## CHAPTER THREE

## SOCIAL RESPONSIBILITY AND ETHICS IN STRATEGIC MANAGEMENT

The chapter examines the relationship between business firms and society and presents issues in social responsibility and ethics. It describes the relationship between social responsibility and corporate performance. The chapter considers stakeholder concerns and presents various responsibilities of business firms as well. Ethics and ethical behavior are considered in light of the challenge from moral relativism. It describes guidelines for ethical behavior according to utilitarianism, individual rights, and justice approaches.

### LEARNING OBJECTIVES

1. Discuss the relationship between social responsibility and corporate performance.
2. Explain the concept of sustainability.
3. Conduct a stakeholder analysis.
4. Explain why people may act unethically.
5. Describe different views of ethics according to the utilitarian, individual rights, and justice approaches.

### TOPICS OUTLINE COVERED

1. Social Responsibilities of Strategic Decision Makers
    a. Responsibilities of a Business Firm
    b. Sustainability
    c. Corporate Stakeholders
2. Stakeholder Analysis
3. Ethical Decision Making
    a. Some Reasons for Unethical Behavior
    b. Encouraging Ethical Behavior
4. View on Ethical Behavior

### SUGGESTED ANSWERS TO MYMANAGEMENTLAB QUESTIONS

**3-1. How has moral relativism led to criminal activities by some employees in companies?**

Moral relativism suggests that morality is relative to some personal, social, or cultural standard. There is no method for deciding whether one decision is better than another. For this very reason, many people justify their unethical positions, arguing that there is not one absolute code of ethics.

**3-2. How does a company ensure that its code of ethics is integrated into the daily decision-making process of the company and is not just a symbolic trophy or plaque hanging on the wall?**

When management of a company wants to improve the ethical behavior of employees in the organization, a code of ethics should be communicated in training programs, in performance appraisal systems, policies and procedures, and also through their own actions.

### SUGGESTED ANSWERS TO DISCUSSION QUESTIONS:

**3-3. What is the relationship between corporate governance and social responsibility?**

This question is partially answered by the last trend in corporate governance presented in Chapter 2. Quite simply, it states that society, in the form of special interest groups, increasingly expects boards of directors to balance the economic goal of profitability with the social needs of society. Issues dealing with workforce diversity and the environment are now reaching the board level. If business corporations are to avoid increased governmental restrictions on their activities, management will need to be even more aware of the various needs of their stakeholder groups. The board of directors is in a unique position to view the corporation as a whole and to evaluate management's performance in terms of stakeholder criteria. To the extent that boards use only shareholder value as their key criteria, they may not be acting responsibly from society's point of view. Increasingly, concerns over social responsibility may be directed through the board of directors. Agency theory defines the board's interests quite narrowly. Perhaps it is time for agency theory to be expanded to include stakeholders other than just shareholders. Stewardship theory may provide the rationale to expand the responsibilities of the board and top management in terms of the corporation's overall social responsibilities. This is likely to continue being a controversial issue for quite some time.

**3-4. What is your opinion of Apple having a code of conduct for its suppliers? What would Milton Friedman say? Contrast his view with that of Archie Carroll's.**

Do a company's responsibilities end at its boundary, or do its responsibilities extend to include its suppliers and distributors? This very thorny question has become a point of contention in the area of social responsibility. The question includes a basic question in organization theory: what is the boundary of an organization? Certainly, one could argue that a company is composed of its employees and all of its assets, such as land, buildings, and equipment. These can thus define a company's boundary. Given this view, everything else may be called a company's "environment" and therefore outside of a company's control or responsibility. One could thus argue that a company such as Apple or Nike cannot be held responsible for the actions of a separate and independent supplier company/contractor. The very popularity of outsourcing as a substitute for vertical integration means that more firms are contracting with other firms to fulfill functions a company no longer wishes to do on its own. If the contract is long term in nature or if the purchasing company owns a substantial amount of stock in the supplying company, then the hands-length nature of transactions is compromised and it becomes difficult to discern where one firm's boundary begins and another firm's leaves off. Such a relationship suggests that one company does have some influence over another company's actions by nature of the other company's dependency on the first company. One could thus argue that a company's social responsibilities extend beyond what is normally thought of as its boundary to the extent that it has some control and influence over the other company's actions. Clearly, Apple's management was thinking this way when it drafted its code of conduct.

Milton Friedman would probably be very much against Apple's meddling with the rights of its suppliers to freely contract with their employees. Using Carroll's categories, Friedman would probably argue that the only responsibilities of a business firm are economic *and* legal. Friedman does say that business should play "within the rules of the game." This can be interpreted as meaning a supplier's legal responsibilities to follow the rules established within that country. If a purely economic justification is used, it may be difficult but still possible to justify ethical and discretionary responsibilities. Carroll points out that a refusal to consider ethical responsibilities is likely to lead to an increase in a firm's legal responsibilities—which, considering the usual inefficiencies of government, will lead to higher costs and lower long-run business efficiency. Either the U.S. federal government or the United Nations may force companies in developed countries to follow a code like Gap's or else face sanctions. Friedman would say that this is foolishness, but Carroll would argue that this is a natural result of ignoring one's ethical responsibilities.

**3-5. Does a company have to act selflessly to be considered socially responsible? For example, when building a new plant, a corporation voluntarily invested in additional equipment that enabled it to reduce its pollution emissions beyond any current laws. Knowing that it would be very expensive for its competitors to do the same, the firm lobbied the government to make pollution regulations more restrictive on the entire industry. Is this company socially responsible? Were its managers acting ethically?**

This is a tough question. At first, it seems to be more appropriate to a philosophy class than to a strategic management class. Should motivation and attitudes be considered when judging a company's actions? The legal system normally does this when differentiating between different degrees of guilt: intentionally killing is called murder and is usually punished severely; unintentional killing is called homicide and may not be punished at all if it is considered to be an accident or self-defense. Using this approach, one could say that a company is not socially responsible unless its motives fit its actions. A counterargument could be made, however, by arguing that the essence of the free enterprise system is laissez-faire capitalism in which the selfish motivations of business people result in a better society in terms of material goods. In this system, it is acceptable for a successful business firm to selfishly work for its own good, given that its actions result in side effects that are functional for society as a whole. We do not demand that a firm be altruistic when fulfilling its economic and legal responsibilities. Why should we then require that a firm be altruistic when fulfilling its ethical and discretionary responsibilities? This is not the type of question that pragmatic undergraduate business students are used to. Grad students will enjoy playing with the concepts involved. This question could either result in some interesting class discussion or it could bomb. Hopefully, it will make the class think on a higher level than simply regurgitating the book.

**3-6. Are people living in a relationship-based governance system likely to be unethical in business dealings?**

The chapter states that developing nations tend to have relation-based governance. Transactions are based on personal and implicit agreements, not on formal contracts enforceable by a court. Information about a business is largely local and private—thus cannot be easily verified by a third party. In contrast, rule-based governance relies on publicly verifiable information—the type of information that is typically not available in a developing country. The rule-based system has an infrastructure, based on accounting, auditing, ratings systems, legal cases, and codes, to provide and monitor this information. If present in a developing nation, the infrastructure is not very sophisticated. The relation-based system in a developing nation is inherently nontransparent due to the local and nonverifiable nature of its information. A businessperson needs to develop and nurture a wide network of personal relations. In a relation-based system, the culture of the country (and the founder's family) strongly affects corporate culture and business ethics. What is "fair" depends upon whether one is a family member, a close friend, a neighbor, or a stranger. Because behavior tends to be less controlled by laws and agreed-upon standards than by tradition, business people from a rule-based developed nation perceive the relationship-based system in a developing nation to be less ethical and more corrupt. In contrast, the people living in a relationship-based country see their behavior as following what to them are well-known traditional guidelines and don't necessarily understand why foreigners from developed nations have such difficulty understanding how things are done. What is perceived by one person to be corruption is simply how things are done in a developing nation.

**3-7. Given that people rarely use a company's code of ethics to guide their decision making, what good are the codes?**

The chapter states that managers tend to ignore codes of ethics and try to solve ethical dilemmas on their own. To combat this tendency, corporations should not only develop a comprehensive code of ethics, but also communicate the code in their training programs, performance appraisal systems, and policies and procedures. Developing codes of ethics can be a useful way to promote ethical behavior, especially for people who are operating at Kohlberg's conventional level of moral development. A code of ethics (1) clarifies company expectations of employee conduct in various situations and (2) makes clear that the company expects its people to recognize the ethical dimensions in decisions and actions. If nothing else, developing and communicating a comprehensive code of ethics can help protect a company from lawsuits.

## ADDITIONAL DISCUSSION QUESTIONS FOR INSTRUCTORS

**These are not found in the text and may be used by the instructor for classroom discussion or exams.**

**A3-1. How appropriate is the theory of laissez-faire in today's world?**

As indicated in the chapter, Milton Friedman contends that it is very appropriate. The quote from his classic article, "The Social Responsibility of Business Is to Increase its Profits" does suggest a certain modification, however, to pure laissez-faire. He states that business should work to increase its profits "so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." These "rules of the game" form the crux of the argument. What should these rules be and who should communicate and enforce them? This leads directly into Archie Carroll's contention that there are four responsibilities of business corporations: economic, legal, ethical, and discretionary. Pure laissez-faire argues for economic responsibilities only. Friedman modifies laissez-faire by presumably adding legal responsibilities. One could make the point that the "rules of the game" should include ethical responsibilities as well. The problem, of course, is what happens to the concept of laissez-faire when one adds all these responsibilities to it and then expects businesspeople at all levels to accept them without outside force? Does laissez-faire as proposed by Adam Smith and argued by others include only economic responsibilities? If legal and ethical responsibilities are also expected by society of business corporations, is it still "free enterprise" laissez-faire or some other kind of system?

**A3-2. Using Carroll's list of four responsibilities, should a company be concerned about *discretionary* responsibilities? Why or why not?**

Except for a few die-hard followers of Milton Friedman's philosophy, few people would agree that a business firm should fulfill *only* its economic and legal responsibilities and completely ignore ethical ones. The same is not true of discretionary responsibilities, however. Because discretionary responsibilities are defined by Carroll as purely voluntary, there is no pressure by anyone for a business firm to fulfill them. One can argue, nevertheless, that there are three good reasons to undertake these kinds of responsibilities. The first reason is the morality rationale—it may be the right thing to do, even though the company may not benefit and may even be hurt in the short run. The second reason is enlightened self-interest. If a firm undertakes a discretionary activity, it may gain short-run advantages in the marketplace (e.g., a company offering free day care to its employees may attract more potential workers at lower wages). It may also serve as a role model for government to legislate if and when that responsibility moves from discretionary to ethical and finally to legal (and thus the firm is able to do things its way instead of the government's way). The third reason is also one of enlightened self-interest. If a company develops a reputation for voluntarily doing socially useful activities even though it gains little economically in return, it may collect valuable public relations credit in people's minds. This may translate into better sales or a willingness on the part of some government agency to overlook a questionable activity the company might unthinkingly engage in.

## SUGGESTIONS FOR STRATEGIC PRACTICE EXERCISE

The end of chapter exercise asks the student to evaluate the position of an organization facing a particular dilemma and to suggest a course of action to the manager. Students should read the exercise and make the decision in an ethical manner for the manager. Ideally, students may analyze the problem in three ways: fiduciary duty, stakeholder analysis, and the Kantian categorical imperative. If students view the manager's fiduciary duty to the shareholders as paramount, they will decide to make the gamble. If they see a duty to stakeholders other than shareholders (e.g., employees, customers, etc.), they will still choose to act as if the product closer to release is THE ONE. Students will also reach a conclusion based on the Kantian categorical imperative explained in the chapter.