The Organization: Ethics and Corporate Social Responsibility

CHAPTER 5

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Chapter Outline

- **Organizational Direction: Mission, Goals, and Objectives**
- **The Agency Problem**
- **Managerial Ethics**
- **Social Responsibility**
- **Takeovers**
- **Outsourcing and Offshoring**
- **Linking Ethics and Social Responsibility**

External analysis—including industry competition and the external environment—was addressed in Chapters 2–4. The focus in this chapter shifts to internal analysis. This transition from the industry to the organization reflects a change in emphasis from firm similarities (factors that tend to affect all of an industry's organizations in a like manner) to differences (issues specific to a particular firm). This shift also relates to theoretical perspectives discussed in Chapter 1, marking the beginning of a movement from an industrial organization (IO) perspective to a resource-based view (RBV) of the firm. The emphasis on unique firm resources continues with discussions of the corporate, business, and functional levels of strategy in Chapters 6–8; IO and RBV are integrated into a contingency perspective in Chapter 9.

This chapter begins with a discussion of organizational direction—why the firm exists and what its owners hope to accomplish. Because shareholders are usually absent in corporate entities, professional managers are hired in their stead, a dynamic that can create tension and disagreements about appropriate behavior. Overcoming this challenge requires a clear understanding of the roles and expectations of both individual managers and firms in society. This chapter examines these roles in the context of managerial ethics and corporate social responsibility (CSR) as a precursor to understanding the strategic options available to organizations at firm, business, and functional levels.

Although both ethics and CSR represent internal challenges for the organization, they also reflect and are influenced by society as a whole. Put another way, organizations exist for a purpose, and their members are expected to adhere to certain general—and sometimes specific—guidelines. Behavioral expectations for *individual managers* are linked to perspectives of managerial ethics, whereas those for *firms* are linked to notions of CSR.

Organizational Direction: Mission, Goals, and Objectives

Managerial ethics and CSR represent realms of potential conflict between societies and both individual managers and firms. To understand the nature of such conflicts, one must first understand the purpose of the organization and the direction in which its owners and managers wish to take it. This section outlines the essential concepts that pertain to organizational direction.

Several terms are commonly used to delineate the direction of the organization. The mission (introduced in Chapter 1) is the reason for the firm's existence and is the broadest of these terms. The mission can be viewed as a choice that identifies the specific market(s) the organization intends to serve and the activities the firm plans to undertake. A mission statement can range in length from a single sentence to several pages; statements that are too short tend to provide little if any guidance, however, while long ones can be too cumbersome. Although crafting a mission statement can be time consuming, an explicit mission statement is essential because it provides necessary direction for the firm and gives members a sense of appropriate boundaries for organizational activity. Missions can and should be constantly reevaluated, but changed only when there is a compelling reason to do so.

goals Desired general ends toward which efforts are directed.

objectives Specific, verifiable, and often quantified versions of a goal.

The organization's **goals** represent the desired general ends toward which efforts are directed. **Objectives** are specific, and often quantified, versions of goals. It can be difficult to determine if a firm's mission or select goals are being met because they are usually not quantified. Unlike goals, objectives are verifiable and specific, and are developed so that management can measure performance. Without verifiability and specificity, objectives will not provide a clear direction for strategy.

For example, the mission of a regional grocery chain might be to "provide communities with a broad array of quality packaged goods, produce, and meats in a clean, friendly environment and at competitive prices." Management may establish a goal "to expand the size of the firm through acquisition of small, locally owned rivals." From this goal, a number of specific objectives may be derived, such as "to increase its market share by 20 percent each year for the next five years." Alternatively, management may set a goal "to be known as the innovative leader in the industry." Based on this goal, one of the specific objectives may be "to have 30 percent of sales each year come from new products developed during the preceding four years."

Goals and Stakeholders

stakeholders Individuals or groups who are affected by or can influence an organization's operations.

At first glance, establishing a mission, goals, and objectives for a firm does not appear to be a difficult process. This is a complex task, however, because various **stakeholders**—individuals or groups that are affected by or can influence an organization's operations—have different perspectives on the purpose of the firm. Stakeholders include such groups as shareholders, members of the board of directors, managers, employees, suppliers, creditors, and customers (see Table 5-1). How stakeholder concerns are balanced—and to what extent—form the basis for debates over both managerial ethics and CSR.

As owners, shareholders traditionally represent the dominant group of stakeholders, but conflicts with other stakeholder goals can be substantial. For example, shareholders are generally interested in maximum profitability, whereas creditors are more concerned with long-term survival so that their loans will be repaid. Meanwhile, customers desire the lowest possible prices, even if offering them would result in losses for the firm. However, top managers should be concerned not only with the shareholders' primary objective of profits, but also with those of other stakeholders, whose efforts may be required to maintain a healthy organization over the long run. They face the difficult task of attempting to reconcile these differences while pursuing their own set of goals, which typically includes quality of work life and career advancement.

TABLE 5-1 Common Goals of Stakeholders

Stakeholders	Goals
Customers	The company should provide high-quality products and services at the most reasonable prices possible.
General public	The company should provide goods and services with minimum environmental costs, increase employment opportunities, and contribute to social and charitable causes.
Suppliers	The company should establish long-term relationships with suppliers and purchase from them at prices that allow the suppliers to remain profitable.
Employees	The company should provide good working conditions, equitable compensation, and opportunities for advancement.
Creditors	The company should maintain a healthy financial posture and a policy of on-time payment of debt.
Shareholders	The company should produce a higher-than-average return on equity.
Board of directors	Current directors should be retained and should be shielded from legal liability.
Managers	The company should allow managers to benefit financially from the growth and success of the company.

This balancing act is evident when one considers the clash that can occur when top management goals are pitted against those of the board of directors. While both groups are primarily accountable to the owners of the corporation, top management is responsible for generating financial returns and the board of directors is charged with general oversight of the firm's management. Some have argued, however, that this traditional *shareholder-driven* perspective is too narrow, and that financial returns are actually maximized when a *customer-driven* perspective is adopted, a view that is consistent with the marketing concept.[1] Consumer advocate and former U.S. presidential candidate Ralph Nader has argued for more than thirty years that large corporations must be more responsive to customers' needs.[2] Of course, meeting the needs of customers can be good for business, so a customer orientation need not conflict significantly with a shareholder orientation, especially over the long term.

Conflicts between shareholders and customers can occur in the short run, however. When home prices dropped after the 2008 mortgage crisis hit the United States, many homeowners found themselves "underwater," owing more on their mortgages than their homes were worth. Some had taken out interest-only loans with little or no money down, while others even held negative amortization loans whereby the amount owed on the home actually *increased* over time. Some mortgage analysts had reasoned that these loans were not problematic given recent and consistent hikes in property values, but they did not anticipate what was about to happen. While such loans might be appropriate under a narrow set of circumstances, Branch Banking and Trust (BB&T) chose not to offer any negative amortization loans even if prospective clients decided to take their business elsewhere. Then-CEO John Allison noted that some did, but others took the bank's advice and were in a much stronger financial position when prices dropped as a result.[3]

The Agency Problem

Ideally, top management should attempt to maximize the return to shareholders on their investment while simultaneously satisfying the interests of other stakeholders. However, for as long as absentee owners (i.e., the shareholders) have been hiring professionals to manage their companies, questions have been raised concerning the degree of emphasis these managers actually place on maximizing financial returns vis-à-vis other goals.[4] Of course, managers emphasizing their own goals over those of the shareholders can raise serious ethical questions.

In centuries past, most organizations were small family enterprises. Owners and family members actively managed the firm, sometimes assisted by a small number of outsiders employed as professional managers. Because the owners made most strategic decisions, conflicting goals between managers and owners were not common. This has changed markedly in recent decades, however, as shares of publicly traded firms have become more widely dispersed, making it more difficult for shareholders to exert control over a firm. For this reason, it is not uncommon to see successful small, privately held firms seeking to stay small so the owner can remain personally in charge of the major business decisions.

agency problem A situation in which a firm's top managers (i.e., the "agents" of the firm's owners) do not act in the best interests of the shareholders.

moral hazard When parties in an arrangement do not share equally in the risks and benefits.

adverse selection The inability of shareholders to identify the precise competencies and personal attributes of top managers when they are hired.

The **agency problem** refers to a situation in which a firm's managers—the "agents" of the owners—fail to act in the best interests of the shareholders. The problem emanates from a precarious situation known as **moral hazard**, when the parties in an arrangement do not share equally in the risks and benefits. Moral hazard is prevalent in everyday life. For example, individuals with low health insurance copayments are more likely to visit the doctor for marginal ailments, thereby shifting some of the unnecessary medical costs to others in the pool. This principle can be applied to managers and shareholders as well. Owners risk the capital required to operate an organization, while managers seek other benefits and typically enjoy only a limited benefit from returns.

The agency problem is also complicated by the reality of **adverse selection**, the inability of shareholders to identify the precise competencies and personal attributes of top managers when they are hired. Try as they might, owners can never be certain that professionals appointed to manage the enterprise in their absence have the owners' best interests at heart. This is a key problem at middle and lower management positions—where strategies are put into action—because shareholders are far removed and have little or no influence over individual selection decisions at these levels.

The extent to which the agency problem adversely affects most firms is widely debated, and factors associated with the problem can even vary across nations.[5] Indeed, some argue that management primarily serves its own interests, whereas others contend that managers share the same interests as the shareholders. These two perspectives are briefly discussed in the following sections.

Management Serves Its Own Interests

According to one perspective, top managers tend to pursue strategies that ultimately increase their own salaries and other rewards. In particular, top executives are likely to grow their firms because increases in rewards usually accompany increases in organizational size and their greater responsibilities, even if growth is not the optimal strategy for the firm. This perspective is based on the tendency for management salaries to increase as the organization grows.[6]

Excessive CEO compensation has been widely criticized in recent years.[7] Although what is considered excessive varies among stakeholders, many CEOs have come under fire for their annual compensation. According to a number of surveys, most managers believe that CEOs earn too much. The ten highest-paid CEOs in the United States earned a collective $420 million in 2013, led by Oracle's Larry Ellison. The median direct compensation for CEOs at the 300 largest U.S.-traded public corporations in 2013 was $11.4 million, about two-thirds of which was tied to performance.[8] Of course, what constitutes "too much" and who decides are not simple questions to answer.

Hewlett-Packard's former CEO (and 2016 U.S. presidential candidate) Carly Fiorina was one of the highest-paid chief executives in the world, with a compensation package valued at $80 to $90 million when she joined the company in 2000. However, the element of the package that is most intriguing to some is a grant for the equivalent of 580,000 restricted HP shares over three years, a block of stock worth $66.1 million when Fiorina's tenure began. When HP fired her in 2005, Fiorina received cash, stock, and pension benefits worth about $40 million, prompting protests from union officials and shareholders alike.[9] Four others occupied the CEO post at HP before the firm hired former eBay CEO Meg Whitman in 2011 at a salary of only one dollar, plus a bonus package.[10]

Executive Compensation

CEO pay is an important issue in many firms.

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Limiting CEO pay is not easy, and the justification for doing so is not always sound. Sparked by the "Occupy Wall Street" protests of 2011, some U.S. lawmakers supported legislation to limit CEO pay by indirectly taxing high salaries at a higher rate. A number of academics, mutual-fund trustees, institutional investors, union leaders, and politicians have taken stands on this issue.[11] CEO pay can become a complex issue when a firm is going through a financial crisis and demanding sacrifices from the rank and file. In addition, many firms have discovered difficulties when attempting to reclaim pay from executives even in the case of malfeasance.[12]

CEOs in the United States earn on average far more than their counterparts in other countries do. However, American firms have become more likely than their global counterparts to employ non-Americans as CEOs. Interestingly, a number of studies have demonstrated that CEO salary is more closely tied to company size than to performance. This perspective is troublesome to critics because it associates pay with the breadth of responsibility more than with organizational outcomes.

Some have called for government restrictions on CEO pay. For example, in late 2013, Swiss voters rejected 65 percent to 34 percent an initiative that would have constitutionally limited CEO pay to twelve times that of the lowest-paid individual in a firm. Proponents of the measure argued that no executive should earn more in a month than any other worker earns in a year. Opponents argued that arbitrary limitations are simply noncompetitive. At the time of the vote, the CEOs of the three largest Swiss companies—Roche, Nestlé, and ABB—earned 261, 238, and 225 times the salary of the lowest-paid employee in their respective organizations.[13]

Firms have begun to tie compensation more closely to corporate performance, with a substantial piece of compensation paid only when specific company targets are met. As a result, compensation at large U.S. firms was relatively flat in 2011 after a 10 percent increase in 2010. Although firm revenue and net income rose 10 and 12 percent, respectively, in 2011, Nike CEO Mark Parker's compensation actually declined 5.8 percent to \$12.7 million because three-year targets for revenues and earnings were not met.[14] Hence, most firms appear willing to continue to pay large sums to chief executives, provided that the corporation performs at a comparable level.

There are some exceptions, however, as surveys of CEO compensation practices continue to uncover special arrangements and considerable bonuses. For example, a 2012 *Wall Street Journal* analysis of 300 top U.S. companies identified several notable disconnects. Citigroup's CEO Vikram Pandit earned \$43 million in 2011, while the firm's shareholder returns declined 44 percent during the year and 27 percent over the previous three years. Meanwhile, Family Dollar's CEO Howard Levine earned only $4.6 million in 2011 after the company posted a 27 percent increase in shareholder returns for the year and 31 percent over the three previous years.[15] The compensation dilemma is similar to the case with professional athletes, who often must perform at a high level and prove their value before receiving a lucrative contract. Of course, there is no guarantee that the athlete will perform at the same level or that the team will be successful after the athlete signs a new deal.

Executives pursuing their own interests tend to avoid risks—even calculated ones—because failure can have severe negative career implications. They may also pursue **diversification**, the process of increasing the size of their firms by acquiring other companies that may or may not be related to the firm's core business. Diversification not only increases a firm's size but may also improve its survivability by spreading operational risks among its various business units. However, diversification pursued only to spread risk is generally not in the best interest of shareholders, who always have the option of reducing their financial risks by diversifying their own financial portfolios.[16] This perspective does not necessarily suggest that top management is unconcerned with the firm's profitability or market value, but rather that top managers may emphasize business performance only to the extent that it discourages shareholder revolts and hostile takeovers.

diversification The process of acquiring companies to increase a firm's size.

Ironically, the notion that executives pursue their own interests is also consistent with a firm's strong CSR engagement. Executives concerned with their own *personal* reputations may be willing to allocate considerable *firm* resources to social causes that are not in the best financial interest of the firm. In other words, the heightened executive accountability to shareholders called for by critics would likely result in only the types of social activity closely aligned with specific firm goals, and quite possibly less social engagement overall.

The extent to which this perspective is accurate can create an advantage for relatively small, entrepreneurial organizations whose owners actively manage the firm. For this reason, such firms may be able to compete aggressively and successfully with their larger, more established competitors.

Management and Stockholders Share the Same Interests

Because managers' livelihoods are directly related to the success of the firm, one can argue that managers generally share the same interests as the stockholders. This perspective is supported at least in part by a number of empirical studies. One study, for example, found that firm profit—not size—is the primary determinant of top management rewards.[17] Another points to a significant relationship between common stock earnings and top executives' salaries.[18] Hence, according to these studies, management rewards rise with firm performance, a relationship that encourages managers to be most concerned with company performance.

One of the most common suggestions for aligning the goals of top management and those of shareholders is to award shares of stock or stock options to top management, transforming professional managers into shareholders. Many companies have adopted **employee stock ownership plans (ESOPs)** to distribute shares of the company's stock to managers and other employees over a period of time. Stock option plans and high salaries may bring the interests of top management and stockholders closer together.[19] Top executives seek to protect their salaries and option plans and can do so only by delivering higher business performance. Indeed, research has suggested that as managerial stock ownership rises, the interests of managers and shareholders begin to converge to some extent.[20] This view has gained support from others, but for different reasons.[21] Many suggest that managerial jobs contain structural imperatives that force managers to attempt to enhance profits.[22] In addition, when managers are major shareholders, they may become entrenched and risk averse, adopting conservative strategies that are beneficial to themselves but not necessarily to their shareholders.

employee stock ownership plan (ESOP) A formal program that transfers shares of stock to a company's employees.

In sum, the debate over whether top managers are primarily concerned with their firms' returns or their own interests continues. The competing perspectives can be viewed as anchors on a continuum, with reality for a particular firm contingent on various eco-

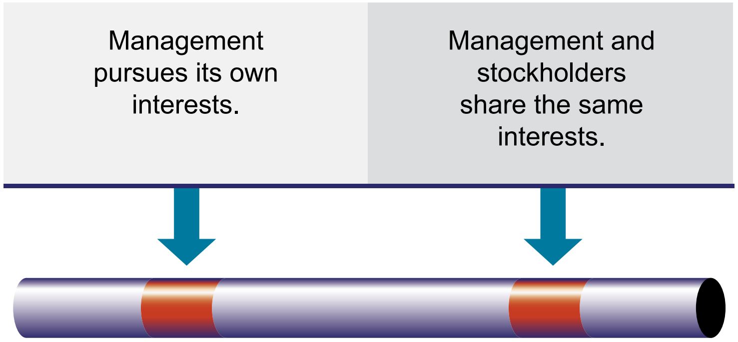

FIGURE 5-1
Agency Perspectives

nomic, industry, and organizational factors (see Figure 5-1). Most scholars and practitioners believe both perspectives have merit, and pursue compensation models designed to bring the two sides together, such as those that emphasize stock options and profit sharing for managers instead of fixed pay levels.

Managerial Ethics

Ethics has become a high-profile topic in boardrooms and family rooms over the past two decades, with charges of impropriety launched at CEOs, prominent legislators and politicians, and even long-time news anchor Dan Rather. **Managerial ethics** refers to an individual's responsibility to make business decisions that are legal, honest, moral, and fair. Ethical problems have plagued a number of top executives in recent years (see Table 5-2).

managerial ethics An individual's responsibility to make business decisions that are legal, honest, moral, and fair.

TABLE 5-2 Select Recent Ethical Problems of Top Executives[23]

Firm	Year	Executive	Problem
Volkswagen	2015	Martin Winterkorn (CEO)	VW installed software in an estimated eleven million vehicles that allowed them to circumvent emissions regulations.
Peanut Corporation of America	2015	Stewart Parnell (CEO)	Sentenced to twenty-eight years in prison after failing to stop the shipment of salmonella-tainted peanuts
Hewlett-Packard	2010	Mark Hurd (CEO)	Resigned amid ethics probe concerning improper use of an expense account
IBM	2009	Robert Moffat (Senior VP)	Resigned after being implicated in an insider trading scheme
BP	2007	John Browne (CEO)	Resigned after admitting to lying to a judge while trying to prevent a British newspaper from exposing details about his personal life
Starwood Hotels & Resorts Worldwide	2007	Steven Heyer (CEO)	Fired after the board of directors received an anonymous letter accusing Heyer of creating a hostile work environment, including inappropriate contact with a female employee
Time Warner Inc.'s Home Box Office	2007	Chris Albrecht (CEO)	Resigned after pleading no contest to battery against his girlfriend
American Red Cross	2007	Mark W. Everson (President and CEO)	Resigned after an affair with a female subordinate
Boeing	2005	Harry Stonecipher (CEO)	Fired for violating the company code of conduct by having an affair with a female executive of the company
Walmart	2005	Thomas Coughlin (Vice Chairman)	Resigned amid allegations that he abused expense accounts and fabricated invoices totaling approximately $500,000

Ethics in Business

The business world is replete with temptations to take shortcuts for short-term gain.
Source: Adisorn Saovadee/ Shutterstock.com.

Here are a few recent examples of ethical problems in major global organizations. Ford overstated the fuel-economy ratings on six of its 2013 and 2014 models, blaming the discrepancies on errors in conducting government-prescribed tests. Mileage for the Ford C-Max hybrid was originally touted at 47 miles per gallon for combined city and highway driving, but the number was adjusted downward to 43 and then again to 40. Mileage for the Lincoln MKZ hybrid was reduced from 45 to 38. Fiesta and Fusion models were also involved. When acknowledging the error, Ford agreed to compensate more than 200,000 consumers between $125 and $1,050 to cover additional fuel cost, depending on the vehicle involved and whether it was purchased or leased.

Proctor & Gamble agreed to pay $850 million in civil penalties and costs when California prosecutors charged that it misled consumers by selling jars of Olay face cream in containers much larger than the content. A 1.7-ounce jar of its high-end Olay Regenerist Luminous sold for $35, but its package was more than twice the size of a box containing a 2-ounce, $10 jar of Olay Active Hydrating cream. P&G agreed to the settlement while arguing that the company never intended to misrepresent the size.[24]

In 2015, Volkswagen revealed that rogue engineers in the company programmed software that allowed 2.8 million vehicles sold since 2008 to outwit emissions tests; the estimated number of affected vehicles quadrupled in a matter of weeks. Michael Horn, head of Volkswagen Group of America, said he was unaware of the cheating until a few days before a September 3, 2015, meeting when VW officials revealed the problem to regulators. A month into the scandal, the company had already set aside over $7 billion to resolve the problem through recalls. The total cost is likely to be much higher and does not include damage to the company's reputation that could affect sales for years to come. VW CEO Martin Winterkorn resigned because of the scandal. As with many ethical breaches, the crisis (see Chapter 12) that ensues can severely damage the firm.[25]

The temptation to engage in unethical activities is often tied to the notion that compromising one's ethics can be good for an individual's—and a firm's—bottom line. Some contend that firms with a strong ethical orientation outperform their rivals, but this issue remains unresolved. Indeed, cutting ethical corners can be viewed as profiting unfairly at the expense of others. Alternatively, a strong ethical stance can enhance a firm's reputation and may help retain existing customers and attract new ones. Researchers at the University of Western Ontario released the results of a study in 2008 that sought to resolve this dilemma. Remi Trudel and June Cotte conducted several experiments and concluded that ethical behavior can be a wise investment for firms, regardless of national origin, as customers tend to be willing to pay a little more for products produced by companies perceived to be more ethical than their competitors.[26] The problem with this type of research is that it tests hypothetical, not actual, buyer behavior. While customers tend to appreciate ethical behavior from firms, exactly how much they are willing to pay for it remains unclear.

There is another problem with the alleged link between unethical activity and individual benefit. In general, ethical shortcuts that generate short-term gains typically result in long-term losses. Consider that customers who purchase a product based on misleading information are likely to consider other alternatives when it is time to buy again. Moreover, business leaders who gain financially because of dubious activity lose respect among their peers over time. While individual scenarios can be elusive, the idea that unethical behavior is somehow in an individual's long-term best interest is difficult to defend.

It is important to remember that managerial ethics pertains to *individual, not corporate, behavior*. Organizations can foster ethical decision-making in a number of ways, ranging from establishing clear ethical guidelines to hiring and promoting employees with demonstrated integrity to reprimanding and firing those who fail to conform. Nonetheless, organizations are not ethical per se; when we refer to "ethical firms," we are really referring to those whose executives have taken clear and genuine steps to encourage and uphold ethical principles. While this does not guarantee that all employees in such firms behave in an ethical manner, executives with ethical problems often find their way to companies that lack appropriate core values and standards. When multiple executives within a single organization shun clear ethical principles, corporate scandal or even demise can follow (see Strategy at Work 5-1).

What is morally right or wrong can be a topic of debate, especially when firms operate across borders, where ethical standards can vary considerably. In the United States, bribes to government officials to secure favorable treatment would be considered unethical. In a number of other countries—especially those with developing economies—small "cash tips" are an accepted means of transacting business and may even be considered an integral part of an underpaid government official's compensation. This issue became prominent in early 2012 when it was revealed that Walmart executives in Mexico had been involved in bribes in exchange for site approvals, although results of an investigation released in 2015 provided little evidence that corporate executives were aware of the activity. **Ethical relativism** is the idea that ethics is based on accepted norms in a culture. In this example, most ethical relativists would argue that bribery is acceptable business practice—at least to some extent—in countries like Mexico where it is the culturally accepted means of getting things done.

ethical relativism
A perspective on ethics whereby right and wrong are based on accepted norms in a culture.

Strict opponents of ethical relativism argue that actions are either ethical or unethical without consideration to cultural acceptance. They argue that bribery might be an accepted practice in some parts of the world, but not necessarily for the right reasons. Following this logic, ethical relativism results in a society where the ethical nature of all decisions is negotiable and clear standards of right and wrong cannot be established.

Although the debate between these two sides is legitimate, most decision-makers balance these contrasting views in practice. Many managers who embrace ethical relativism, for example, would acknowledge that certain actions in organizations—such as stealing from a coworker or defrauding a customer—are simply unethical in any culture. Likewise, most managers who eschew ethical relativism would acknowledge that other actions—such as giving a small gift of appreciation to a major customer—are more complex and might be ethical in some cultures but not in others.

Ethical concerns are most prominent at the top of the organization, where individual character is a desired attribute. Selecting a CEO can be a perilous task, especially when a leader departs abruptly. While evaluating professional qualifications is still important, personal characteristics are gaining prominence. Consider that Hewlett-Packard's CEO Mark Hurd was dismissed in 2010 following an ethics probe concerning improper use of an expense account. Events such as these have prompted directors to search for personal behavior that might disqualify them as leaders, including sexual harassment, drinking problems, or failing to file income taxes properly.[27]

Even the acquisition of competitive intelligence can also create ethical concerns. Few would argue that obtaining competitive information from one's own customers or purchasing and "breaking down" a competitor's products would be unethical. However, some companies have been known to extensively interview managers with key competitors for executive positions that do not exist.

"Channel checks" constitute generally acceptable retail intelligence and include such practices as counting cars in parking lots, quizzing suppliers, and chatting with customers. The practice can go much further, however. Discount retailer Big Lots sued Research Intelligence Group (RIG) in 2010, alleging that the firm stole trade secrets, and aided and abetted

Strategy at Work 5-1

Ethical Concerns and the Corporate Scandals of 2001 and 2002[28]

Major corporate scandals occur every now and then, but the period from mid-2001 to mid-2002 witnessed an unprecedented number of ethical misdoings that jolted American confidence in corporate America. In August 2002, *Forbes* published "The Corporate Scandal Sheet" in an effort to keep track of the dearth of ethical violations and allegations rampant at that time. The *Wall Street Journal* also followed in January 2003 with an extensive chronicle of events for 2002. In late 2001, Enron, once one of the world's largest electricity and natural gas traders, admitted overstating its earnings between 1997 and 2001 and filed for Chapter 11 bankruptcy protection shortly thereafter. In another case, the astute craft and décor authority Martha Stewart sold a large number of her ImClone Systems shares one day before the company released damaging news about an experimental cancer drug, raising the specter of insider information, and resulting in a conviction.

Although the deluge of news surrounding such scandals began to slowly subside in late 2002, public fervor concerning a perceived lack of corporate accountability and widespread corporate legerdemain has not. This fervor has been sparked further by press reports of executive prosecutions associated with these scandals several years later. U.S. governmental agencies have responded with new regulations designed to foster a more complete disclosure of corporate financial doings and make it more difficult for executives to mislead investors about the performance of their firms. The Sarbanes-Oxley Act of 2002 (discussed in Chapter 1) created more detailed reporting requirements for boards and executives in public U.S. companies and accounting firms.

The effects of these and other scandals have fueled fervor among anticorporate activists as well, including those who spawned the "Occupy Wall Street" movement in 2011. "Occupiers" often pit the "top 1 percent" of wage earners against the other 99, blaming corporate greed for a host of economic and social maladies affecting the United States and other developed nations.

employees' break of fiduciary duty by illegally inducing its store managers to divulge proprietary information. Some might argue that the research firm was doing exactly what it was paid to do, but Big Lots argued that the company crossed both legal and ethical boundaries. The suit was dropped the following year after RIG agreed not to use information it obtained from Big Lots employees and not to survey its employees in the future.[29]

Ethical problems are not limited to internal affairs. Many firms must battle ethical problems outside of their organizations. Consider the computer software industry. Sales of personal computers in China and the United States were almost identical in 2010, but Microsoft's revenue from China was only about 5 percent of that in the United States. "Pirated" copies of Office and Windows are available on the street in China for $2 or $3 each, only a fraction of the retail price. Five years later, this problem remains pervasive. Selling unauthorized copies of software is illegal in China, but enforcement of intellectual property rights is weak.[30]

Ethical decisions are not always resolved easily and can even be observed differently at different times. In 1991, for example, the U.S. Food and Drug Administration (FDA) banned silicone breast implants in most instances, a decision that fueled the demise of many of their original marketers who lost billions of dollars in lawsuits alleging product flaws, breast cancer, and other serious health concerns. Dow Corning lost $3.2 billion in settlements and remained in bankruptcy protection from 1995 to 2004. Since that time, however, several major studies found no link between silicone implants and major diseases. In 2006, the FDA re-approved the sale of silicone implants. Hence, what was originally termed as "unethical" behavior by Dow Corning is once again being touted as an acceptable product.[31]

Addressing ethical problems is confounded by the elusive nature of the truth. Indeed, investigating allegations of wrongdoing is not always easy. Whistleblowers have been instrumental in uncovering a number of problems. In 2010, pharmaceutical firm GlaxoSmithKline agreed to pay $750 million and plead guilty to a criminal charge to settle a U.S. government probe into manufacturing deficiencies at a former plant in Puerto Rico. The investigation was initiated after a former employee filed a lawsuit. Under a federal whistleblower law, the whistleblower was awarded $96 million.[32]

Perspectives on Ethics

Calls for ethical management practice are common, but what constitutes ethical behavior can be viewed in a number of ways. The following six perspectives on ethical decision-making are not always mutually exclusive, however, and most managers employ a combination of ethical perspectives when making decisions.

The **utilitarian view of ethics** suggests that anticipated outcomes and consequences—the decision's utility—should be the only considerations when evaluating an ethical dilemma. The primary shortcoming associated with this approach, however, is that a decision may have multiple consequences, some of which may be positive, others negative, and still others undetermined. For example, a decision to lay off 10 percent of an organization's workforce will harm those who lose their jobs but may help shareholders by increasing the projected returns on their investments. The long-term effect of the layoff could be positive if the organization emerges as a more competitive entity or negative if employee morale suffers and productivity declines. Hence, the utilitarian view is not always easy to apply, although it is commonly employed in organizational decisions.[33]

utilitarian view of ethics Perspective suggesting that anticipated outcomes and consequences should be the only considerations when evaluating an ethical dilemma.

The **self-interest view of ethics** suggests that benefits of the decision-maker(s) should be the primary considerations. This view assumes that society will likely benefit when its individual members make decisions that are in their own best interests. Firms that attempt to maximize their returns within the legal regulations of society behave ethically and also promote positive outcomes for society over the long term, including employment, desired products, and tax revenues.

self-interest view of ethics Perspective suggesting that the benefits of the decision maker should be the primary consideration when weighing a decision.

As discussed earlier, self-interest can be viewed from a narrow, short-run perspective or from a broader, long-term perspective. One who always promotes his or her *short-term* interests at the expense of others will likely suffer greater loss in the *long term*. For example, firms whose managers construct loopholes in their product or service warranties to promote short-term profits can ultimately alienate their customers. While critics highlight the short-run/long-run dilemma, proponents of this view emphasize the benefits of the individual pursuit of long-term self-interests.

The self-interest perspective is largely consistent with **objectivism**, a philosophical perspective espoused by Ayn Rand in her famous novel *Atlas Shrugged*. Objectivism emphasizes an objective reality understood by logic and reason, and focuses on individual freedom and property rights. Capitalism is the economic system that follows because it respects the rights of individuals to pursue their own self-interests by trading freely with others. Rand emphasized that personal fulfillment can only be derived from an informed, long-term perspective on self-interests.

objectivism A philosophical perspective, espoused by Ayn Rand, that emphasizes an objective reality understood by logic and reason, and focuses on individual freedom and property rights.

The **rights view of ethics** evaluates organizational decisions to the extent to which they protect basic individual rights, such as a customer's right to privacy and an employee's right to a safe work environment. Although protecting individual rights is always desirable, doing so can occur at the expense of group progress or productivity. Organizations requiring drug tests choose not to grant employees a particular privacy right in the interest of firm safety and productivity.

rights view of ethics Perspective that evaluates organizational decisions on the extent to which they protect individual rights.

The **justice view of ethics** suggests that all decisions will be made in accordance with pre-established rules or guidelines. For example, employee salaries may be administered by developing a formula that computes salary based on level of experience, amount of training, years of experience, and previous job evaluations. The key shortcoming associated with the justice view is that it requires decision-makers to develop rules and procedures for every possible anticipated outcome, an arduous task indeed.

justice view of ethics Perspective suggesting that all decisions will be made in accordance with pre-established rules or guidelines.

The **integrative social contracts view of ethics** suggests that decisions should be based on existing norms of behavior, including cultural, community, or industry factors. This perspective can create confusion, however, when norms are not well understood or when an organization operates in multiple environments with different expectations. Consider the common use of bribes in many developing nations discussed earlier in this chapter. Following the integrative social contracts view, bribes would be acceptable in some nations but not others, depending on local practices and expectations. Although this

integrative social contracts view of ethics Perspective suggesting that decisions should be based on existing norms of behavior, including cultural, community, or industry factors.

perspective emphasizes the situational influences on a particular decision, it deemphasizes the need for clear standards of right and wrong devoid of the situation.[34]

religious view of ethics Perspective that evaluates organizational decisions based on personal or religious convictions.

The **religious view of ethics** is based on personal or religious convictions. In the United States, the Judeo-Christian heritage has formed a distinct notion of ethics, whereas Islam, Hinduism, and other religions comprise the majority viewpoint in many other nations. From the Christian perspective, for example, individuals should behave in ways that benefit others, treating other people as they would wish to be treated.[35] In one respect, the religious perspective counters the integrative social contracts view because it emphasizes clear principles of right or wrong with limited regard to situational variables. Needless to say, however, the religious view would result in markedly different ethical perspectives across cultures with different prominent religious traditions.

These six competing ethical perspectives underscore the ethical complexity inherent in certain decisions. Consider two prominent examples. In 2000, Philip Morris introduced the Merit brand of cigarettes, designed to reduce the risk of fire when left unattended. The manufacturer claimed that the ultra-thin paper used to wrap the tobacco burned more slowly and would cause fewer fires. Shortly after introduction, however, a company scientist reported that the cigarettes actually increased the risk of fire. Philip Morris fired the scientist in 2002 and continued to market the cigarette, although the fire-reduction claim was avoided. The U.S. Department of Justice launched a lawsuit against Philip Morris in 2004, alleging that the action was part of a broader attempt to conceal the negative effects of cigarette smoke from the public.[36] In response, most states later passed laws requiring that all cigarettes be self-extinguishing.

In the 2000s, the Recording Industry Association of America launched several hundred lawsuits at teenagers and college students in an effort to emphasize the notion that swapping copyrighted music files via the Internet is against the law. Critics charged that "suing kids" was both bad business and unethical, while industry executives argued that the law was clear and that widespread violations were taking a serious toll on its member firms.[37]

Some firms and individuals indiscriminately use bulk e-mails to "spam" the public by e-mailing unwanted direct response advertisements of pornography sites, mortgage and investment services, and the like. Studies suggest that spam costs U.S. corporations billions of dollars each year, due to loss of worker productivity, consumption of bandwidth and other technological resources, and the use of technical support time. Although this practice is largely illegal and is deplored by most industry groups and Internet users, enforcement is a complicated legal endeavor.[38] Strategic managers are challenged to know where to "draw the line" concerning such practices.

Why do some organizations portray a pattern of unethical business practices? Anand and Ashforth identified six commonly used rationalization tactics to explain this behavior.[39] First, individuals *deny responsibility*, rationalizing that they have no other choice but to participate in unethical behavior. One employee may contend that the practice is directly associated with another's responsibility.

Second, individuals *deny injury*, suggesting that the unethical behavior did not really hurt anyone. This perspective defines behavior only as unethical if directly injured parties can be clearly identified and then hesitate to acknowledge the injury.

Third, individuals *deny rights of the victims*, rationalizing "they got what they deserved anyway." This perspective rationalizes unethical behavior when competitors or other related parties are alleged to be involved at least at the same level of corruption.

Fourth, individuals engage in *social weighting* by making carefully controlled comparisons. One way this is done is by character assassination of those suggesting that a particular pattern of behavior is unethical. If those condemning us are corrupt—the argument goes—then how can credence be given to their claims? Another way this is done is by selectively comparing the unethical action to others whose actions are purported to be even more unethical. For example, falsifying an expense account for meals not eaten on a business trip is not considered a major offense when compared to someone who falsifies expenses for an entire business trip that never occurred.

Fifth, individuals can *appeal to higher values* by suggesting that justification of the unethical behavior is due to a higher-order value. In this sense, one might argue that it is necessary to accept some degree of lower-level unethical behavior in pursuit of ethical responsibility at a higher level. For example, a sales rep who is brought in to help resolve a dispute between a customer and another sales rep may deny the legitimate claims of the customer, rationalizing that loyalty among sales representatives is a higher-order value.

Finally, individuals may invoke the *metaphor of the ledger*, arguing that they have the right to engage in certain unethical practices because of other good things they have done. For example, a manager on a business trip may justify padding a travel expense account because she has already done "more than her share" of traveling in recent months.

Improving the ethical stance of an organization is not easy, however. Treviño and Brown identified five commonly held myths concerning ethics in organizations (see Table 5-3).[40] In concert, they argue that ethical decision-making is a complex process that extends beyond removing the "bad apples" from the organization and establishing formal ethics codes. It begins with proactive behavior on the part of top executives that infuses ethics into the fabric of the organization.

Social Responsibility

Managerial ethics concerns *individual* decisions that affect an organization. **Social responsibility** refers to the expectation and obligation that business *firms* should serve both society and the financial interests of the shareholders. Although ethics and corporate social responsibility (CSR) are often related, they represent distinct concepts. Whereas managers and nonmanagers are always expected to behave ethically, the extent to which social responsibility is relevant in strategic decision-making is another issue altogether, and is widely debated.

social responsibility The expectation that business firms should serve both society and the financial interests of shareholders.

The notion of social responsibility infers an obligation for the business firm to serve its myriad stakeholders in ways beyond the normal course of business activity. Today, many consumers also expect firms to preserve the environment, support community development efforts, and even provide employee benefits such as health insurance aimed at improving the society as a whole.[41] Some are even expected to provide training to unemployed workers, contribute to education and the arts, and help revitalize urban areas.

Social responsibility is addressed in various ways and to varying extents at different firms. Avon's sales representatives promote breast cancer awareness by selling pink-ribbon items. McDonald's provides support for seriously ill children through the Ronald McDonald House. ConAgra provides refrigerated trucks to assist America's Second Harvest program. Countless other firms are engaged in continuous product redesign to improve efficiency, reduce scrap, and minimize packaging. Many consumers accept the broad notion that firms have some kind of social responsibility. Generally speaking, they argue that firms—particularly large ones—are indebted to consumers and communities

TABLE 5-3 Myths and Realities of Organizational Ethics[42]

Myth	Reality
1. Ethical decision making is easy.	Ethical decision making is a complex process.
2. Unethical behavior can be traced to a limited number of "bad apples" in an organization.	Unethical behavior can be a systemic part of the organization's culture.
3. Ethics can be managed by developing formal ethics codes and programs.	Formal codes and programs are helpful, but ethical expectations must be part of the culture and fabric of the organization.
4. Ethical leadership is really about leader morality and honesty.	Leader morality and honesty is a good start, but the leader must also infuse ethics into the organization and hold others accountable.
5. Business leaders are less ethical today than they used to be.	Ethical concerns in organizations have always been a pervasive issue.

for their financial success and should be willing to "give back" in the interest of fairness and goodwill. Moreover, firms have both the influence and resources necessary to advance social progress through appropriate advertising, product development, and community involvement. Advocates of the social responsibility perspective often refer to the **triple bottom line**, the notion that firms must maintain and improve social and ecological performance in addition to economic performance. The heightened emphasis on environmentalism and "green" initiatives among consumers—most notably in the United States and other developed nations—is part of this perspective. As such, responsible firms should seek to preserve precious natural resources and not pollute the environment.

triple bottom line The notion that firms must maintain and improve social and ecological performance in addition to economic performance.

However, many economists, including such notables as Adam Smith, Ludwig von Mises, Friedrich Hayek, and Milton Friedman, have argued that social responsibility should not be part of management's decision-making process. Put another way, a firm's strategic managers should behave ethically and should be focused on the needs of its shareholders, while considering the needs of other stakeholders as they support those of the owners. Business functions best when managers concentrate on maximizing returns by producing goods and services within society's legal restrictions. When executives lend financial support to CSR activities, they are placed in the position of determining what is really good for society. Moreover, they are spending shareholder funds in a manner that is not necessarily designed to enhance returns. As such, corporations should be concerned only with the legal pursuit of profit, while shareholders are free to pursue other worthy goals as they individually see fit. The firm becomes less competitive when resources are expended in unrelated areas, which can ultimately lead to higher prices, lower tax contributions, and fewer employment opportunities.

While CSR proponents and critics share an interest in effective resource management and reduced pollution, their differences are often nuanced. CSR advocates argue that because a strict profit motive encourages resource depletion, a substantial government role in regulating firm behavior is necessary. Opponents note that government regulations are often overbearing and costly, and can engender negative unintended consequences. Moreover, supply and demand forces in the markets for natural resources like oil and copper tend to encourage their preservation without excessive government intervention.

Aneel Karnani presented a succinct argument against corporate social responsibility in the *Wall Street Journal*: *http://online.wsj.com/article/SB10001424052748703338004575230112664504890.html.*

CSR opponents challenge the obligatory nature of the concept, the notion that society has claims on property owned by individuals or firms. The idea that successful firms should "give back" to society infers that society gave something to firms in the first place. By definition, successful firms already contribute to society by virtue of their existence, as they only succeed when they produce goods or services that consumers purchase voluntarily. Along the way, they provide employment and contribute to social programs through taxation. From this perspective, the relationship between business firms and society is already mutually beneficial *before* the idea of CSR is considered.

Personal property rights and individual choice are central to the CSR debate. For example, CSR advocates argue that fast-food restaurants have a social responsibility to promote healthier food in addition to the hamburgers, French fries, and milkshakes that have contributed to their success over the years. Some have called for restrictions on the types of food that can be sold, the ways in which it can be advertised, and the locations of the restaurants. Others have even halted the construction of new fast-food restaurants in certain regions. McDonald's has been a key target, as discussed later in this chapter.[43]

CSR opponents reject such claims. They argue that restaurants have the fundamental right to market products that consumers demand. While advocacy groups have every right to encourage consumers to *voluntarily* dine elsewhere, they lack the moral authority to *require* that consumers not engage in a certain activity that does not affect others in a significant and negative way. Such restrictions not only prevent private organizations from investing capital as they see fit, but they also prevent consumers from exercising their liberties in the free market. Informed consumers—not governments, advocacy groups, restaurants, or even physicians—are in the best position to determine what products to buy.

Debates over liberty and property rights can also be seen in less controversial social activity. When a community seeks to build a new park, its leaders often look to major

Corporate Social Responsibility

CSR is the hot-button issue of our time.

Source: Ribah/Shutterstock.com.

employers for financial contributions to the project. Although few individuals would debate the merits of a new park, CSR proponents question the inference that private firms are *obligated* to support such an initiative. Moreover, one could argue that the purported benefits of the park do not justify the expense if individuals and prospective beneficiaries are not willing to finance the entire project on their own.

CSR in Practical Terms

Arguments against CSR may be compelling, but all executives—regardless of their personal views—should consider social issues and expectations for practical reasons. Doing so does not satisfy the definition of CSR in a strict sense because social engagement is done in the interest of shareholders rather than from of a sense of *obligation* to society. Of course, identifying the motivation for social engagement is difficult anyway. For example, Danish toy maker Lego A/S/ used 77,000 metric tons of petroleum in 2014 to manufacture 60 million plastic Lego pieces. In 2015, the company launched a fifteen-year research effort to develop a plant-based alternative to plastic that generates the same quality.[44] It is impossible to determine the motive for such action—minimizing the use of plastics, creating a positive image among consumers, or some combination of the two.

CSR aside, there are two reasons why addressing social concerns can be beneficial to shareholders. First, ignoring social considerations can increase the likelihood of more costly government regulation. Historically, regulations over business operations were enacted in part because some firms refused to act responsibly. Had some organizations not damaged the environment, sold unsafe products, or engaged in discrimination or misleading advertising, legislation in these areas would not have been deemed necessary. Government regulation is always possible when firms appear to act in ways contradictory to the presumed interests of society. For example, Puma's shift from cardboard shoeboxes to recyclable bags in 2010 could be viewed as a positive sustainability effort, but was also widely seen as an attempt to stave off government regulation in the European Union.[45]

Second, stakeholders affected by a firm's social responsibility stance—most notably customers—are also those who must choose whether to transact business with the firm. Many consumers have become more interested in learning about a company's social and philanthropic activities before making purchase decisions. Those who value CSR and believe a firm is not socially responsible may take their business elsewhere. Hence, many executives—especially those in large firms—have concluded that their organizations must at the minimum *appear* to be socially responsible or face the wrath of angry consumers. As such, they are greatly concerned not only about the actual behavior of the firm, but also about how it is perceived.

Many consumers want the firms that produce the products and services they buy not only to support public initiatives, but also to uphold the same values in terms of the day-to-day decisions of running the company (see Strategy at Work 5-2).[46] Nonetheless, the additional amount—if any—consumers are willing to pay for products or services produced by socially active firms is debatable.

Strategy at Work 5-2

Good Neighbor or Good Business?[47]

After creating considerable destruction in the Caribbean, Hurricane Ivan hammered the Gulf Coast of the United States in September 2004. Because meteorologists had forecast the magnitude of the storm several days prior, many Americans soon to be affected turned to rivals Lowe's and Home Depot for power generators, plywood to board up their homes, and other supplies. Both stepped into high gear to meet consumer needs.

Neither chain raised prices amidst the storm preparation, and most stores made valiant attempts to remain open as long as possible. In one respect, Home Depot and Lowe's went the extra mile to assist customers in a crisis. In reality, however, remaining open extra hours was simply good business and helped minimize local inventories that could be damaged if the stores were devastated by the storm

Indeed, the two rivals were well aware of possible long-term effects that could stem from their ability to help customers prepare for the storm. As Home Depot's Eastern division president Tom Taylor put it, "They'll remember who got them stuff. They'll remember who stayed open. The better job we can do during a hurricane, [the more] we can gain market share [after the storm]."

Could the Lowe's and Home Depot actions be described as good neighbor or good business? The answer is probably both.

Addressing the overlap between the firm and society is not always simple. The recent increase in rail shipments in the United States, coupled with regulations requiring trains to honk at most street-level crossings, has created a backlash from many who see railroads as a noisy nuisance or even a safety hazard. Trains have historical right-of-way and are often more than a mile long. When they slow down amid safety concerns, they can block traffic for longer periods of time.[48]

Because profits are necessary for survival and growth over the long term, a firm seeking to be socially responsible must be able to generate both profits and societal benefits. However, exactly what is good for society is not always clear.[49] For example, society's demands for high employment and the production of desired goods and services must be balanced against the pollution and industrial wastes that may be generated by manufacturing operations. The decisions made to balance these concerns, however, can be quite difficult to make.

When consumers demand greater social responsibility from firms, they typically challenge industry leaders. For example, in 2010, the nonprofit Physicians Committee for Responsible Medicine launched an advertisement linking McDonald's hamburgers to heart disease. In the ad, a woman weeps over a dead man lying in a morgue. The man is holding a hamburger. At the end, the golden arches appear followed by the words "I was lovin' it," a play on McDonald's advertising theme at that time. A voiceover closes the ad stating, "High cholesterol, high blood pressure, heart attacks. Tonight, make it vegetarian."[50]

In 2011, more than 550 health professionals and organizations signed a letter to McDonald's requesting that the firm stop marketing "junk food" to kids and retire Ronald McDonald. The letter, published in six major U.S. newspapers on May 18, 2011, also sought to get McDonald's to produce a report assessing its "health footprint." The campaign was organized by Corporate Accountability International, a nonprofit group that has also targeted PepsiCo and Coca-Cola concerning the environmental impact of plastic bottles.[51]

Corporate Accountability International succeeded at filing a resolution to require McDonald's to produce the report, but only 6 percent of shareholders at the firm's shareholder meeting the following day voted in favor of it. CEO Jim Skinner defended the clown, saying, "Ronald McDonald is going nowhere."[52] But later in the year—amid pressure from regulators and other government entities—McDonald's agreed to change its Happy Meal by replacing 2.4 ounces of French fries with a quarter-cup of apples (without the caramel dipping sauce) and 1.1 ounces of fries. Although the change reduced the calories and fat content from 520 and 23 grams to 410 and 17 grams, respectively, it did not quell opposition. A spokesperson for the Center for Science in the Public Interest—an advocacy group—referred to the move as a step in the right direction, adding, "McDonald's clearly has a lot more to do, for both kids and adults."[53]

CSR and Profitability

Firms must generate profit in a socially complex world.

Source: Ase/Shutterstock.com.

Negative publicity was also generated when two Girl Scouts initiated a campaign to eliminate palm oil from the Trefoil variety of Girl Scout cookies. Rhiannon Tomtishen and Madison Vorva objected to the use of the oil because its harvest disrupts the habitat of orangutans. The organization's bakers shifted from partially hydrogenated vegetable oil to palm oil to eliminate trans fat, but argue that there is no other good alternative to palm oil that would ensure high quality, including taste, texture, and shelf life. Activist groups such as the Rainforest Action Network, the Center for Biological Diversity, and the Union of Concerned Scientists have joined the effort against the Girls Scouts. The organization sells about 200 million boxes of cookies each year.[54]

General Mills is also endeavoring to make its cereals healthier. In addition to emphasizing whole grains, the cereal giant began reducing the amount of sugar in many of its cereals, particularly those consumed primarily by children. By 2011, the sugar content in Apple Cinnamon Cheerios had been reduced from thirteen grams per serving to ten; the sugar content in Lucky Charms had been reduced from twelve grams to ten. But General Mills must address both health and taste concerns to retain customers. Producing a tasty cereal that floats for three minutes is important to compete in the children's segment. Balancing these factors with more whole grains and fiber has been a challenge. John Mendesh—a company vice president—is sensitive to the need for a balance, but notes, "Every ingredient…is there for multiple reasons. If we just took the sugar out, you wouldn't want to eat the product left behind."[55]

Social responsibility is an especially prominent issue in certain industries. Pharmaceutical manufacturers, for example, spend billions to develop drugs for treating a wide range of ailments. The costs of the drugs, however, can determine the extent to which patients will benefit from them. In the United Kingdom, government officials called on physicians to stop prescribing various drugs for Alzheimer's disease, acknowledging their benefits but arguing that they do not justify the cost.[56] The same realities can be true for medical procedures, especially in emerging economies. The pay-as-you-go system for medical treatment in China ultimately can deny costly life-saving treatment for the majority of its citizens who lack health insurance.[57]

The notion of social responsibility is also renowned among producers of alcoholic beverages. Consider three cases during the past decade. In early 2007, for example, Anheuser-Busch launched Spykes, a caffeine-infused drink containing 12 percent alcohol by volume and sold in two-ounce bottles. Advocacy groups pressured the company, charging that the brewer was subtly marketing the product to underage drinkers. Anheuser-Busch denied the claims, but halted production only four months later. Officials cited both disappointing sales and "unfounded criticism" as reasons for pulling the product.[58]

In 2009, Anheuser-Busch InBev launched a marketing campaign featuring Bud Light cans decorated with college-team colors. Janet Evans, a senior attorney at the U.S. Federal Trade Commission (FTC), expressed a "grave concern" and argued that the firm was promoting underage and binge drinking. A number of colleges and universities also complained. Although the brewer argued that the promotion targeted only customers of legal drinking age and did not include any institutional logos, it stopped distributing the cans in communities where colleges filed formal complaints. This incident raises questions about both social responsibility and the role of the FTC in such disputes.[59]

In 2012, the Oglala Sioux tribe sued Anheuser-Busch InBev for selling large quantities of alcohol in a Nebraska town adjacent to the Pine Ridge Indian Reservation in South Dakota, knowing that most of the alcohol would be consumed in an illicit manner or by individuals with serious drinking problems. Alcohol is illegal on the reservation, but one in four children born there suffers from fetal alcohol syndrome. The case was later dismissed, but the tribe's suit raises interesting questions.[60]

Society's expectations of an organization typically increase as the firm grows. For example, various constituencies have charged Walmart with socially irresponsible behavior in recent years. Critics allege that the mega-retailer often competes unfairly, does not always follow fair hiring and promotion practices, and even contributes to local economic problems by abandoning strip mall locations when larger stores are constructed. For example, following considerable pressure from select interest groups, Walmart stopped selling hunting rifles and bullets at most of its stores in 2006. In 2011, following a backlash from hunters and pro–Second Amendment groups, the retailer brought guns and ammunition back to many of those stores. Company spokesperson David Tovar referred to the move as a business decision designed to bring struggling stores back in line with local customer needs and expectations.[61] Numerous smaller retailers also sell firearms and ammunition, but opposition groups usually target large, more visible companies like Walmart.

Sustainable Strategic Management

sustainable strategic management (SSM)
The strategies and related processes that promote superior performance from both market and environmental perspectives.

A broader notion of social responsibility, **sustainable strategic management (SSM)**, has received increased attention in recent years. SSM refers to the strategies and related processes that promote superior performance from *both* market and environmental perspectives. Hence, an ideal strategy should seek market sustainability by meeting buyer demands profitably and environmental sustainability by proactively managing finite resources. Organizations able to meet this challenge are more likely to perform well and benefit society over the long term.

The notion of SSM is consistent with the work of organizations like Conscious Capitalism. Founded by Whole Foods CEO John Mackey and author Michael Strong, Conscious Capitalism is dedicated to defending both free enterprise and sustainability. The nonprofit organization sponsors conferences and workshops for business leaders and academics, countering the notion that sustainable practices are inconsistent with capitalism.

The soft-drink industry provides an interesting example of sustainability challenges. PepsiCo teamed up with Waste Management in 2010 to install 3,000 kiosks throughout the United States, with a goal of recycling at least 400 million bottles and cans. Customers swipe a key fob, scan the barcodes on their used plastic and aluminum bottles, and insert them into the proper chute. Customers can receive reward points good for movie tickets or other products. By engaging in the "Dream Machine" project, PepsiCo enhances its environmental image, eliminates a large number of bottles and cans from landfills, and recaptures plastic and aluminum for future production.[62]

Recycling efforts in the soft-drink industry have had mixed results, however. In 2009, Coca-Cola opened a $60 million, 120,000-square-foot modern recycling facility in Spartanburg, South Carolina, with a goal of 100 million pounds of plastic recycled from polyethylene terephthalate (PET). By 2011, the plant was operating at only about one-third capacity. Coke and Pepsi bottles contain only about 5 and 10 percent PET content.

PET demand is high in China, where it is transformed into fiber for use in furniture and textiles. According to Coke officials, transporting PET to China on otherwise empty barges can be less costly than shipping the material across the United States. Efforts to recycle aluminum have been more successful, however, with 68 percent reused content industry-wide.[63]

Efforts aimed at environmental sustainability can conflict with product performance. PepsiCo's Frito-Lay introduced biodegradable packaging for its Sun Chips in early 2010, but returned to its old packaging for five of the six flavors by the end of the year after customers complained that the new bags were too noisy.[64]

Takeovers

When shareholders conclude that the top managers of a firm with ineffective board members are mismanaging the firm, institutional investors, blockholders, and other shareholders may sell their shares, depressing the market price of the company's stock.[65] Depressed prices often lead to a **takeover**, a purchase of a controlling quantity of a firm's shares by an individual, a group of investors, or another organization. Takeovers may be attempted by outsiders or insiders, and may be friendly or unfriendly. A friendly takeover is one in which both the buyer and seller desire the transaction. Government regulators can often veto friendly takeovers for competitive or other concerns, however. In early 2009, Coca-Cola attempted to acquire China Huiyuan Juice Group as part of the firm's aggressive global growth strategy. The Chinese Commerce Ministry blocked the acquisition, arguing that such a move would crowd out smaller producers and ultimately result in price increases for consumers.[66]

takeover The purchase of a controlling quantity of shares in a firm by an individual, a group of investors, or another organization. Takeovers may be friendly or unfriendly.

An unfriendly takeover is one in which the target firm resists the sale, whereby one or more individuals purchase enough shares in the target firm to either force a change in top management or to manage the firm themselves. Interestingly, groups that seek to initiate unfriendly takeovers often include current or former firm executives. Individuals need not obtain controlling shares of a company to wield substantial influence. Activist investor Keith Meister, founder of hedge fund Corvex Management LP, a group with a 3.5 percent ownership stake in Yum Brands in 2015, was able to obtain an appointment to the board of directors and instigate the spin-off of the company's Chinese KFC and Pizza Hut operations into a separate, publicly traded franchisee of Yum Brands.[67] Billionaire Oprah Winfrey purchased 10 percent of and obtained a board seat at Weight Watchers International in 2015. Following a 44 percent decline in the first ten months of the year, the stock price more than doubled in one day following the news of Winfrey's investment.[68]

The debate over the ethical and social implications of corporate takeovers resurfaced during the U.S. presidential primary in early 2012. Candidate Mitt Romney previously served as CEO of Bain Capital, a venture capital firm that invested in and sought to turn around struggling companies. Although Bain's successes include a number of well-known firms like Staples and Domino's Pizza, turnarounds at some companies resulted in job losses or even liquidation. Critics and some political opponents questioned Romney's involvement with Bain, labeling its activity as "vulture" capitalism. However, Bain Capital—like other venture capital firms—invests in a number of enterprises already on the brink of collapse. The restructuring attempts are usually painful but often necessary for a reasonable chance at survival in a highly competitive marketplace.[69]

In many cases, sudden takeover attempts rely heavily on borrowed funds to finance the acquisition, a process referred to as a **leveraged buyout (LBO)**. LBOs strap the company with heavy debt and often lead to a partial divestment of some of the firm's subsidiaries or product divisions to lighten the burden.[70]

leveraged buyout (LBO) A takeover in which the acquiring party borrows funds to purchase a firm.

Corporate takeovers have been defended and criticized on economic and social grounds. On the positive side, takeovers provide a system of checks and balances often required to initiate changes in ineffective management. Proponents argue that the threat of LBOs can pressure managers to operate their firms more efficiently.[71] However, the need to pay back large loans can cause management to pursue activities that are expedient in the short run but not best for the firm in the long run. In addition, the extra debt required to finance an LBO tends to increase the likelihood of bankruptcy for a troubled firm.[72]

Outsourcing and Offshoring

outsourcing Contracting out a firm's noncore, nonrevenue-producing activities to other organizations primarily to reduce costs.

Outsourcing—contracting out a firm's noncore, nonrevenue-producing activities to other organizations primarily (but not always) to reduce costs—has become more widespread in the United States in recent years. Many consumers and activists have become increasingly concerned about trade deficits with other nations and job losses that occur when a firm moves a production facility abroad or a retailer stocks its shelves with imported products.[73] A number of American firms have closed production facilities in the United States and opened new ones in Mexico, China, India, and other countries where labor costs are substantially lower and regulations are less inhibitive.[74]

The facts are compelling. The U.S. trade deficit was $505 billion in 2014, with China responsible for $343 billion of the gap.[75] Chinese firms export large quantities of everything from apparel to electronics to the United States. Outsourcing—most notably to China—is a sensitive issue among many politicians and business leaders.

Another key beneficiary of the outsourcing trend is India. GE's former CEO Jack Welch was instrumental in one of the earliest partnerships with India. Welch first met with the Indian government in 1989, and GE formed a joint venture to develop and market medical equipment with Wipro Ltd. in 1990. By the mid-1990s, much of GE's software development and maintenance activities had been shifted to Indian companies. GE Capital Services established the first international call center in India in 1999. GE sold 60 percent of this business for $500 million in 2004, freeing it to compete against IBM, Accenture, and Indian firms.[76] By the late 2000s, India had become the beneficiary of outsourcing efforts from many countries, not just the United States.[77] This rapid growth rate has continued into the mid-2010s.

Wage differences between the United States and countries like China and India are intensifying global outsourcing efforts in a broad array of professional and technical fields, such as architecture, accounting, and even law.[78] Developing a particular legal database for contracts that costs about $60,000 in the United States might cost as little as $5,000 in India.[79] Tens of thousands of technical jobs are outsourced to India each year, totaling over $1 billion in annual Indian revenue from legal outsourcing firms. This phenomenon partially explains why some "temp" agencies in the United States that paid their workers as much as $200 per hour in 2001 paid as little as $20 per hour in 2011.[80]

Chinese firms are competing for many of the information technology (IT) outsourcing contracts U.S. firms originally awarded to companies in India. Consulting firm A.T. Kearney still ranks India highest among outsourcing countries based on financial structure, business environment, and people skills and availability. India is followed closely by China, and then Malaysia and the Czech Republic. However, Kearney believes China can catch India in the 2010s as it improves its accounting, financial, and IT skills.[81]

While outsourcing offers opportunities for firms throughout the world, it presents challenges as well. Consider the automobile industry in China. In 2011, GM held a 10 percent market share in the Chinese automobile market. Ford held a 2.7 percent share by selling only a few models, most notably the Mondeo and the Focus. With the completion of four additional manufacturing facilities fast approaching, Ford plans to sell more than fifteen models by the mid-2010s, including some luxury Lincolns. Most vehicles sold in China—including GM and Ford models—are manufactured there as well.[82]

The pros and cons of outsourcing are discussed at *www.prlog.org/10181084-outsourcing-pros-and-cons.html*.

When implemented properly, outsourcing can cut costs, improve performance, and refocus the core business. Outsourcing is often cost driven but can also be part of a strategy that promotes innovation. Many outsourcing efforts fail, however, due to unforeseen hidden costs, loss of control of the outsourced activity, or simply outsourcing activities that should not be outsourced.[83] For example, Cincinnati's Standard Textile experienced a number of problems when it opened its first factory in northern China in 2005. The heating did not work for two weeks, causing more than an inconvenience for workers whose job is to separate thousands of fine cotton threads. Custom-made parts ordered from Chinese suppliers did not meet specifications. Early on, Chinese authorities hiked electric charges for the plant by 18 percent.[84]

Cost savings aside, excessive outsourcing can leave a firm in a compromised position. When an organization no longer performs key activities, it loses expertise and can find itself at the mercy of suppliers. When a company's resource strengths erode, the available array of strategic options becomes much more limited. Re-evaluating suppliers and changing them when necessary is a proactive means of managing this downside.[85]

Politicians have also been watching outsourcing trends very closely. Growing concern in the 2000s over the deluge of inexpensive textile products from China resulted in agreements in 2005 and 2006 to curb exports to Europe and the United States. In response, the Chinese government offered preferential treatment to firms producing higher-priced items when calculating the volume of their exports, thereby encouraging them to develop and produce higher-quality, premium products.[86]

Offshoring—relocating some or all of a firm's manufacturing or other business processes to another country typically to reduce costs—is similar to outsourcing, but enables the firm to retain control of the operations abroad instead of relinquishing them to other firms. A key incentive for outsourcing and offshoring—cost containment—is the same, however.

offshoring Relocating some or all of a firm's manufacturing or other business processes to another country to reduce costs.

The globalization effect that has fostered an increase in outsourcing and offshoring has also had other effects that are not as easy to identify. As Ford and General Motors eliminated jobs in Detroit in the mid-2000s and continued production overseas, Asian and European manufacturers and their top-tier suppliers were expanding their operations in the United States, particularly in the South where labor unions are not as strong. Nissan's facility in Smyrna, Tennessee; Toyota's plants in Georgetown, Kentucky, and San Antonio, Texas; Mercedes-Benz' facilities in Vance, Alabama; and BMW's plant in Spartanburg, South Carolina, are a few examples. Population growth in Vance and Smyrna has exploded since the openings.

With American auto manufacturers growing outside of the United States and foreign firms producing in the United States, the difficulty in distinguishing "local" products from "imported" ones in the automobile industry has become quite complex. Ford's "Red, White, and Bold" mid-2000s advertising campaign encouraged Americans to be patriotic and purchase a Ford Mustang instead of an "imported" vehicle. However, data from the U.S. National Highway Traffic Safety Administration showed that only 65 percent of the parts for the 2005 Mustang came from the United States or Canada, compared to 90 percent of the parts for the 2005 Toyota Sienna, a vehicle built in Indiana. Many vehicles produced by other Asian carmakers like Honda and Nissan are also built in the United States with predominantly local parts.[87] GM and Ford continue to promote their vehicles as "American-made."

Rising health-care costs have created incentives for many firms to outsource or offshore their production, most notably in the United States, where employers often pay a significant portion of employee health insurance premiums and where such costs are rising an average of 15 percent per year. Union Pacific, for example, no longer hires smokers in states where it is legal to do so. The issue became even more pronounced in 2005 when a draft of an internal Walmart memo proposed that the retailer cut costs by discouraging "unhealthy" people from applying for jobs. The memo proposed adding physical activity to all jobs—such as requiring cashiers to collect shopping carts—so that those not able to perform the tasks would be less likely to apply.[88]

Health-care costs at General Motors account for between $1500 and $2000 of the price of each car sold in the United States.[89] Like many other firms, GM has broadened its efforts to encourage healthy living by discouraging unhealthy habits and adding gym facilities at some of its production facilities.[90] Hence, all firms—especially large ones based in the United States—are challenged to cover these expenses or consider shifting production to countries where costs are lower or health care is provided through government agencies.

Outsourcing decisions are influenced by trends in exchange rates. When the U.S. dollar weakened in international markets in 2010, many firms began to reconsider their global production strategies. Late in 2010, GE announced plans to spend $432 million on four new production facilities in the United States. The weaker dollar reduced the cost of labor in the United States relative to many other nations, although transportation risks and benefits of marketing American-made products were among the reasons as well.[91] When the U.S. dollar strengthened in the mid-2010s, many companies began to look abroad again. Of course, the volatility of exchange rates makes it difficult for producers to evaluate when making long-term production decisions.

Outsourcing is often employed to transition a firm from a strategy that emphasizes in-house production to one that focuses on partnerships with other firms, but offshoring is typically a signal that the nature of production is being restructured. As Brynjolfsson and McAfee put it, "Offshoring is only a weigh station on the road to automation."[92]

Outsourcing and offshoring decisions can be difficult. New Balance is the only major athletic-shoemaker with production in the United States. The company manufactures about one-quarter of its shoes in the United States and is willing to trade off the higher labor costs—about $3 to $5 a pair—in exchange for greater flexibility and shorter production turnaround times. The U.S.-based plants benefit from tariffs that increase the cost of imported shoes, but competitors have been lobbying for trade legislation that eliminates them. New Balance has argued in favor of the tariffs, even though they raise costs on shoes the company produces outside of the United States because competitors must pay the tariffs on *all* of the shoes they sell in the United States, thereby giving New Balance a relative production cost benefit.[93]

The debate over outsourcing and offshoring is complex and can take on a new tack when companies outsource business activities that are politically sensitive or have safety concerns. In 2005, for example, JetBlue flew a number of its Airbus A320 jets to El Salvador for maintenance. In the same year, about half of U.S. carrier heavy-overhaul work was performed outside of the United States.[94]

Although conventional wisdom is that the wages of unskilled workers decline when firms pursue cheaper labor abroad, some have suggested that global outsourcing and offshoring can have a positive effect on both wages and economic development in the richer nation. An industry in a richer nation may rely on local inputs such as specialized workers that are not available to its competitors in new foreign markets. The proximity to these inputs can create a substantial advantage in the new market, boosting productivity throughout the industry and enabling the firms to pay higher wages.[95]

The outsourcing/offshoring debate can also be difficult to resolve because of differences in regulatory environments and the complexity of relationships among firms across borders. A lack of data is also a key concern. Chinese officials, for example, compute trade deficits differently from their American counterparts and always calculate lower figures. While the United States and Europe account for the majority of India's $130 billion information technology industry, U.S. exports to India approached $15 billion in 2014.[96] Hence, it is difficult to determine the extent to which such an exchange is beneficial to both nations from a trade perspective.[97]

Some firms have attempted to avoid the outsourcing controversy, as is the case with the "Big Three" U.S. auto producers. Because union contracts prevent global outsourcing under certain conditions, the automakers simply pressure suppliers to outsource.[98] In addition, a number of firms have become more sensitive to this issue. Some firms give their customers a choice; E-Loan allows customers to decide whether their loan applications will be processed in Delhi or Dallas, with the latter taking as much as two days longer.[99]

Interestingly, the assumption that outsourcing always refers to firms in developed nations seeking labor from emerging economies is not always true. After a large number of airline pilots were laid off in the mid-2000s, many American pilots departed U.S.-based carriers for airlines in China, India, Southeast Asia, and the Middle East. Pilots who faced a glut in the United States find a shortage of experienced pilots in most parts of the world. Many have secured more attractive compensation and benefits in their new positions in other countries.[100]

In sum, outsourcing and offshoring offer intriguing options to strategic managers. In an increasingly competitive global marketplace, firms must take steps to minimize costs and improve efficiency. These steps may not be taken without political or buyer repercussions in the home market, however, as recent developments in the United States illustrate.

Linking Ethics and Social Responsibility

Ethics and social responsibility—while distinct concepts—are sometimes conflated. In 2009, for example, some animal rights groups engaged in a number of corporate attacks throughout Europe. Individuals set fire to the homes of some executives at NYSE Euronet, the stock exchange where one large animal-research company is listed. Cars and homes of employees at Shering-Plough, Pfizer, Novartis, and Bayer AG have also been vandalized. Those carrying out these unethical attacks did so in the name of social responsibility.[101]

The "Occupy Wall Street" movement that started in the United States in late 2011 represents a protest against both alleged corporate social irresponsibility and unethical executive behavior. Although the demands of protestors were often unclear, many challenged the notion of free enterprise, demanding everything from guarantees of employment, higher minimum wages, absolution of college loan debt, and higher taxes for the "top 1 percent" of wage earners.[102] A theme of the protests—and an ongoing concern of many Americans—is the notion of *crony capitalism*, the idea that many companies earn profits by lobbying for government favors and subsidies, not serving customers in a competitive marketplace. The term *cronyism* is a better description of this activity because pure capitalism does not promote close ties between government and business. Some scholars use the terms *market* and *nonmarket orientation* to distinguish between activities designed to generate profit through open competition and those designed to do so through other means.[103]

Industrialist Charles Koch, CEO of Koch Industries, distinguished between these two modes of operation with the terms *good* and *bad profit*. Good profit is based on win-win, voluntary relationships between producers and customers; it adds real value by improving the lives of others. In contrast, bad profit is derived through preferential financial arrangements with government; it reflects disdain for customers, who must pay for the subsidies indirectly through their taxes, instead of determining an industry's winners and losers through customers' purchase decisions. Koch promotes the pursuit of good profit in his company through an integrated approach he calls *market-based management*.[104] Unfortunately, there is growing evidence that many weaker firms from a competitive standpoint are placing greater emphasis on political factors, an approach akin to Koch's notion of bad profit.[105]

The line between social responsibility and managerial ethics can be difficult to draw, as what may be considered by some to be socially irresponsible firm behavior may be a direct result of unethical managerial decision-making. Consider the following example in China. Cadmium batteries are safe and inexpensive when compared to others on the U.S. market. The problem, however, is that they are hazardous to make. About 400 workers at Hong Kong–based GP Batteries International contain in their bodies unsafe levels of cadmium, a toxic metal that can cause kidney failure, lung cancer, and bone disease.[106] Some might contend that the production itself is unethical, while others might express social responsibility concerns because of the effect on workers. Whether this represents more of an ethical problem or one associated with social responsibility is not entirely clear.

Sometimes the distinction between issues associated with social responsibility and those associated with ethics is clear, but not for all companies involved. In 2006, Chinese government investigators discovered a pipe buried underneath the factory floor at the Fuan Textiles mill in southern China. The pipe was being used to discharge about 22,000 tons of water contaminated from its dyeing operations each day into a nearby river. This would be considered an ethical problem for Fuan Textiles, as the company was in clear violation of regulations prohibiting such dumping. A number of American retailers, including Walmart, Target, Gap, and Nike, all used the company's fabric in their clothes.[107] One could argue that these firms have a social responsibility to find other suppliers unless immediate changes are made at the facility, while others might categorize the decision to continue contracting with Hong Kong–based Fountain Set Holdings—majority owner of the factory—as an ethical concern.

Moreover, some issues are difficult to categorize as social responsibility or managerial ethics concerns. For example, in 2011 Dutch satellite navigation company TomTom apologized to its customers after it was revealed that the firm's driving data collected from customers were sold to the police. The information was used by police departments to set speed traps for motorists. Although sales of traffic-related data to government and other agencies account for 36 percent of TomTom's revenues, data were typically used to help authorities identify traffic bottlenecks and improve plans for new roads.[108] While some might argue that TomTom was *socially irresponsible* by selling data to police departments, others would suggest that the decision was simply *unethical*.

Summary

An organization's mission outlines the reason for its existence. A clear purpose provides managers with a sense of direction and can guide all of the organization's activities. Goals represent the desired general ends toward which organizational efforts are directed. However, managers, shareholders, and board members do not always share the same goals. Top managers are challenged to reconcile and satisfy the interests of various stakeholder groups, a task that creates a number of challenges with regard to managerial ethics and corporate social responsibility.

Whereas ethics concerns individual behavior, CSR considers appropriate firm activities. While ethical management is an obvious imperative, competing conceptualizations of ethics can make it difficult to distinguish between ethical and unethical behavior in some instances. Although many scholars, practitioners, and consumers broadly accept the notion of CSR, others argue that firms should engage in social activities only to the extent that they enhance shareholder returns. Issues like outsourcing and offshoring represent practical ethical and CSR concerns, and reflect the difficulty often associated with identifying and addressing problematic behavior in firms.

Key Terms

adverse selection
agency problem
diversification
employee stock ownership plan (ESOP)
ethical relativism
goals
integrative social contracts view of ethics
justice view of ethics
leveraged buyout (LBO)
managerial ethics
moral hazard
objectives
objectivism
offshoring
outsourcing
religious view of ethics
rights view of ethics
self-interest view of ethics
social responsibility
stakeholders
sustainable strategic management (SSM)
takeover
triple bottom line
utilitarian view of ethics

Review Questions and Exercises

1. What is and should be the relationship between an organization's mission and its strategy?
2. What is the difference between social responsibility and managerial ethics? Why is this distinction important?
3. Select a company that has published a mission statement on its website. Evaluate its mission statement along each of the following criteria:
   a. Is the mission statement comprehensive? Is it concise?
   b. Does the mission statement delineate, in broad terms, what products or services the firm is to offer?
   c. Is the mission statement consistent with the company's actual activities and competitive prospects?
4. Why do stakeholders in the same organization often have different goals? Would it not be best if they shared the same goals? Explain.
5. What are the key advantages and disadvantages of outsourcing and offshoring? Should these practices be regulated? Why or why not?

Chapter 5 Practice Quiz

True or False

1. Goals are specific and often quantified versions of objectives.
2. If a firm is able to consistently earn above-average profits, it is effectively balancing the goals of its stakeholders.
3. The agency problem refers to the balancing act a firm must exhibit when attempting to satisfy the myriad of governmental agencies.
4. Most organizations can be classified as either ethical or unethical.
5. The integrative social contracts view of ethics suggests that decisions should be based on religious convictions.
6. Offshoring refers to the relocation of some or all of a firm's manufacturing or other business activities to another country, usually to reduce costs.

Multiple Choice

7. The reason for the firm's existence is known as
   A. the vision.
   B. organizational goals.
   C. organizational objectives.
   D. none of the above
8. Which of the following is not an example of a stakeholder?
   A. customers
   B. suppliers
   C. employees
   D. none of the above
9. An individual's responsibility to make business decisions that are legal, honest, moral, and fair is known as
   A. social responsibility.
   B. the social imperative.
   C. managerial ethics.
   D. all of the above
10. Leveraged buyouts can
   A. strap the company with a large amount of debt.
   B. serve as a system of checks and balances.
   C. lead to the sale of company assets.
   D. all of the above
11. The ethical perspective that suggests that organizational decisions should be made in accordance with pre-established rules or guidelines is known as
   A. the self-interest view.
   B. the justice view.
   C. the rights view.
   D. the integrative social contracts view.
12. The assessment of strategies and related processes that promote superior performance from both market and environmental perspectives is known as
   A. corporate social responsibility.
   B. managerial ethics.
   C. management decision-making effectiveness.
   D. none of the above

Case 5: Starbucks

Starbucks was founded in 1971 in Seattle by Gordon Bowker, Jerry Baldwin, and Ziv Siegl. By 1982, Starbucks had five retail stores and was selling high-quality whole-bean and ground coffee products to restaurants and espresso stands in the Seattle area. In that same year, Howard Schultz joined Starbucks to manage retail sales and marketing. After convincing the firm to open a downtown Seattle coffee bar in 1984, which was successful, Schultz left Starbucks to open his own coffee bar, Il Giornale, which served Starbucks coffee. Schultz acquired Starbucks in 1987, and locations were opened in Chicago and Vancouver. In 1991, Starbucks became the first U.S.-based private company to offer stock options to all employees. The company went public in 1992.

Today, Starbucks coffee shops and kiosks can be found in a variety of shopping centers, office buildings, bookstores, and other outlets. Starbucks' product line includes food and beverage items, such as coffee, coffee beans, and pastries, as well as accessories, such as mugs and grinders. Starbucks' beans are also marketed to restaurants, airlines, hotels, and directly to the public through mail-order and online catalogs. Interestingly, Starbucks is capitalizing on taste changes that predate the company's founding.

In the early 1960s, American adults consumed an average of three cups of coffee each day. Consumption has declined since this time, with a greater preference for decaffeinated coffee. In addition, a new category of intensely loyal coffee drinkers was born. This group of adults consumes "specialty" or "premium" coffees, including regular and decaffeinated versions with a variety of origins and flavors. The specialty coffee category in the United States has grown rapidly during the past decade—to about $3.5 billion annually in 2015—and currently accounts for about half of all coffee sold.

Because Starbucks markets both whole beans and coffee beverages, its competition comes from two distinct groups of firms. A number of regional coffee manufacturers distribute premium coffees in local markets, while several large national coffee manufacturers, such as Nestlé, Proctor & Gamble, and Kraft General Foods, market and distribute specialty coffees in supermarkets. Coffee beverages are distributed by restaurants, grocery stores, and coffee retailers. Seattle's Best Coffee is a fierce competitor.

Growth slowed in the late 2000s, due primarily to a global economic decline and increased competition from McDonald's, but Starbucks pursued steady expansion again in 2012. Today, Starbucks operates over 23,000 stores in over sixty-five countries. More than half of the stores—including those in the United States—are company owned, while the remaining non-U.S. units are franchised.

Case Challenges

1. What are some of the challenges associated with Starbucks' aggressive international growth strategy?
2. Could an unanticipated change in coffee consumption patterns disrupt Starbucks in the same way that it paved the way for the company's growth in the 1980s and 1990s?
3. To what extent do lower-priced competitors like McDonald's and Dunkin' Donuts present a threat to Starbucks' premium-priced coffee?

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Simulation 101: Ethics and CSR

Many strategy simulations have components related to ethics and/or CSR. The means by which ethical and CSR dilemmas are presented varies significantly across simulations. Your firm might be presented with a dilemma and you must determine how to address it. When ethical considerations are front and center, "doing the right thing" is very important. When the key issues are related to CSR or social engagement, consider the long-term effects on all of the stakeholders before making a decision. You want to be proud of the virtual firm you manage.

Decisions with ethical or CSR ramifications can also have an impact on the bottom line. Failing to resolve a quality problem could result in costly litigation. Likewise, investing in voluntary efforts to reduce waste from production can improve your company's reputation and increase sales in future rounds. Students often look for an expedient course of action when their firms are faced with such challenges. Take the time to think through the decision criteria. The situation might be deliberately complex so that you will be forced to do so.

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