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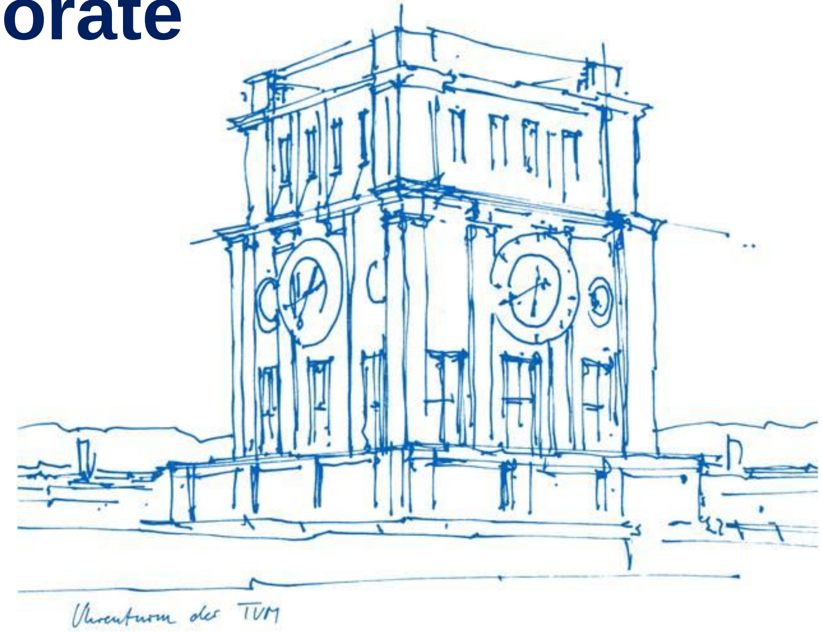
Introduction to Business Ethics:

Corporate Ethics – Corporate social responsibility



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Corporate Ethics

Corporate Governance & Compliance =>
Relations internally and to Business Partners

Corporate Social Responsibility =>
Relations to Stakeholders and Society

Content of Lecture:

Milestones in theories on Corporate Social Responsibility

Conceptual Development

Milton Friedman 1970:	"The business of business is business"
Archie B Carroll 1979:	CSR Pyramid
Freeman 1984:	Stakeholder Management
Michael Porter 2011:	Shared Value

Pivotal Question: CSR as descriptive or normative

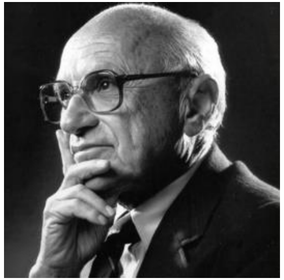
If the descriptive/empirical claim does not hold, i.e. if corporation can be long term profitable as a result of unethical business, then proponents of CSR would have to claim, that corporations have a moral obligation.

=> Appeal to individual ethics of business persons, which might be in conflict with incentives

1970 Friedman: Profit Maximization as Corporate Goal

"The Social Responsibility of Business is to Increase its Profits"

\- Milton Friedman



- Friedman's essay „The Social Responsibility of Business is to Increase its Profits" (1970) is regarded one of most influential views in Business Ethics
- According to this view, managers have clear and well-defined goal they should achieve: **Maximization of profits** for shareholders
- "CSR" would be use of resources for goals that are not required by shareholders

Tasks of Managers

- Shareholders employ managers for specific purpose (profit maximization)

→ Use for "moral" purposes (social, ecological, etc.) is thus **improper use of resources**

  - Managers don't have expertise to make good use of resources in areas outside their area of business
  - Resources will be allocated to achieve certain ends that are chosen by management (non-democratic decision)
  - Costs of this behavior will usually be allocated to customers or employees (forced tax)

- Managers thus undermine ownership rights

  → **endangering of liberal economic system**

- Responsibility for **social problems lies with state** - not with companies

Goal of Companies

Companies:
→ Friedman: Companies emerged from free association of individuals and their property
→ Objective and tasks of companies: determined by owner (has the right to do so)

Who determines tasks of company and who bears responsibility?

→ usually managers, employed by owner

Agent (Manager) → Profit maximization → **Principal** (Owner)

According to Friedman, a company can **NOT be responsible** for an act because of its nature → **"Corporate responsibility" is in fact semantic category defect**

Social Goals and Corporate Responsibility

Assumption: companies are resource-rich actors → they should be **responsible for society**

BUT:
How can individual know if expenditures of resources serves "**social interest**" if **manager can not know** what "social interest" is?

Through **agent's commitment** to principal, goal of business is to **maximize profits** (fiduciary duty). Principal can easily judge fulfillment of goal and quality of work of agent via data **(≠ "Social goals")**

→ By complying with legal frameworks and basic moral standards, company is already **paying attention to other stakeholders**

Social Goals and Corporate Responsibility

Friedman's examples of misunderstood forms of "social justice":

1. Forego price increase to meet social desire to avoid inflation
2. Environmental protection beyond legal framework (achievement only by cost factor)
3. Recruitment of long-term unemployed rather than better-qualified workers (social integration)

Criticism:

- Managers, as agents, utilize resources that do not belong to them and are entrusted to them for another purpose
- Risk of shifting decision-making power over social developments → undermine central pillar of free society, namely property
- Only small group (of managers) who neither have the mandate nor the competence decides on social investment
- Incentive problem (no means to audit manager's performance)

Social Goals and Corporate Responsibility

Criticism:
Investment in social projects would **diminish profit; it is illegitimate form of taxation** of owners (against paradigm of profit maximization)

- **Illegitimate**: Taxation is not brought about by adequate procedure (**checks and balances**), but by small group of managers who do not have sufficient competence

Danger of **collectivism through corporate social responsibility**: By emphasizing social responsibility, it is implied that **profit motive of companies is wrong**

- Assumption of social responsibility as **"compensation" for morally dubious profit** striving
- If managers do not fulfill claims: "**iron fist" by state compulsion** (danger for liberal social order)

→ Task of state institutions is to account for social responsibility

Events after Friedman‘s 1970 article changing the context of business

- 1950 – 1970: Unprecedented economic growth in Europe and the United States. => „The Golden Age“
- 1970s: Economic crisis caused by the Oil Crisis (1973) and early globalisation marking the end of the golden age
- 1980s: Decade of economically liberal and right wing policies favourable to business.
- US President Ronald Reagan: Deregulation (banking sector and antitrust law), tax cuts.
- UK Prime Minister Margaret Thatcher: Privatisation of public enterprises and reduction of trade unions influence
- 1990s: World Trade Organisation. Accelerating globalisation. China joins 2001

Globalisation has enabled the growth of multinational corporations => debates on the role and the power of business in society

Demonstrating the increasing significance public opinion

Two case examples

1. IHC Caland in Burma

2. Brent Spar from 1995

→ Both cases demonstrate how corporations can lose control over public opinion and how civil society and NGOs can put corporations under pressure even though there cases might be controversial

IHC Caland in Burma (1/4)

Compliance to legal and self-imposed rules on its own does not protect a company from a loss of image or boycotts (even in the B2B sector)!

Burma Mid 90s:

- Bad human rights situation in Burma
- 1997: Clinton issued ban on new investments
- Heineken, Interbrew, HP, etc. then withdrew from the country
- US/NL: Consumers threatened with protests against companies continuing to operate

IHC Caland:

Dutch corporation in the offshore gas and oil industry (formerly also shipbuilding), today: SBM Offshore

IHC Caland in Burma (2/4)

IHC Caland's investments in Burma:

- IHC Caland’s investment in Burma: Signature of a 15-year contract with the Burmese Government in 1998 for an offshore project (volume: several hundred million euros, joint venture)
- Previously, US oil company Texaco had withdrawn, presumably because of US investment ban

Protests against the investments:

- Worldwide protests against the involvement of IHC in Burma
- <u>Allegation</u>: support for oppression of the Burmese people/support of the military regime
- Publication of IHC Caland financial networks by protest groups to identify which investors were indirectly involved in business with Burma

Source: http://www.ib-sm.org/CaseIHCCaland.pdf

IHC Caland in Burma (3/4)

IHC Caland's point of view:

- Business is legitimate as long as there is no NL/EU embargo
- Duty of company is only to act within the legal framework
- IHC referred to its B2B relationships which played no role in moral issues
- Nevertheless, IHC had difficulty financing the project as Dutch banks refused to finance it

Code of Conduct and compromise:

- In 2000, IHC Caland set up code of conduct
- Nonetheless, they wanted to stick to the policy of signing contracts in countries without official embargo
- Another contract with Burma was closed
- Two important shareholders sold their shares
- In 2003, representatives met with Burma's ambassador to discuss human rights issues
- IHC Caland follows OECD guidelines → FNV and CNV check compliance

IHC Caland in Burma (4/4)

Further Developments:
- 2003: Stricter sanctions against Burma (President Bush)
- 2013: EU suspends sanctions against Burma

Conclusion:

- Regardless of whether investments by western companies promote human rights violations, IHC Caland case shows that public can also exert considerable pressure on B2B
- It is also in the interest of company to calculate reputational risks beyond legal framework

→ **Compliance alone is not sufficient!**

Shell and Brent Spar (1/3)

Brent Spar: Oil container for oil waiting to be picked up by boats, off the Norwegian coast.

1995: The tank was damaged, and Shell’s plan was to sink it in the Atlantic Ocean.
Permission granted from British authorities including scientists & wildlife experts.
The tank would have created an artificial reef supporting marine life

Greenpeace: The bottom of the ocean is not a dump for industrial waste. Shell just wants to save money! Brent Spar contains 5500 tons of poisonous oil residues*. Bring it to shore and recycle the parts.

Brent Spar occupied by Greenpeace activists

*In September 1995, Greenpeace admitted that their estimate of the amount of toxic oil residues in the tank was much too high. In fact, the oil residues amounted to 75 to 100 tons, i.e. about 1.37-1.8% of what was claimed.

Shell and Brent Spar (2/3)

Media attention. Boycott Shell! Employees attacked, Gasolin station burned down

20% drop in sales from Shell stations

Shell underestimated the power of a well orchestrated campaign encouraging consumers not to buy their petrol at Shell.

Shell forced to dismantle Brent Spar and the parts were used to extent the harbour facilities of Stavanger in Norway

1996 General prohibition on disposing redundant facilities at the bottom of the ocean

Shell and Brent Spar (3/3)

After the initial permission from the relevant UK authorities

- No violation of law or regulations.
- Debatable whether dismantling Brent Spar was better for environment
- Assessment of environmental damage: nothing extraordinary; is also undertaken in economic evaluation of environmental protection

Still, a scandal with dire consequences for Shell and demonstrated that corporations can lose control of public communication, even though the have broken no laws

Business and Society (1)

The two cases exemplify public debate on the safety of producing goods and environmental challenges

They are also symptomatic for a problematic relation between business and society rooted in traditional political conflicts

Public hostility towards firms – towards the corporate world – can lead to business hostile political developments

Firms depend on the support of the population => there has to be a certain level of trust between firms and their the and the general population

Business and Society (2)

Symptoms of lacking trust between firms and civil society

Greenwashing: Firms offering green products, which are not really green.

1) McDonald's replacing plastic straws with papers straws. Paper straws cannot be recycled and their sourcing and production have raised questions
2) Royal Dutch Shell committed to reduction of CO2 emissions and at the same time exploring new opportunities for oil and gas production
3) "Coca-Cola Life" as green version of Coca-Cola.

Places the responsibility of environmental pollution on the corporations and corporations reply be engaging in less projects with low credibility

Business Ethics as Business Strategy: Trust (1)

OECD‘s definition of trust:

1) A person’s belief that another person or institution will act consistently with their expectations of positive behaviour”.

2) The willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor irrespective of the ability to monitor or control that other party.“ (Mayer et al., 1995, S. 712, Lütge & Uhl p. 248)

Trust as reciprocal altruism: A is altruistic towards B in the expectation the B will eventually return the altruism

Business Ethics as Business Strategy: Trust (2)

Trust saves **transaction costs** from economic perspective
Economic perspective on ethical concept of trust:

How can trust be built and maintained in modern society? Which risks arise?

„The definition of trust proposed in this research is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor"

Trust correlating with prosperity

High level of social trust requires predominantly predictable and law-abiding behaviour

Trust has a positive effect on prosperity of a nation for the following reasons:

1) General trust in fellow citizens increases the willingness to cooperate and build business relations with people outside immediate social biotope.
2) Trust and being trustworthy reduces transaction costs by making time consuming contractual agreements redundant
3) Trust reduced the risk of lawsuits because issues can be solved in informal communication
4) Trust as social capital: Trust in multilateral relationships. If A trusts B, then others will also trust B. Multi lateral trust as social capital requires string institutions who can impose sanction

Business Ethics as Business Strategy: Social Capital

→Example: **Alumni associations**
Graduates can expect support from each other, even if unknown
Social capital thus facilitates interaction and saves resources: no costly and time-consuming controls

Protection of social capital: By **sanctions** in case of **misuse of trust**
- Sanctions can be imposed by contracting party or third parties
- Due to implicit nature of contracts: sanctions of informal nature, such as damage to reputation, public disregard or social exclusion

› Even in globalized world, moral misconduct becomes risk factor for businesses (e.g. legal consequences of bribery)

CSR as Business Strategy: Social Capital

Corporate social responsibility manifesting in relations of trust between corporations and citizens

Theoretical positions described in this lecture describe different manners in which to strengthen trust between firms and citizens, either

1) Strengthen business and free market economy (Friedman)
2) Focus on the interests of stakeholders
3) Accept responsibility for finding solution to social problem (Shared Values)

Next Lecture: Legislation and practical aspects of sustainability reporting as the openness and transparency required for safeguarding public trust in the corporations

Corporate Social Responsibility

Theoretical mile stones after Milton Friedman’s article

1979: Archie B Carroll: Pyramid

1984: R. Edward Freeman’s Stakeholder Theory

2011: Michael E. Porter and Mark R Kramer: Creating Shared Value

1979: Archie B Carroll

Different levels of responsibility

Economic and legal responsibilities as fundamental and preconditioning other responsibilities

Ethical standards: Expectation exceeding Legal requirements

Philanthropic responsibilities: Active commitments to promoting the common good

The different levels of responsibility in more detail

Economic responsibility is fundamental because society expects of companies that they are capable of sustaining themselves. Lack of profitability would drive the firm out of business.

Legal responsibilities: Ground rules as codified ethics. Compliance as condition for license to operate and for an effective economic system. Corruption and mistrust undermines effective business practices.

Ethical responsibility: Living up to normative expectations of society which are not codified in legislation. For example: Global corporations' conduct in countries with more lax regulations

Philanthropic responsibilities: Active commitment to promote good. Example: Encourage employees to participate in charity work

Challenge of Carroll’s pyramid

Ethics and philanthropy is conditioned by profitability

=> Identifying the level at which a corporation has satisfied its economic responsibility

Significant difference between **the level of profitability at which the public believes** that a corporation has satisfied its economic responsibility

and

The **level of profitability at which the company believes** the economic responsibility is satisfied

From the perspective of company profits should be retained for consolidation

The public would expect higher commitment to ethical responsibility and philanthropy on the basis of lower profits

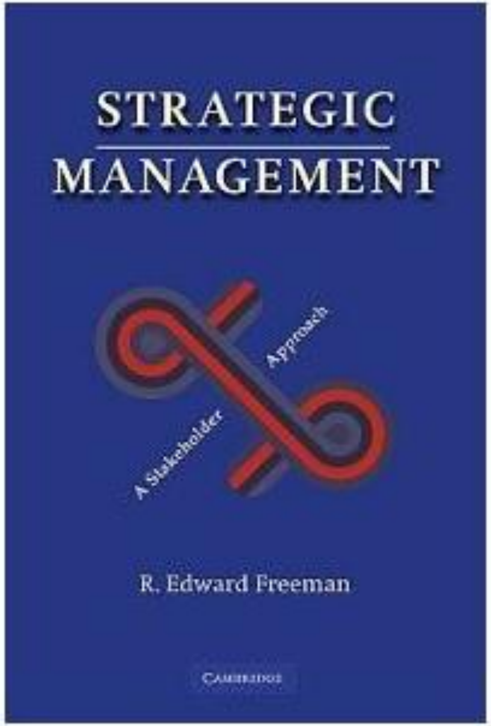
Stakeholder Theory (1/5)

Expression used by Stanford academics since the early 1960s

Most importantly in 1984 by:

R. Edward Freeman:
Strategic Management. A Stakeholder Approach

Stakeholder: Person or group of persons with an interest in the company.



Stakeholder Theory (2/5)

Stakeholder theory emphasises the common interest of the firm and all the stakeholders

Friedman: Management of firms are obliged towards all their shareholders

Freeman's stakeholder theory encourages firms to take into account all stakeholder concerns

Stakeholder Theory (3/5)

Task of management. To balance a multiplicity of interests of sometimes conflicting interests of stakeholders.

Strategies for balancing interests of stakeholders:

1) Specific stakeholder strategy: Maximise benefit for what is believed to be the most important stakeholder(s).
2) Utilitarian strategy: Maximise benefits to all stakeholders (within means)
3) Rawlsian strategy: Raise the level of the worst off stakeholder

Employees may require higher wages and shareholders investment in production
Conflict between consumers desire for cheap products and their requirement for a cheap environment

Essential claim of Stakeholder Theory: Firms benefit from taking the interests of stakeholder into account. If the can affect the firm, the firm should deal with them.

Challenge of Stakeholder Theory (4/5)

The increasingly critical civil society has often blamed firms for using stakeholder management in particular and CSR in general strategically. Accordingly it is not real CSR if it benefits the firm.

This creates the following dilemma for businesses

1) As moral obligation: Stakeholder theory as requirement for moral surplus => untenable in competitive market economy
2) Stakeholder theory as empirical claim: Considering the interests of stakeholders beyond legal obligations increases profit – controversial claim

Claim valid in societies with strong civic society and for corporations with high public exposure and replaceable products (VW, H&M, Shell)

Challenge of Stakeholder Theory (5/5)

Dilemma: If stakeholder management is purely strategic, i.e. only caring about stakeholders because it increases profit, there is no difference between Friedman's shareholder focus and Freeman's stakeholder management.

Freeman in interview: "I actually think if Milton **Friedman** were alive today, I think he'd be a **stakeholder theorist**. He would understand that the only way to create value for shareholders in today's world is to pay attention to customers, suppliers, employees, communities and shareholders at the same time."

If Friedman and Freeman are coherent: Then the theory is in no need of moral surplus.

If stakeholder management is meant as a moral obligation to take the interests of stakeholders into consideration, Freeman is asking for "Moral Surplus"

Source: https://www.derby.ac.uk/online/course-taster/business-and-management-bsc-hons-online/the-instrumental-perspective-of-csr/shareholders-vs-stakeholders---friedman-vs-freeman-debate.php

The challenge of moral surplus

CSR as Moral Obligation: The Honorable Businessman

CSR	Honorable businessman
Responsibility of a business (rather bigger companies)	Acting Person (e.g., managers in small and medium-sized companies)

→ Promotion of ethical behavior of legal person (in form of enterprise)
 → character of entrepreneur

→ Individual ethical concept (moral demands on individual)

→ Virtue-ethical approach (strong connection to individual character traits and virtues)

CSR as incorporating the honorable businessperson

- Many professional groups have guiding principles, e.g. doctors, lawyers, etc.

Statute on the Provisional Regulation of Law of Chambers of Commerce and Industry
§ 1
"... It is incumbent on them in particular to support and advise authorities through proposals, expert opinions, and reports and to work for the preservation of the decency and customs of the honorable businessman."

There are numerous models in various organizations and associations that define virtues of honorable merchant, but:

→ **Principles derived from these virtues are indeterminate and abstract**

Concept of Honorable Businessman

Lack of a unified basis of concept → **historical and conceptual approximation necessary**

Businessman (m/w) refers to **economic subject** who conducts any kind of **commerce** (purchasing and reselling/production and distribution) with degree of **autonomy**

Quelle: IHK Nürnberg

Concept of Honor

- Interpretation of term only possible within **social context**
  → Which actions are considered "honorable", "venerable", etc.?
- Term consists of Old High German root *êre* and the Greek term for "good reputation" (emphasizes social character of term)

→ An action is honorable if it is assessed positively by society (e.g. if it meets/ exceeds norms)

Dual concept of honor

Internal honor:
Feelings of individual itself regarding its conscience (recognition of other people necessary!)

External honor:
Evaluations of social group (mostly outsiders)

Concept of Honorable Businessman Today

- Harvard Business School has issued MBA Oath for graduates to ensure "**ethical conduct**" in business-related decisions (voluntary signing!)

Commitment to:

→ Not promoting their own interest at expense of their company or society

→ Rejecting corruption and avoiding business practices that harm society

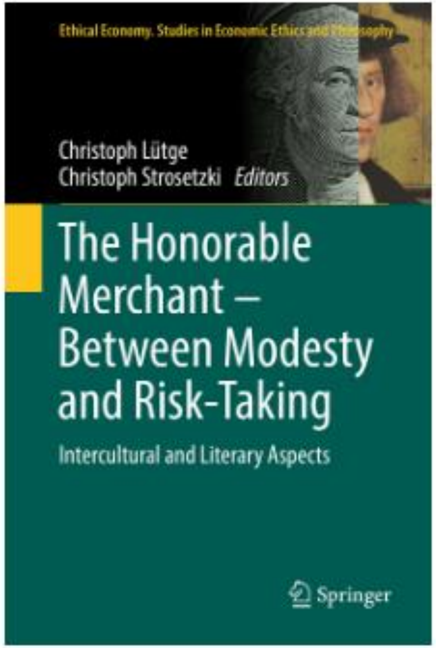
→Supporting management profession as whole, acting ethically and create sustainable prosperity

→Reinforcing integrity and confidence in oneself through one's own behavior

Book recommendation

The Honorable Merchant – Between Modesty and Risk-Taking

(Lütge & Strosetzki, 2019)



Criticism on Individual Ethics (1/4)

External concept of honor:
intercultural differences and **historical fluctuations** in meaning

- Different markets require different behaviors in order to get **social recognition** of respective society
- Concept of honorable businessman is **not stable**!
- How can ethical model be implemented against background of **value pluralism**?
- Divergences in **evaluation of actions** even within cultural circle

Concept of honorable businessman **can not act as guideline!**

Criticism on Individual Ethics (2/4)

Free market economy: Demand for honorable businessman can become superfluous, since companies have vested interest in being **perceived as "honorable"** and respectful

Is **inner motivation** to act with great honor relevant?

- Businessman would not be honorable if he or she did not act out of intrinsic motivation, but do purely instrumentally what is expected from him or her

Trust: trust-based relationships are very important in business ethics

Criticism on Individual Ethics (3/4)

Concept of honorable businessman has fallen out of time:

- Concept comes from time, in which economic system was much simpler than today (Late Middle Ages: no large organizations with complex chains of action and responsibility)

Modern world: individual ethics meaningful on conditional level!

- Need to implement ethical values in form of institutions and rules

Source: IHK Nürnberg

> Plea to individuals to behave ethically are unenforceable unless competitors behave "honorably" as well

Criticism on Individual Ethics (4/4)

Confidence-inducing performance of businesses essential, but mainly for purpose of creating reputation (investment in future)
→ **Concept of honor seems unnecessary**, even threatening

Concept depicts company's untimely normative ideal

Honorable businessman suggests a "trustworthy, proper official“

But: Dynamics and entrepreneurship should not be in the background!

Ethics necessary for a modern, dynamic society!

Creating Shared Value (CSV) (1)

Harvard Business Review 2011:
Creating Shared Value. How to reinvent capitalism and unleash a wave of innovation and growth

Claim: "The capitalist system is under siege. In recent years business increasingly has been viewed as a major cause of social, environmental, and economic problems. Companies are widely perceived to be prospering at the expense of the broader community."

Solution: Creating economic value by addressing needs and challenges of society => company success connected to social progress

(Lütge & Uhl, p. 266)

Creating Shared Value (CSV) (2)

CSV as enhancement of existing ideas within the field of corporate social responsibility

Question of Stakeholder Management: Where do corporations harm society and where are they obliged to give back to society

Question of CSV: How can corporations become part of the solution to the societal challenges by actively searching for win-win opportunities

CSV encourages business to actively seek out areas of business where they can make profit by contributing to social and societal solutions

For mature business the idea is useful as basis for supplementary projects, for start-ups with shared value as foundation CSV is an optimal alignment of interests

Creating Shared Value (CSV) (3)

Examples:

Novartis' "Access" programme: A cooperation between Novartis, governments of emerging economies and NGOs to deliver affordable treatments, including innovative medicines against chronic diseases, to the poorest people in the world.

Increasing access for the poorest and building foundations for future markets

CSR as mitigating reputational risk

Immoral Behavior as Business Risk? (1/2)

Beginning of Business Ethics!

Critical Public:
Demands Responsible Business Conduct

❯ From then on, companies had to dealt with the new factor "reputation"

Cases like Ford Pinto, Brent Spar and IHC Caland : Immoral behavior can lead to business risk

There are hardly any large companies that do business without corporate ethics activities

Economic Perspective: Why do Companies practice business ethics?

Immoral Behavior as Business Risk? (2/2)

Also: fundamental objection to Friedman's point of view → every company has the inherent duty to assume social responsibility

Stakeholder theories:

- Corporate Responsibility: In case of doubt, also against economic interests of company
- Question: How can demands be realized under permanently competitive conditions?

Business Ethics as Business Strategy: Reputation (1/2)

Theoretical core of economic and business ethics: **monism**
Problems characterized by conflicts of interest

Aim: Win-Win-Situation

- Non-anticipated **interaction uncertainties**: situation in which neither contracts nor laws govern the rights and obligations of contractors
- **Mistrust**: Does the other side use the loopholes for their own benefit?
  → Can lead to preventive counterfeiting

❱ Actors can counteract this with help of confidence-building measures and build reputation!

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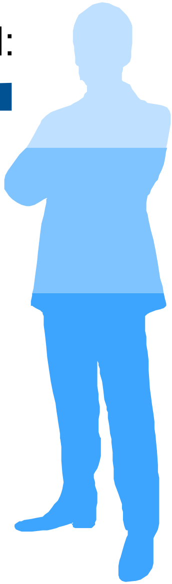
Business Ethics as Business Strategy: Reputation (2/2)

Reputation represents capital:

Creating trust and reliability



- Establishes **business relations** and thereby saves transaction costs
- Accumulating reputation by engaging in moral principles such as **integrity and fairness**
- Under conditions of globalization: reputation as important **prerequisite for successful entrepreneurship**

Premodern: trade limited to few actors, "face-to-face control"; immoral behavior was punished with ostracism

In globalized world: this type of control is systematically eliminated (trade worldwide) → **Mistrust and risk of preventive deception is growing**

CSR as incorporated in legislation

Implicit versus explicit CSR (Lütge & Uhl, p. 253)

Implicit: European Union. Social welfare is the responsibility of the state => corporations practice CSR by complying with legislation and codified

Explicit CSR: Strongly represented in the United States. Social welfare the responsibility of citizens. Tradition for engaging in charity projects

Organisational information

- On the 8th of February, we will have an exam preparation session.
- Amongst other, we would like to recap the content that you are still unclear about.
- Therefore, please use **Tweedback** to indicate the content that you have questions about (please always state the date/session & slide number you are referring to).
  - Here you can **paste your questions**: https://tweedback.de/ze14/chatwall
  - You can also upvote questions of your fellows. This way, we get a feeling of most pressing questions.
- The deadline for pasting questions is on the **6th of February**.

Thank you for your attention!