HAAS SCHOOL OF BUSINESS
UNIVERSITY OF CALIFORNIA, BERKELEY

ETHICS AND RESPONSIBLE BUSINESS LEADERSHIP

FINAL EXAMINATION

Monday, May 8 – 9:00 a.m. to 11:00 a.m. Pacific Time

***Instructions* – read carefully before you begin, and read again before submitting to ensure you are in compliance with all stated conditions**

Ground rules

This exam is to be posted under "Assignments" on bCourses at 9:00 a.m., and is take-home, open-book and open-notes but **strictly individual**. It will also be emailed to you as a bCourses announcement. You may **not** use the Internet, email, chat software, or any other medium of communication with others during the exam. You may use the Internet with the goal only to receive and submit your exam and access course material on bCourses. At the end of your exam, add the honor pledge included as the last page of this exam (you can cut and paste the page), and date and sign it by typing your name in the designated space. The exam consists of eight questions based on a case provided with this exam. The weight given to each question is stated in brackets at the end of the question. You may want to consider these weights when allocating your time and space.

Format

The total length of your answers is not to exceed three pages with single-spaced paragraphs – this limit will be strictly enforced. You do not need to rewrite the questions in your answers file. Allocate your time to allow for proofreading and final editing. Be advised that it is easy for graders to discern between thoughtful answers and repetition from class slides. Margins must be at least 1 inch—top, bottom, and sides—and font must be 12-point, Times New Roman.

Please title your exam file thus: [last name_first name_cohort.doc], where cohort is either Oski or Axe.

Submission

Unless you have a special accommodation, you must return your answers as an assignment submission through bCourses by 11:00am or, if you have difficulty uploading, through email to the course's GSI Sebastian Arechaga sebastian_arechaga@haas.berkeley.edu. The system will stop receiving answers after that time.

Help

If you need to ask (clarifying only) questions during the exam, you may email the instructor (guo.xu@berkeley.edu). I will reply to everyone in our sections, including both question and answer, as well as the identity of the person asking the question. I will answer up to 5 questions in total. So bear in mind that a question from you may crowd-out a question from a classmate. Try not to burn a question asking "May I assume…?" We are flexible on assumptions if you apply frameworks consistently. But state your assumptions and choose them wisely; avoid assuming the core ethical issues away.

Case: Sweet drinks and bitter truths

It was a long, uphill trek to the position of Head of Responsible Strategy at McBurger, a major privately-held fast-food chain-store. After settling into the position, the owner and CEO summons you to discuss a strategic quandary. The main competitor, PattyPrince, just announced that it will offer all of its soda drinks at $1.

The typical response would be to lower soda prices correspondingly to remain competitive. Strategy and Marketing VPs advocate for taking that route. However, the CEO wants to hear other opinions before deciding. She reminds you that McBurger and its competitors had been attacked by health and nutrition specialists for contributing to the obesity epidemic. In response, the company had tried to build a brand as a healthier option by accurately reporting calorie counts for all dishes and by launching a menu featuring lower-fat and plant-based alternatives. The CEO wants a sound strategic response to PattyPrince's move, but does not want to dilute the PR effect of McBurger's previous efforts.

Before the day is out, you schedule meetings with McBurger pricing team, and task your own team with researching the price effects of soda drinks and the economics of soda taxes.

Pricing

Upon meeting with them, the pricing team tells you that changing the price of soda drinks shifts consumers within the fast-food segment, with little or no effect on consumer choices across segments. More health-conscious customers are already choosing other restaurants, and their behavior is unlikely to be affected by changing soda drink prices at McBurger. The main effect of matching PattyPrince's prices would be to retain customers who would otherwise migrate there.

They also mention that soda pricing does alter demand within the segment. Lower prices lead to more consumption. Before PattyPrince's move, prices were close to profit-maximizing, yielding very high margins; it would have been better for profits if PattyPrince had not lowered prices, but given their shift, matching would best protect McBurger's profits.

Public health

Your team then sends you a worrying brief based on new research. According to several recent studies, above one in three Americans adults and 18.5% of American kids are obese. The estimated healthcare costs of obesity reach $147 billion (in 2008 dollars).[1] Much of the cost comes from diabetes and pre-diabetes (blood sugar levels higher than normal, but not high enough to trigger a diabetes diagnosis). According to the CDC, diabetes and pre-diabetes affect around 100 million Americans. 90% of those with diabetes have Type-2 diabetes, which is related to lifestyle choices like eating and exercise. Experts worry that, at the current pace, "obesity-related diabetes alone will break the bank of our healthcare system."[2] Moreover, diabetes prevalence rates are highest among Blacks and Hispanics, and Americans with less education.

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[1] Data from the Center for Disease Control (CDC): https://www.cdc.gov/obesity/data.

[2] Morgan Griffin, "Obesity Epidemic `Astronomical'" - https://www.webmd.com/diet/obesity/features/obesity-epidemic-astronomical#1

Americans consume more than twice the amount of added sugars recommended by the American Heart Association, of which more than a third is in the form of sugary drinks.[3] Studies cited by UCSF's Sugarscience project, state that "one soda exceeds the American Heart Association daily limit for added sugar" and "drinking just one soda per day can increase the risk of dying from heart disease by nearly one-third and raise the risk of diabetes by 26 percent." A member of your team then says, "According to these data, millions of Americans overconsume sugary drinks. There is a real possibility that we, and our competitors, are over-selling. If this is true, and we care about health impacts, instead of lowering prices, we should be raising them."

This is not the first time you have heard these health facts. But you wonder if indeed the socially responsible action would be to sell less. You remember that the previous CEO was often confronted with the public health implications of fast food and was very skeptical about those arguments. "Consumers are responsible," he once said at a board meeting. "If they are choosing to spend money to eat and drink at our restaurants, that means we are creating value by providing them a product and experience they enjoy." But that answer does not address what seems to be a key issue: "Why would people *over*-consume sugary drinks?"

Current versus future selves

Your team is ready for your question, and they produce several studies showing that sugar is addictive. According to some, sugar creates similar neuro-chemical patterns to those of illegal drugs, including the release of dopamine, the habituation of neuro-receptors, and withdrawal.[4] A member of your team chimes in to say there are health specialists who complain that casting the sugar discussion in terms of addiction could be counter-productive.[5] You agree – especially for a fast-food chain – since this puts all the blame on the product.

Another team member then brings up present bias—a more subtle self-control issue from behavioral economics—which could also lead consumers to under-weight the future health costs of sugary drinks and thus make decisions today that they could regret in the future.[6] This happens because the current self of a present-biased individual makes decisions today that cause problems for the future self. Behavioral economists call these "internalities" because they are like externalities but affect one person over time. Internalities can be positive: for example, going to the gym, eating healthy, or avoiding sugar would positively impact one's future self. Not doing those things, by contrast, would generate negative internalities for one's future self. When we think about our future self, it is easy to say we would like to work out and avoid unhealthy foods. But when the time comes to order lunch, the current self often forgets about the future self. As you hear this, you realize that while the addiction view places blame on the product, the self-control view puts the consumer at center stage.

Coming up with a plan – value scorecard analysis

After the meeting with your team is over, you go home to mull things over. Strategy in a large corporation is a complex process, but surely the first step is to determine what would be the ethical

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[3] UCSF Healthy Beverages Initiative - http://sugarscience.ucsf.edu/ucsf-healthy-beverages-initiative.html#.Xfg68uhKhhF
[4] See https://www.healthline.com/health/food-nutrition/experts-is-sugar-addictive-drug#1
[5] See https://health.usnews.com/wellness/food/articles/2018-11-16/sugar-is-addictive-bs-these-health-pros-say
[6] Much of this strand of research was developed at Berkeley. For a seminal contribution on present-biased preferences, see O'Donoghue and Rabin "Doing it now or later," *American Economic Review* 89(1), March 1999.

thing to do. You can worry about compromises later. A sense of déjà vu comes over you. You decide it's time for a values scorecard analysis.

Consider McBurger's choice of keeping prices at the status quo against matching PattyPrince's price drop. Then evaluate that strategy according to:

1. *Act Utilitarianism [15 pts.] (hint: in what way may switching across fast-food chains affect your answer)*
2. *Rule Utilitarianism [15 pts.]*
3. *Duty Ethics [15 pts.]*
4. *Justice as Fairness [15 pts.]*
5. *Justice as Entitlement [15 pts.] – (hint: in what way may the principle of justice in transfers be violated?)*

From unilateral decision to industry-wide regulation

As you are finalizing your values scorecard analysis, the CEO reminds you that there is a pending conference with representatives from the American Beverage Association (ABA). They want to enlist McBurger and other fast-food chains to lobby against soda taxes being enacted in various US cities.

The first city to pass a soda tax (of 1 cent/ounce) was Berkeley, CA, in 2014. Several others followed using the same tax rate, beginning in the Bay Area (Albany, Oakland, and San Francisco). The call to action stemmed from health concerns. According to a report from Berkeley's Goldman School of Public Policy,

> This crisis has disproportionately negative impacts on low-income communities of color. Black residents in Berkeley are four times as likely to have diabetes as white residents and are hospitalized for the disease at 14 times the rate of white residents. […] Advocates believe that a sugary drink tax is one intervention which, alongside a suite of other public health measures, can challenge inequitable outcomes stemming from the ubiquity and affordability of sugary drinks.[7]

According to the report, the dominant approach in these tax interventions has been to invest the proceeds of the tax to educate the community in ways that promote healthy nutrition. The strongest argument against soda taxes is perhaps that a soda tax is regressive. By raising the price of soda drinks, the tax hurts the wallet of the same people the policy aims to help. ABA is a prominent opponent of soda taxes.

Your team is divided. Some of them argue that higher prices will protect people from overconsumption. Others argue that people may still consume, pay more, and be poorer as a result. If demand is very elastic, people will consume much less, so the health benefits will dwarf the costs from the additional expense. If demand is very inelastic, by contrast, people will consume just as much, and the policy will only increase costs. But which one is it? Nobody in your team has an answer. A quick search brings up a recent paper analyzing this very problem. Its conclusion: demand is elastic enough that "sin taxes" like soda taxes have positive effects on welfare. In particular, socially optimal (i.e, welfare-maximizing) taxes should be set in the range

[7] See "The Bay Area Sugar-Sweetened Beverage Taxes: An Evaluation of Community Investments": https://food.berkeley.edu/wp-content/uploads/2019/05/GSPP-Soda-Tax-Evaluation-Final-Draft_withdate.pdf

of 1 to 2.1 cents/ounce. As luck would have it, the Bay Area taxes had been set on the lower bound of this safety range.[8]

6. Evaluate how conclusions in 1-5 would change if the policy under consideration were not a unilateral pricing policy, but joining a lobbying effort against ABA, in support of nation-wide soda taxes set at socially optimal levels.
[15 pts.]

7. Suppose a socially optimal nation-wide soda tax is put in place. Would complying–by selling whatever quantities are demanded at the new price—be an exercise of corporate social responsibility? Why or why not?
[5 pts.]

8. Can McBurger's decision to join a lobbying effort against ABA, in support of soda taxes, be considered an exercise of corporate social responsibility? Why or why not?
[5 pts.]

[8] See Allcott, Lockwood, and Taubinsky (2019) "Regressive Sin Taxes, With an Application to the Optimal Soda Tax," *Quarterly Journal of Economics* 134(3) - another piece of research involving Berkeley faculty. The piling up of Berkeley-based research in this case is coincidental. Some universities just produce outstanding research…