeholder
An entity that is benefitted or burdened by the actions of a corporation or whose actions may benefit or burden the corporation. The corporation has an ethical duty toward these entities.

The Stakeholder Model

The stakeholder model in Figure 1.5 shows the corporation at the center of an array of relationships with persons, groups, and entities called *stakeholders*. Stakeholders are those whom the corporation benefits or burdens by its actions and those who benefit or burden the firm with their actions. A large corporation has many stakeholders, all divisible into two categories based on the nature of the relationship. But the assignments are relative, approximate, and inexact. Depending

FIGURE 1.5
The Stakeholder Model



primary stakeholders
Entities in a relationship with the corporation in which they, the corporation, or both are affected immediately, continuously, and powerfully.

secondary stakeholders
Entities in a relationship with the corporation in which the effects on them, the corporation, or both are less significant and pressing.

on the corporation or the episode, a few stakeholders may shift from one category to the other.

Primary stakeholders are a small number of constituents for which the impact of the relationship is mutually immediate, continuous, and powerful. They are usually stockholders (owners), customers, employees, communities, and governments and may, depending on the firm, include others such as suppliers or creditors.

Secondary stakeholders include a possibly broad range of constituents in which the relationship is one of less immediacy, benefit, burden, or power to influence. Examples are activists, trade associations, politicians, and schools.

This model is based on a growing body of work by academicians who follow the lead of R. Edward Freeman, a management scholar and ethicist whose seminal 1984 book consolidated rudimentary ideas into a cohesive theory.[37] Now the idea seizes the imagination of many, including Pope Benedict XVI who writes of

[37] R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pitman Publishing, 1984).

"a growing conviction that business management cannot concern itself only with the interests of proprietors, but must also assume responsibility for all the other stakeholders who contribute to the life of the business."[38]

Exponents of the stakeholder model debate how to identify who or what is a stakeholder. Some use a broad definition and extend the idea to include, for example, natural entities such as the earth's atmosphere, oceans, terrain, and living creatures because corporations have an impact on them.[39] Others reject this broadening, since natural entities are defended by conventional stakeholders such as environmental groups. At the farthest reaches of the stakeholder idea lie groups such as the poor and future generations. But in the words of one advocate, "[s]takeholder theory should not be used to weave a basket big enough to hold the world's misery."[40] If groups such as the poor were included in the stakeholder network, managers would be morally obliged to run headlong at endless problems, taking them beyond any conceivable economic mission. Still, any group becomes a stakeholder simply by attacking the reputation and image of the corporation. Political activism equals right to consideration.

The stakeholder model reorders the priorities of management away from those in the market capitalism model. There, the corporation is the private property of those who contribute its capital. Its top priority is to benefit one group—the investors. The stakeholder model, by contrast, removes this priority, replacing it with an ethical theory of management in which the welfare of each stakeholder must be considered as an end. Stakeholder interests have intrinsic worth: They are not to be valued only as they enrich investors. Managers have a duty to consider the interests of multiple stakeholders, and thus, "the interests of shareowners . . . are not always primary and never exclusive."[41] Beyond this, other ethical duties that have been suggested include avoiding harm, justifying decisions, and protecting future generations.[42]

The stakeholder theory is at heart a political ideology that regards traditional capitalist corporate governance as akin to an undemocratic political system in which the "population" of stakeholders is not given proper representation. Without checks and balances autocratic managers will be tempted by greed into various degrees of economic oppression, treating the un- and underrepresented stakeholders unfairly. The ethical concept of duties introduces such a mechanism of representation. Stakeholder management creates duties toward multiple

[38] Benedictus PP.XVI, Encyclical Letter, *Caritas in Veritate* (2009), no. 40.

[39] See Edward Stead and Jean Garner Stead, "Earth: A Spiritual Stakeholder," *Business Ethics Quarterly,* Ruffin Series no. 2 (2000), pp. 321–44.

[40] Max Clarkson, *A Risk-Based Model of Stakeholder Theory* (Toronto: The Centre for Corporate Social Performance & Ethics, 1994), cited in Robert Philips, *Stakeholder Theory and Organizational Ethics* (San Francisco: Berrett-Koehler, 2003), p. 119. See also James P. Walsh, "Taking Stock of Stakeholder Management," *Academy of Management Review* 30, no. 2, p. 205.

[41] James E. Post, Lee E. Preston, and Sybille Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Stanford, CA: Stanford University Press, 2002), p. 17.

[42] For a list of ethical duties toward stakeholders see Advisory Panel, Newmont Community Relationships Review, *Building Effective Community Relationships: Final Report of the Advisory Panel to Newmont's Community Relationship Review,* February 8, 2009, appendix 7.

entities of the corporation—duties not emphasized in the traditional capitalist firm, which tries to dominate its environment out of an obsessive focus on enriching stockholders. Management must raise its gaze above profits to see and respond to a spectrum of other values; it must manage to make each stakeholder "better off."[43] The stakeholder model is intended to "revitalize capitalism" with a "new conceptualization" of how the corporation should work.[44] It rejects the shareholder-centered view of the firm in the market capitalism model as "ethically unacceptable."[45]

Not everyone agrees. Critics argue that the stakeholder model is an unrealistic assessment of power relationships between the corporation and other entities. It seeks to give power to the powerless by replacing force with ethical duty, a timeless and often futile quest of moralists. In addition, it sets up too vague a guideline to substitute for the yardstick of pure profit. Unlike traditional criteria such as return on capital, there is no single, clear, and objective measure to evaluate the combined ethical/economic performance of a firm. According to one critic, this lack of a criterion "would render impossible rational management decision making for there is simply no way to adjudicate between alternative projects when there is more than one bottom line."[46]

In addition, the interests of stakeholders so vary that often they conflict with shareholders and with one another. With respect to corporate actions, laws and regulations protect stakeholder interests. Creating surplus ethical sensitivity that soars above legal duty is impractical and unnecessary.[47] And finally, a lasting conviction, going back to Adam Smith, is that even the most fanatical pursuit of profit, if guided by law and the invisible hand, creates greater lasting good for society than pursuit of profit tempered by compassion. If a new conception of capitalism redistributes decision-making power and resources to stakeholders it can only impair the efficiency of the firm in maximizing both profits and social benefits.[48]

Some puzzles exist in stakeholder thinking. It is not always clear who or what is a legitimate stakeholder, to what each stakeholder is entitled, or how managers should balance competing demands among a range of stakeholders. Yet its advocates find two arguments compelling. First, a corporation that embraces stakeholders prospers more, better sustaining its wealth-creating function with the support of a network of parties beyond shareholders. Put bluntly by an advocate of the stakeholder perspective, "[e]xecutives ignore stakeholders at the peril of the survival of their companies."[49] Second, it is the ethical way to manage because stakeholders have moral rights that grow from the way powerful corporations

[43] R. Edward Freeman, Jeffrey S. Harrison, and Andrew C. Wicks, *Managing for Stakeholders: Survival, Reputation, and Success* (New Haven: Yale University Press, 2007), p. 12.

[44] Freeman, Harrison, and Wicks, *Managing for Stakeholders,* pp. x and 3.

[45] Post, Preston, and Sachs, *Redefining the Corporation,* p. 16.

[46] John Argenti, "Stakeholders: The Case Against," *Long Range Planning,* June 1997, p. 444.

[47] Anant K. Sundaram, "Tending to Shareholders," *Financial Times,* May 26, 2006, p. 6.

[48] James A. Stieb, "Assessing Freeman's Stakeholder Theory," *Journal of Business Ethics,* 87 (2009), p. 410.

[49] R. Edward Freeman, "The Wal-Mart Effect and Business, Ethics, and Society," *Academy of Management Perspectives,* August 2006, p. 40.

affect them. Despite academic debates, in practice the stakeholder ideology has been powerful enough to change the way capitalist corporations are managed. Most of the largest global corporations now analyze their stakeholders and enter into dialogue with a wide range of them. This trend is discussed in Chapter 6.

OUR APPROACH TO THE SUBJECT MATTER

Discussion of the business-government-society field could be organized in many ways. The following is an overview of our approach.

Comprehensive Scope

This book is comprehensive. It covers many subjects. We believe that for those new to the field seeing a panorama is helpful. Because there is less depth in the treatment of subjects than can be found in specialized volumes, we suggest additional sources in footnotes.

Interdisciplinary Approach with a Management Focus

The field is exceptionally interdisciplinary. It exists at the confluence of a fairly large number of established academic disciplines, each of which contributes to its study. These disciplines include the traditional business disciplines, particularly management; other professional disciplines, including medicine, law, and theology; the social sciences, including economics, political science, philosophy, history, and sociology; and, from time to time, natural sciences such as chemistry and ecology. Thus, our approach is eclectic; we cross boundaries to find insight.

strategic management Actions taken by managers to adapt a company to changes in its market and sociopolitical environments.

The dominant orientation, however, is the discipline of management and, within it, the study of *strategic management*, or actions that adapt the company to its changing environment. To compete and survive, firms must create missions, purposes, and objectives; the policies and programs to achieve them; and the methods to implement them. We discuss these elements as they relate to corporate social performance, illustrating successes and failures.

Use of Theory, Description, and Case Studies

theory A statement or vision that creates insight by describing patterns or relationships in a diffuse subject matter. A good theory is concise and simplifies complex phenomena.

Theories simplify and organize areas of knowledge by describing patterns or regularities in the subject matter. They are important in every field, but especially in this one, where innumerable details from broad categories of human experience intersect to create a new intellectual universe. Where theory is missing or weak, scholarship must rely more on description and the use of case method.

No underlying theory to integrate the entire field exists. Fortunately, the community of scholars studying BGS relationships is building theory in several areas. The first is theory describing how corporations interact with stakeholders. The second is theory regarding the ethical duties of corporations and managers. And the third is theory explaining corporate social performance and how it can be measured. Theory in this last area focuses on defining exactly what a firm does to be responsible in society and on creating scales and rulers with which to weigh and measure its actions. Scholarship in all three areas shows increasing sophistication and wider agreement on basic ideas.

Despite the lack of a grand theory to unify the field, useful theories abound in related disciplines. For example, there are economic theories about the impact of government regulation, scientific theories on the risks of industrial pollution, political theories of corporate power, ethical theories about the good and evil in manager's actions, and legal theories on subjects such as negligence applied by courts to corporations when, for example, industrial accidents occur. When fitting, we discuss such theories; elsewhere we rely on descriptions of events. In each chapter, we also use stories at the beginning and case studies at the end to invite discussion.

Global Perspective

Today economic globalization animates the planetary stage, creating movements of people, money, goods, and information that, in turn, beget conflicts as some benefit more and others less or not at all. Viewing any nation's economy or businesses in isolation from the rest of the world is myopic. Every government finds its economic and social welfare policies judged by world markets. Every corporation has a home country, but many have more sales, assets, and employees outside its borders than within. For now, capitalism is ascendant. It brings unprecedented wealth creation and new material comforts, but it also brings profound risks of economic shocks, imposes burdens on human rights and the environment, and challenges diversity of values for those who stand aloof from the free market consensus. A fitting perspective on the BGS relationship must, therefore, be global.

Historical Perspective

history
The study of phenomena moving through time.

History is the study of phenomena moving through time. The BGS relationship is a stream of events, of which only one part exists today. Historical perspective is important for many reasons. It helps us see that today's BGS relationship is not like that of other eras; that current ideas and institutions are not the only alternative; that historical forces are irrepressible; that corporations both cause and adapt to change; that our era is not unique in undergoing rapid change; and that we are shaping the future now. In addition, the historical record is relatively complete, revealing more clearly the lessons and consequences of past events as compared with current ones that have yet to play out and show their full significance.

Despite appearances of novelty, the present is seldom unparalleled and is best understood as an extension of the past. So we often examine the origins of current arrangements, finding them both enlightening and entertaining. Readers of this book, many at the beginning of long business careers, can take heart from the words of Nicolò Machiavelli, a student of history who believed that "whoever wishes to foresee the future must consult the past; for human events ever resemble those of preceding times."[50]

[50] Niccolò Machiavelli, *Discourses on the First Ten Books of Titus Livius* (New York: The Modern Library, 1950), book 3, chapter 43, p. 530, written in 1513.