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Corporations and their Social Responsibility

Understanding Corporations and CSR

The subject of this book is *corporate social responsibility* (CSR), a broad term that refers generally to the ethical role of the corporation in society. Before we define CSR more precisely and before we explore in depth a number of case studies that illustrate aspects of the ethical role of corporations, we first need to understand exactly what corporations are, why they exist, and why they have become so powerful.

Today, the global role of corporations rivals that of national or local governments. In 2000, it was reported that, of the 100 largest economic organizations in the world, 51 were corporations and 49 were countries.¹ General Motors, Walmart, Exxon, and Daimler Chrysler all ranked higher than the nations of Poland, Norway, Finland and Thailand (in terms of economic size, comparing corporate revenues with national gross domestic product, or GDP). This trend has continued, and for the past decade, 40 to 50 of the world's 100 largest economic organizations have been corporations, with the rest being national economies. In 2012, Walmart was the twenty-fifth largest economic organization in the world, putting it ahead of 157 countries.²

For corporate employees, as for citizens living in communities dominated by large corporations, the corporation is arguably the most important form of social organization. For people such as corporate executives and shareholders, whose lives depend directly on corporations, it is not surprising that company politics often are considered more relevant than national or local politics. Corporations are also a major part of the daily lives of the world's citizens and consumers. For devoted fans of iconic brands like Nike, Apple, Mercedes, or Louis Vuitton, the corporation can occupy a

psychological niche very much like that of a member of the family. Indeed, if many teenagers today were forced to choose between an iPhone and a memorable night out celebrating their parents' anniversary, the parents would likely celebrate alone. Similarly, those parents might also be loath to part with their cherished products. Dad would not easily say goodbye to his Chevrolet Corvette or Bose stereo, and Mom might not be easily persuaded to part with her Yamaha piano or Rossignol skis.

At the opposite extreme, for citizens who have been harmed physically or financially by corporations—like the Louisiana or Alaska residents whose beaches were fouled by massive oil spills, or the thousands of small investors who found their life savings wiped out by the Ponzi schemes of Bernie Madoff's investment company—the corporation can seem as dangerous as an invading army, or as destructive as an earthquake.

Despite their vast social role, corporations remain poorly understood by the world's citizens. While school children everywhere are expected to study the structure and history of their nation's government, they are not similarly taught to appreciate the functions, motivations, and inner workings of corporations. Let us begin with a brief review of the nature of corporations.

image



BP oil rig explosion, photo by United States Coast Guard (2010, public domain). Figure 1.1 The 2010 explosion of a British Petroleum (BP) oil rig off the coast of Louisiana, the cause of the worst environmental disaster in U.S. history.

Why Do Corporations Exist?

There were no corporations in ancient Egypt, Greece, or Rome; or in imperial China or Japan; or among the precolonial kingdoms of the Zulu or Ashanti. The Aztecs and Incas had no corporations, nor did the Sioux, Cherokee, or Navajo. It is true that in some classical and traditional societies there were certain forms of communal and religious organizations that anticipated the organizational capacities of corporations, but strictly

speaking, they were not corporations.

Corporations are a relatively modern social innovation, with the first great corporations dating from about 1600. Since then, the growth of corporations has been phenomenal. What explains it? Why has the corporate structure been so successful, profitable, and powerful? Here are a few of the distinguishing characteristics of corporations.

Corporations are Creatures of Law

The first point to make about corporations is that they are not informal organizations or assemblies. In order to exist at all, corporations must be authorized by state or national laws. In their daily operations, corporations are regulated by a specific set of laws. Every country has laws that stipulate how corporations can be created; how they must be managed; how they are taxed; how their ownership can be bought, sold, or transferred; and how they must treat their employees. Consequently, most large corporations have large legal and government affairs departments. Since the laws and rules that may constrain corporations are written and enforced by the government, most corporations consider it of vital importance to seek influence over governmental regulators and lawmakers. In most countries, the very largest corporations have privileged access to top decision makers. The extent and reach of corporate influence over governments is one of the most controversial aspects of corporate existence.

Corporations Raise Capital for Major Undertakings

The first great benefit of corporations is that they provide an organized vehicle for pooling cash and capital from a large number of investors so that they can undertake major enterprises. Thus, one great stimulus to the growth of corporations was the rapid growth of international trade between 1400 and 1700 CE. In that era, sending a large vessel across the oceans was a major financial and logistical undertaking, which was also extremely

risky; ships were often lost in storms. These early commercial ventures required such large capital investments that, at first, funding them was only within the reach of royalty. American schoolchildren are taught that the legendary explorer Christopher Columbus needed the royal patronage of Queen Isabella of Spain to support the voyages that led to the “discovery” of the New World. However, as new ocean trading routes were established and the vast potential for profits from trading spices became known, the first modern corporations were formed: the English East India Company, chartered in 1600, and its archrival, the Dutch East India Company, chartered in 1602. These companies are considered the world’s first multinational corporations, and they possessed most of the hallmarks of corporate structure that we see today.

Corporations and Other Business Structures

Not all businesses or companies are public corporations. For example, in the US, it is legal to operate a business in your own name (this is called a *sole proprietorship*) or with partners (a *partnership*). Corporations also come in a bewildering array of forms. Thus, in the US, we have *C corporations*, *S corporations*, *benefit corporations* (also *B corporations*), and *limited liability companies* (LLCs). In the UK, the term *company* is preferred to corporation, and we will notice that the names of most large UK companies followed by the designation *plc* or *PLC* (public limited company), as in Rolls-Royce plc, while smaller companies often have the designation *Ltd* (private limited company). In France, large companies are usually designated *SA* (*société anonyme*), while smaller ones may be known as *SARL* (*société à responsabilité limitée*). In Germany, large companies are designated *AG* (*Aktiengesellschaft*), while smaller ones are known as *GmbH* (*Gesellschaft mit beschränkter Haftung*). In Japan, the corresponding terms are *KK* (*kabushiki kaisha*) and *YK* (*yōgen kaisha*).

All of these terms define two basic aspects of corporations: 1) their limited liability (which applies to all corporations), and 2) their status as

a *public* or *private* company. Public companies are allowed to sell their shares on public stock markets and tend to be the larger type of company.

The Importance of Limited Liability

Why aren't all businesses sole proprietorships or partnerships, instead of corporations? The answer is found in the concept of *liability*, which refers to the risk of loss for debts incurred by the business, or for damages caused by the business.

If you start a business as a sole proprietor or via a partnership, you (and/or your partners) are *personally liable* for any debts or damage that can be attributed to the particular business. Let us say that you have \$1 million in assets and your good friend has \$2 million in assets. Together, you agree to invest \$250,000 each in a pizza delivery business (the business will start with \$500,000 worth of capital). Unfortunately, in the first month of operation, one of your drivers negligently causes a car accident and severely injures a family driving in another car. The family sues you for their injuries and they obtain a court judgment ordering you to pay \$3 million in compensation. Even though you had intended to invest only \$250,000 in the business, now your entire fortune and that of your friend are likely to be wiped out in satisfying that court judgment. The same sort of result could arise if your business ran up \$3 million in debt that it was unable to pay back. Thus, the founder of a sole proprietorship exposes his/her entire personal assets to the risk that the assets will be seized to satisfy liabilities incurred by the business.

The result can be quite different for a corporation. One of the principal advantages of a corporation, from an investor's point of view, is that the corporation provides a legal "shield" from liability. A shareholder of a corporation only risks the stock that the shareholder owns. The shareholder's personal assets are not in jeopardy. When a corporation suffers an adverse legal judgment and does not have sufficient funds to

satisfy the judgment, the corporation simply goes bankrupt. The party or parties who have been injured cannot sue the owners—the shareholders—of the corporation because the corporation acts as a shield from liability.

Why does society allow the shareholders of a corporation to retreat behind the corporate shield, while we do not allow the same for owners of a so-called mom-and-pop business in the form of a sole proprietorship? The main purpose of the liability-shield is to encourage investment in corporations. People are more willing to invest in a corporation (by acquiring stock) because they need not fear that their personal assets can be seized to satisfy the business's debts or liabilities. The underlying implication is that corporations and corporate investment provide important benefits for society, which explains why governments have been willing to adopt laws that protect and encourage corporate ownership. As many U.S. states learned in the nineteenth century, it can make sound economic sense to attract large corporations because they often become major employers and taxpayers. Corporations may enhance the ability of the local economy to compete with foreign economies that are supported by the productivity of their own corporations.

In many instances the ability of corporations to retreat behind the corporate shield has been controversial. For example, several major airlines (notably American Airlines) have been accused of choosing to declare bankruptcy over finding a way to pay high wages to their pilots and cabin personnel.³ The airlines were attacked by labor unions as having used the bankruptcy as a tactic to avoid meeting the union's demands for fair wages. Such corporations are able to benefit from an option provided by US bankruptcy law, known as *Chapter 11 reorganization*, which allows them to enter bankruptcy temporarily. The courts appoint a trustee to run the corporation, and the trustee is empowered to take any actions necessary to reduce the corporation's debts, including revoking labor agreements with employees. Such corporations can later "emerge" from bankruptcy with fewer employees or with employees earning lower salaries.

Corporations Permit Wealth Creation and Speculation in Stocks

While all corporations possess limited liability, not all of them are permitted to raise money in the stock market or have their shares traded in stock markets. Here, we find the important distinction between *public corporations*, which may have their shares traded on stock markets, and *private corporations*, which may not have their shares traded on stock markets.

As a rule, large corporations and multinational corporations choose to do business as public corporations because big companies have such enormous capital needs that they may best raise funds by placing stock for sale in public stock markets. However, this is not always the case; there are some very large corporations that choose to remain private, which means that they raise money directly from investors rather than from making stock available on stock markets.

On the whole, ownership of a corporate interest in the form of stocks is more freely and easily transferable than ownership of an interest in a sole proprietorship or partnership. If you want to sell a mom-and-pop store, you generally have to sell the whole business; you cannot sell a small portion when you need to raise money.

If you are one of the members of a partnership and you want to sell your share, you will generally have to get prior approval from the other partners; needing to do so may discourage possible investors because they may not want to go to the trouble of seeking approval from your partners. However, if you inherit a thousand shares of stock in Apple from your wealthy aunt (which, in 2013, would have had an approximate value of \$420,000), and you find that you need extra money, you can sell one hundred shares (or about \$42,000 worth). Such a transaction is easy because there are lots of investors eager to own Apple shares and you do not need anyone's

approval. This ease of transferability also encourages people to invest in stock instead of in other businesses, because it is so easy to sell corporate stock as needed.

When a corporation grows and/or becomes more profitable, the shareholders benefit financially in two ways. First, the corporation will often distribute a portion of its profits to the shareholders in the form of *dividends*, a certain annual payment per share of stock. Second, if a corporation is growing rapidly and is expected to be very profitable in the future, more investors will want to own its stock and the price of that stock will increase. Thus, ownership of stock is an investment vehicle that provides many advantages over other types of investments. For one thing, you can own stock without having to personally take part in the management of the company. In addition, you can sell all or part of your ownership when you need the funds. Finally, if the corporation is very successful, it will not only pay a steady revenue stream—through dividends—but your shares will become more valuable over time.

The advantages of stock ownership as an investment vehicle explains the growth of the world's great stock exchanges, such as the New York Stock Exchange or the Hong Kong Stock Exchange. Stock exchanges are like enormous flea markets for stock, because you can either buy or sell stock there. Unlike the goods available in ordinary markets, though, the price of stocks fluctuates constantly, literally minute by minute. A stock that was worth \$10 last year may now be worth as much as \$1000 or as little as \$0.10. Thus, stock markets are also somewhat like casinos or lotteries, because they allow investors to speculate on the future.

Speculation has its pros and cons. The potential for wealth creation through stock ownership has spawned an important industry that employs hundreds of thousands of people and generates vast profits: financial services. Stock brokerages, investment banks, and trading houses have arisen to provide expert guidance and services to investors.

American colleges and universities have developed a highly collaborative and perhaps even symbiotic relationship with the financial services industry. For one thing, since there are many jobs and professional occupations in financial services, virtually all universities offer courses and majors in finance or financial economics, and many also have graduate business schools that prepare students for careers in the financial services industry.

Perhaps equally importantly, most colleges and universities depend on private and charitable donations to help defray the cost of running the institution and, consequently, to keep tuition rates and fees lower (although many students will find it hard to imagine how tuition could be any higher). When wealthy individuals and corporations make donations or charitable contributions to colleges and universities, they often do so by giving corporate stock. Even when they make a cash donation, the university may find that it is most financially convenient to use that cash to acquire corporate stock. As a result, the largest universities have amassed vast holdings of corporate stock, among other investments. The financial resources of a university are often held in the form of a special trust known as an *endowment*. Universities prefer not to sell off parts of the endowment but rather seek to cover costs by using the interest and dividends generated by the endowment.

At times, the corporate holdings of universities have become quite controversial. For example, in the 1970s and 1980s, a growing student movement called on universities to *divest* (to sell all their stock) in any corporations that did business with the racist apartheid regime that controlled South Africa at that time. Many commentators believe that it was this pressure on corporations that led to the fall of the apartheid regime and the election of South Africa's first black president, Nelson Mandela.

Corporations Can Have Perpetual Existence

It is possible but rare for family-owned businesses to remain sole

proprietorships for several generations; more commonly, they eventually become corporations, or they are sold or transferred to a new business operator. Very often, a small business is sold when the founder dies, because the founder's children or heirs either do not want to work in the family business or are not as gifted in that business as was the founder. Even in successful, family-owned businesses where a child or relative of the founder inherits the business, it still happens that after a generation or two, no further family members are qualified (or wish) to join the business, and the business must be sold.

However, corporations are structured from the outset to have a potentially perpetual existence, because corporations do business through their officers and executives rather than through their owners. Although it is possible for owners to have dual roles as shareholders and as executives, it is not necessary. One common scenario is for the founder of the corporation to act as its chief executive officer (CEO) until such time as the corporation becomes so large and successful that the shareholders prefer to transfer management responsibility to an executive with specific professional experience in running a large corporation.

Disadvantages of the Corporate Form

Separation of Ownership and Management Functions

One potential disadvantage of the corporate form (from the point of view of its founders) is that, as the corporation grows, the original founders may lose control and even be pushed out of the corporation by newcomers. This happened to Steve Jobs, the legendary cofounder of Apple, who was pushed out of his leadership role in 1985 by Apple's board of directors, only to return in the mid-1990s and retake his role as CEO. More recently, in 2013, George Zimmer, the founder of the apparel retailer Men's Wearhouse, was terminated as chairman of the board by his own board of directors.

This situation can arise because, as a company grows, the founders may be tempted to part with some portion of their equity by selling stock to new investors. Corporations are ultimately controlled by the board of directors, who are voted into office by the shareholders. If a founder allows his or her share of corporate stock to drop beneath 50%, then the founder will no longer be able to elect a majority of the board of directors, and may become subject to termination as an officer by the board. The board of directors is thus a sort of committee that controls the fate of the corporation, and it does this principally by choosing a CEO and supervising the CEO's performance.

Dual Taxation

Although the tremendous growth in the number and size of corporations, and their ever-increasing social role, is due in part to their advantages as an investment vehicle, there are some financial disadvantages worth mentioning. One of the most important is so-called dual taxation, which refers to the practice in most countries of taxing corporate profits twice: once when the corporation declares a certain amount of profit, and again when the corporation distributes dividends to shareholders. The complexity of corporate tax regulations is such that even small corporations must frequently employ specialized accountants and attorneys to handle their tax returns.

Quarterly Financial Reporting for Publicly Traded Corporations

Another disadvantage applies only to publicly traded corporations. Although all corporations are subject to a number of government regulations, the highest degree of regulation applies to public corporations, which raise capital by selling stock in stock markets. Large corporations are often willing to submit to these burdensome regulations because there are strong benefits to being traded on a stock exchange, the most important of

which is the ability to raise a great deal of initial funding when the stock is first made available for trade. This first public sale of stock is known in the US an *initial public offering* or *IPO*. In two famous recent examples, Google raised \$1.67 billion with its IPO in 2004, and Facebook raised \$18 billion with its IPO in 2012.

image



Source: Toms Shoes, photo by Vivianna Love (CC BY 2.0, 2009) Figure 1.2 A well-worn pair of Toms Shoes; Toms gives away free shoes to a poor child for every pair it sells.

Despite the allure of additional financing, a company that is traded on a stock market must make a great deal of financial information publicly

available, usually on a quarterly basis, four times per year. This obligation can be quite onerous because it requires the corporation to employ a number of internal accountants as well as outside auditors. In addition, the information that is publicly revealed can be of strategic value to the corporation's competitors. Moreover, the need to make frequent quarterly reports on the company's ongoing profitability can have a negative impact on corporate strategy, because executives may become fixated on short-term goals while neglecting long-term goals. In light of these disadvantages, it is not surprising that some public corporations decide to take their shares off the stock markets in a process that is known as *going private*, which is the opposite of an IPO. Other corporations simply avoid going public in the first place. Thus, there are also some very large corporations, such as the multi-billion-dollar engineering firm Bechtel, which prefer to remain private even though they could raise investment capital with an IPO. Such companies prefer to raise capital by other means to avoid the requirements of quarterly earnings reports and therefore not revealing financial information to competitors.

Corporate Social Responsibility

In this book, we will make continual reference to the concept of corporate social responsibility, but it is important to realize that CSR is an evolving concept that can be analyzed from multiple perspectives. The term *CSR* may be used quite differently depending on whether a given speaker is looking at it from the point of view of a corporation, a government, a charity sponsored by the corporation, a citizen employed by the corporation, a citizen who has been harmed by the corporation, or an activist group protesting abuses of corporate power. Let us review key concepts and terms related to CSR, starting with CSR itself.

CSR: Definition

We define CSR simply and broadly as the ethical role of the corporation in

society. Corporations themselves often use this term in a narrower, and less neutral, form. When corporations have a director of CSR or a committee in charge of CSR, or when they mention CSR prominently in their mission statements, they are invariably using the term to mean “corporate actions and policies that have a positive impact on society.” Corporations refer most frequently to CSR when they speak of civic organizations they support, or to corporate environmental or social policies.

One related term here is corporate “compliance.” Not only are large corporations subjected to a host of governmental regulations, many of which have social objectives (such as avoidance of discrimination, corruption, or environmental damage), but many corporations also have set up internal guidelines. In order to make sure that a corporation respects or complies with all these laws, regulations, and norms, both internal and external, corporations increasingly employ “compliance” officers or executives. For example, large fashion and apparel companies frequently place a specific executive in charge of “human rights compliance,” to ensure that its clothing was manufactured in safe factories that respect labor laws and do not employ children.

Corporate Philanthropy

Corporate philanthropy refers to a corporation’s gifts to charitable organizations. There is an implication that the corporation’s donations have no strings attached, which is probably quite rare. At a minimum, most corporations expect that their donations will be publicly attributed to the corporation, thus generating positive public relations. When corporations make large cash gifts to universities or museums, they are usually rewarded with a plaque, or with a building or library named after the donor. Such attributions burnish the corporation’s public image, and in such cases we are not dealing with true corporate philanthropy, strictly speaking, but something more in the nature of marketing or public relations.

Stakeholder Capitalism

Stakeholder capitalism refers to a conception of the corporation as a body that owes a duty not only to its *shareholders* (the predominant American view) but also to all of its *stakeholders*, defined as all those parties who have a stake in the performance and output of the corporation.

Stakeholders include the company's employees, unions, suppliers, customers, local and national governments, and communities that may be affected by corporate activities such as construction, manufacturing, and pollution. Stakeholder capitalism is a concept that was largely developed in Europe and reflects the widespread European attitude toward corporate governance, which accepts a great degree of government and social oversight of the corporation. The American approach is often described, in contrast, as *laissez-faire* (meaning "leave alone"), in that corporations are granted more freedom of operation than in Europe. One example of a stakeholder approach is in the German practice known as *codetermination*, in which corporations are required to provide a seat on the corporation's board of directors for a union representative. This is intended to oblige the corporation to be more cognizant of worker needs and demands, and to ensure that corporate strategies are not concealed from workers.

Cause-Related Marketing

Cause-related marketing (CRM) refers to a corporation's associating the sales of its products to a program of donations or support for a charitable or civic organization. An example is provided by the famous Red campaign, in which corporations such as Gap pledged to contribute profits from the sale of certain red-colored products to a program for African development and alleviation of AIDS-related social problems. The basic idea of cause-related marketing is that the corporation markets its brand at the same time that it promotes awareness of the given social problem or civic organization that addresses the social problem. Another well-known example is the pink ribbon symbol that promotes breast-cancer awareness and is used

prominently in the marketing of special lines of products by many corporations, such as Estée Lauder, Avon, New Balance and Self Magazine. In addition to marketing products with the pink-ribbon symbol, Estee Lauder has made support for breast cancer awareness one of the defining features of its corporate philanthropy. Thus, Estee Lauder also frequently refers to such charitable contributions, currently on the order of \$150 million, in its corporate communications and public relations documents.⁴

Sponsorship

Sponsorship refers to a corporation's financial support for sports, art, entertainment, and educational endeavors in a way that prominently attributes the support to the particular corporation. Sponsorship can be considered a form of marketing communications because it seeks to raise awareness and appreciation of the corporation in a given target audience. Arguably, of course, sponsorship benefits society, because society appreciates sports, art, and entertainment. However, in the case of sponsorship, as opposed to philanthropy, the sponsors expect a clear return. Indeed, many corporations carefully analyze the benefits of their sponsorship activities in the same way they measure the impact of their marketing and advertising.

Many prominent global sponsors are companies that find it difficult to advertise through other channels. For example, Philip Morris, the world's largest tobacco company and owner of the Marlboro brand, which finds its global advertising restricted due to a number of bans and limits on tobacco advertising, has invested heavily in sponsorship. Philip Morris has long been the number one sponsor of Formula 1 race car competitions, and it is impossible for a spectator to watch one of these races without observing, consciously or otherwise, huge billboards and banners featuring the famous red-and-white Marlboro logo. Similarly, since alcohol advertising is also increasingly scrutinized, it is not surprising that Budweiser has followed a similar tactic and become the principal sponsor of NASCAR racing.

Pharmaceuticals have also become an area subjected to tight advertising and marketing controls; therefore, Pfizer, the world's largest pharmaceutical company, engages in scores of sponsorship activities, notably in its support for the Paralympics, an Olympic-style competition for physically-handicapped athletes.

Sustainability

Sustainability has become such an important concept that it is frequently confused with CSR. Indeed, for some companies it seems that CSR is sustainability. This is perhaps not surprising, given the growing media attention on issues related to sustainability.

Sustainability is a concept derived from environmentalism; it originally referred to the ability of a society or company to continue to operate without compromising the planet's environmental condition in the future. In other words, a sustainable corporation is one that can sustain its current activities without adding to the world's environmental problems.

Sustainability is therefore a very challenging goal, and many environmentalists maintain that no corporation today operates sustainably, since all use energy (leading to the gradual depletion of fossil fuels while emitting greenhouse gases) and all produce waste products like garbage and industrial chemicals. Whether or not true sustainability will be attainable anytime in the near future, the development and promotion of sustainability strategies has become virtually an obsession of most large corporations today, as their websites will attest in their inevitable reference to the corporation's sincere commitment to sustainability and responsible environmental practices. No corporation or corporate executive today will be heard to say that they do not really care about the environment. However, if we observe their actions rather than their words, we may have cause for doubt.

We will explore specific cases related to sustainability in later chapters. For

now, let us just note that CSR, strictly speaking, is broader than environmental sustainability because it also refers to a corporation's ethical relationship to its employees, shareholders, suppliers, competitors, customers, and local and foreign governments.

More recently, many people have been using the term *sustainability* also to refer to social and political sustainability, which brings the concept closer to that of CSR.

Greenwashing

Greenwashing refers to corporations that exaggerate or misstate the impact of their environmental actions. By the early 1990s a great number of consumer products were being promoted as "environmentally friendly," "eco-friendly," or "green," when in fact there was little or nothing to justify the claims. In 1991, an American Marketing Association study revealed that 58% of environmental ads contained at least one deceptive claim. As a result, many advertising regulatory bodies around the world adopted specific advertising codes to regulate the honesty and accuracy of environmental claims in advertising. For example, in the UK, a producer of a recycling bin advertised that it helped buyers "save the rainforests" by encouraging recycling of plastic and paper products. The advertisement was found to be misleading because most paper products sold in the UK were not made from wood in tropical rainforests, but from wood harvested on northern European tree farms.

In Norway, car manufacturers and dealers are prohibited from claiming that their cars are green, eco-friendly, etc., because in the view of the Norwegian Consumer Ombudsman, it is impossible for cars to be beneficial for the environment; the best they can do is reduce the environmental damage they cause.⁵

Greenwashing is not only a corporate practice but a political one as well, as politicians everywhere promise to undertake actions to improve the

environment. Thus, the administration of former US President George W. Bush was widely criticized for promoting legislation under the name of the “Clear Skies Initiative,” when in fact the purpose of the legislation was to weaken antipollution measures.⁶

Social Entrepreneurship and Social Enterprise

Social entrepreneurship and social enterprise refer to the use of business organizations and techniques to attain laudable social goals. As we will discuss further in Chapter 6, Blake Mycoskie decided to create TOMS Shoes largely as a reaction to his travels in Argentina, which had exposed him to terrible poverty that left many school-age children without shoes. An important part of the corporate mission of TOMS Shoes lies in its pledge to give away a free pair of shoes for every pair purchased by a customer. TOMS Shoes’ model has been imitated by many others, including the popular online eyewear brand, Warby Parker.

The difference between social entrepreneurship and CSR is that, with social entrepreneurship, the positive social impact is built into the mission of the company from its founding. Other examples of social entrepreneurship include The Body Shop, Ben & Jerry’s ice cream, and Newman’s Own. The Body Shop was founded by noted activist Anita Roddick who insisted that all products be derived from ingredients which were natural, organic, and responsibly sourced. Her employment policies famously allowed every employee to take off one day a month from work to engage in social or community projects. Similarly, Ben & Jerry’s was founded to promote the use of organic, locally-produced food. The company’s founders insisted on a policy that executives earn no more than seven times the salary of factory line-workers (although this policy was eventually relaxed when it became difficult to recruit a competent CEO at those wages). Ben & Jerry’s engaged in a number of high-profile political activities in which they encouraged their employees to participate, such as protesting the building of the Seabrook nuclear power plant in Vermont. Newman’s Own was founded by film actor

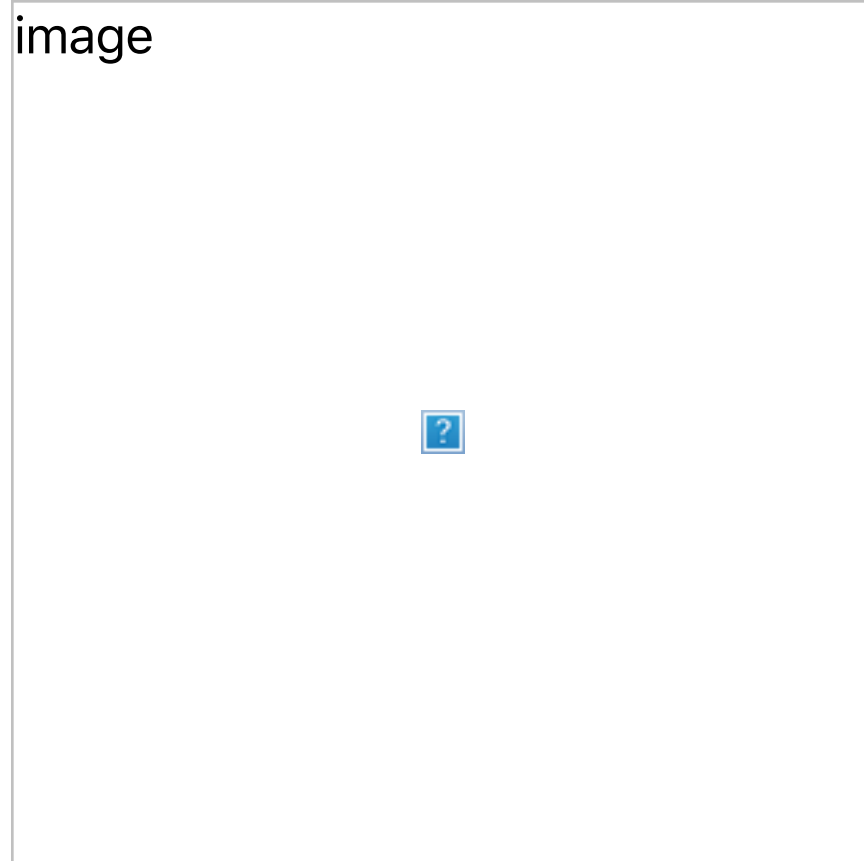
Paul Newman and his friend A. E. Hotchner with the goal of selling wholesome products and giving away 100% of the profits to charitable ventures. To date, Newman's Own has given away over \$200 million.

Social Marketing

Social marketing refers to the use of business marketing techniques in the pursuit of social goals. Often, governments and nonprofit organizations make use of social marketing to make their points more forcefully and effectively to a wide audience. Classic examples are the extremely powerful TV commercials warning of the dangers of unsafe driving or of failing to use seatbelts. Cinematic techniques are employed to portray dramatic, arresting images of crumpled cars and bodies, children and mothers crying. The source of social marketing advertisements is usually a local government or nonprofit organization.

Social marketing is usually used to try to convince citizens to drive more safely, eat better, report child and domestic abuse, and avoid various forms of criminality and drug use. As with ordinary advertising, social marketing can seem overdone or maudlin, and some social marketing ads have been mocked or considered silly. For example, former First Lady Nancy Reagan participated in a social marketing campaign that urged young people to "Just Say No" to drugs, an approach which was ridiculed as simplistic by many. Noted radical activist Abbie Hoffman said that telling drug users to "just say no" to drugs was like telling manic-depressives to "just cheer up." Despite that, drug use in America declined over the time period that the campaign was in progress, though there is no evidence that any part of this decline was due to the campaign.

Business Ethics



Source: United States Marshals Service, 2004, public domain Figure 1.3 The mug shot of former Enron top executive Ken Lay. Lay was eventually convicted on 10 counts of fraud; while awaiting sentencing of up to 100 years in prison he died of a heart attack in 2006.

Business ethics is an academic discipline closely related to CSR, but one that tends to use the tools of philosophy to formally analyze the ethical role of individuals and corporations. Although the terms are quite similar, there are differences of nuance. For example, although academics who study business ethics tend to focus on corporations, the term itself could also apply to the ethical dilemmas of sole proprietors or of individuals involved in commercial situations, such as a private party trying to sell a used car that he knows has a hidden mechanical flaw. While the term *CSR* tends to be used by corporations and social entrepreneurs in a way that assumes a positive connotation, *business ethics* is used in a more neutral and even critical fashion, as one might expect, given the perspective of writers who are not beholden to corporations. Indeed, when the media uses the term *business ethics*, it is often in a negative sense, to draw attention to instances of deception or fraud on the part of corporations or executives.⁷

White-Collar Crime

White-collar crime refers to fraudulent or financially-oriented criminal activities by high-status professionals or businesspeople. The term *white-collar crime* was coined by sociologist Edwin Sutherland, who defined it as a “crime committed by a person of respectability and high social status in the course of his occupation” in a 1939 speech entitled “The White Collar Criminal.” Although the term applies to financial fraud committed by individuals who are not associated with corporations, there is a strong linkage to corporations in actual practice because corporate executives are often well-placed to commit crimes of fraud and corruption. However, a distinction should be drawn between white-collar crime and corporate crime, which refers to crimes for which the corporation itself is responsible. In many cases, such as in violations of US laws against bribing foreign government officials, it may be unclear whether the matter is better classified as white-collar crime or corporate crime. In the law, it may depend on whether the corporation’s senior executives were aware of and supported the acts of criminality.

While there is a popular perception that punishments for wealthy white-collar criminals are less severe than for poor and middle-class criminals, the situation appears to have changed in light of the severe penalties for white-collar crime mandated by the 2002 Sarbanes–Oxley Act, which was adopted by the US Congress in the wake of the notorious Enron scandal. As a result, former Enron CEO Jeffrey Skilling, the architect of Enron’s frauds, was sentenced to 24 years in prison. Bernie Ebbers, former CEO of WorldCom, was convicted of fraudulent misstating of billions of dollars of WorldCom earnings, resulting in a sentence of 25 years. More recently, Bernie Madoff, whose vast Ponzi scheme defrauded investors of up to \$65 billion, was sentenced in 2009 to 150 years in prison for his crimes, effectively a life sentence without possibility of parole.

Topic for Debate: Regulation of Corporations

It is one of the basic premises of this book that we do not want you merely to read and assimilate the material. We want you to engage it personally in an effort to develop and refine your own opinions. Therefore, each chapter will feature a topic for debate (more detailed rules and suggestions for debate will be set forth in the next chapter). Most chapters will feature an in-depth case study based on a real-life business situation, or a fictionalized account of a real business situation or social controversy. In this chapter we will use what we will call a “mini-case study”—a sort of thought experiment, based on a simple set of facts as follows:

Mini-Case Study: The Case of the Undecided Voter

Your close friend, Jane Goodie, is a college student who has registered to vote in her first election. Jane’s father has been a lifelong Republican voter and Jane’s mother a lifelong Democrat. As Jane grew up, she often listened to her parents debating politics at the dinner table. More than once, Jane found herself disconcerted and discouraged by the appearance of biased thinking on the part of one or both of her parents; they rarely seemed to agree or listen to each other in their political debates. Sometimes, Jane even wondered to herself, “Why do they vote at all, since their votes obviously just cancel each other out?” However, since her parents have strongly urged her to vote as soon as she is old enough, and since they have also urged to make up her own mind about which candidate to choose, she is looking forward to expressing her own views at the ballot box. But first she must make up her mind.

Since this is not a presidential election year, the most important office up for election is that of Senator. Both senatorial candidates are very impressive and illustrious people: One is a graduate of Harvard Law School, the other of Yale Law School. The Democratic, or “liberal,” candidate pursued an impressive career as an environmental lawyer before being elected to a position as mayor of one of the leading cities in your state. The Republican, or “conservative,” candidate enjoyed an impressive career as an

advisor to a number of successful start-up companies before also being elected to a position as a mayor of one of the leading cities in your state.

Both candidates appear to be exceptionally bright, eloquent, and dedicated to public service. In this particular campaign, they both espouse very similar views on foreign policy and social policy. In fact, the main difference between the candidates comes down to one thing: their attitude toward government regulation of business, and of large corporations in particular. The Democratic candidate, citing recent examples of fraud, pollution, and layoffs at major corporations, is calling for tighter regulation of corporations. The Republican candidate, citing the importance of the business sector as a major taxpayer and creator of jobs, calls for a loosening and reduction of government regulation of business.

Your friend does not know who to vote for, but believes that she should decide on the basis of the single issue on which the candidates differ: the regulation of business. Your friend asks for your advice.

You are therefore asked to develop the strongest reasons for supporting one of the following two possible responses:

Affirmative Position

Jane should vote for the Democratic candidate.

Possible Arguments:

- It is better to maintain tight regulation of businesses and corporations, given their propensity to cause or contribute to social harms.
- Corporations are able to lobby governments to shield themselves from regulation.
- Corporations are able to attain more power and influence than citizens.

Negative Position

Jane should vote for the Republican candidate.

Possible Arguments:

- It is better to liberate businesses and corporations from onerous and expensive government regulation.
- Corporations are major employers and job-creators.
- Corporations can undertake enormous projects beyond the scope of small business or individuals.
- Corporations stimulate research and innovation.

Readings

The readings below are meant only to stimulate your thinking about possible perspectives to take on corporations. Please supplement them with your own research.

1.1 The Corporation as a "Psychopathic" Creature

Bakan, Joel. "Business as Usual," in The Corporation: The Pathological Pursuit of Profit and Power, 28-59. New York: Simon and Schuster, 2004.

Bakan, Joel. "The Externalizing Machine," in The Corporation: The Pathological Pursuit of Profit and Power, 60-84. New York: Simon and Schuster, 2004.

Business leaders today say their companies care about more than profit or loss, that they feel responsible to society as a whole, not just to their shareholders. Corporate social responsibility is their new creed, a self-conscious corrective to earlier greed-inspired visions of the corporation. Despite this shift, the corporation itself has not changed. It remains, as it was at the time of its origins as a modern business institution in the middle of the nineteenth century, a legally designated "person" designed to valorize self-interest and invalidate moral concern. Most people would find

its “personality” abhorrent, even psychopathic, in a human being, yet curiously we accept it in society’s most powerful institution. The troubles on Wall Street today, beginning with Enron’s spectacular crash, can be blamed in part on the corporation’s flawed institutional character, but the company was not unique for having that character. Indeed, all publicly traded corporations have it, even the most respected and socially acceptable....

As a psychopathic creature, the corporation can neither recognize nor act upon moral reasons to refrain from harming others. Nothing in its legal makeup limits what it can do to others in pursuit of its selfish ends, and it is compelled to cause harm when the benefits of doing so outweigh the costs. Only pragmatic concern for its own interests and the laws of the land constrain the corporation’s predatory instincts, and often that is not enough to stop it from destroying lives, damaging communities, and endangering the planet as a whole.... Far less exceptional in the world of the corporation are the routine and regular harms caused to others—workers, consumers, communities, the environment—by corporation’s psychopathic tendencies. These tend to be viewed as inevitable and acceptable consequences of corporate activity—“externalities” in the coolly technical jargon of economics.

“An externality,” says economist Milton Friedman, “is the effect of a transaction...on a third party who has not consented to or played any role in the carrying out of that transaction.” All the bad things that happen to people and the environment as a result of corporations’ relentless and legally compelled pursuit of self-interest are thus neatly categorized by economists as externalities—literally, other people’s problems.

1.2 “EPA Costs US Economy \$353 Billion per Year”

Young, Ryan. “EPA costs US economy \$353 billion per year.” The Daily Caller. Last modified December 27, 2012. <http://dailycaller.com/2012/12/27/epa-costs-us-economy-353-billion->

[per-year/](#).

Transparency is the lifeblood of democracy. Washington needs more of it, especially in the all-too-opaque world of regulation. The Environmental Protection Agency (EPA), for example, is the most expensive federal regulatory agency. Its annual budget is fairly modest in Beltway terms, at a little less than \$11 billion, but that's not where the vast majority of its costs come from. Complying with EPA regulations costs the US economy \$353 billion per year—more than 30 times its budget—according to the best available estimate. By way of comparison, that is more than the entire 2011 national GDPs of Denmark (\$332 billion) and Thailand (\$345 billion)...

In the last edition of the Unified Agenda, the fall 2011 edition, the EPA had 318 rules at various stages of the regulatory process. Nobody outside the agency knows how many rules it currently has in the pipeline. All in all, 4,995 EPA rules appeared in the Winter Unified Agenda from 1999–2011. Over the same period, 7,161 EPA final rules were published in the *Federal Register*. That means more than 2,000 final rules, which have the force of law, came into effect without first appearing in the Unified Agenda. This could indicate an important transparency problem.

That's just the EPA's *annual* flow of regulations. The agency has existed for more than 40 years. How many total rules does it currently have in effect? Again, the answer doesn't come from the agency. Earlier this year, the Mercatus Center's Omar Al-Ubaydli and Patrick A. McLaughlin ran text searches through the entire *Code of Federal Regulations* (CFR) for terms such as "shall," "must," "prohibited," and the like. The CFR Title covering environmental protection alone contains at least 88,852 specific regulatory restrictions. The number could be as high as 154,350....

Justice Louis Brandeis correctly believed that sunshine is the best disinfectant. With high regulatory costs contributing to a stagnant economic recovery, it is well past time to shine more light on regulatory agencies. Annual agency report cards would make a good start.

1.3 Press Release from the US Consumer Product Safety Commission

Consumer Product Safety Commission. "Port Surveillance News: CPSC Investigators Find, Stop Nearly 650,000 Unsafe Products at the Start of Fiscal Year 2012." News Release. April 5, 2012. <https://www.cpsc.gov/en/Newsroom/News-Releases/2012/Port-Surveillance-News-CPSC-Investigators-Find-Stop-Nearly-650000-Unsafe-Products-at-the-Start-of-Fiscal-Year-2012/>.

Investigators Stop Nearly 650,000 Unsafe Products

Investigators with the US Consumer Product Safety Commission (CPSC) prevented more than half a million violative and hazardous imported products from reaching the hands of consumers in the first quarter of fiscal year 2012.

Working with US Customs and Border Protection (CBP) agents, CPSC port investigators successfully identified consumer products that were in violation of US safety rules or found to be unsafe. CPSC and CBP teamed up to screen more than 2,900 imported shipments at ports of entry into the United States. As applicable, these screenings involved use and abuse testing or the use of an X-ray fluorescence (XRF) analyzer. Their efforts prevented more than 647,000 units of about 240 different non-complying products from reaching consumers, between October 1, 2011 and December 31, 2011.

Topping the list of products stopped were children's products containing levels of lead exceeding the federal limits, toys and other articles with small parts that present a choking hazard for children younger than 3 years old, and toys and child-care articles with banned phthalates.

In addition to violative toys and other children's products, items stopped at import included defective and dangerous hair dryers, lamps, and holiday

lights.

"We mean business when it comes to enforcing some of the toughest requirements for children's products in the world. If an imported product fails to comply with our safety rules, then we work to stop it from coming into the United States," said Chairman Inez Tenenbaum. "Safer products at the ports means safer products in your home."

During fiscal year 2011, CPSC inspected more than 9,900 product shipments at the ports nationwide and stopped almost 4.5 million units of violative or hazardous consumer products from entering the stores and homes of US consumers.

CPSC has been screening products at ports since it began operating in 1973. In 2008, the agency intensified its efforts with the creation of an import surveillance division.

1.4 "Costs of Air Pollution in the U.S."

Taylor, Timothy. "Costs of Air Pollution in the U.S.," *Conversable Economist* (blog), November 7, 2011, <http://conversableeconomist.blogspot.com/2011/11/costs-of-air-pollution-in-us.html>.

What costs does air pollution impose on the U.S. economy? Nicholas Z. Muller, Robert Mendelsohn, and William Nordhaus tackle that question in the August 2011 issue of the *American Economic Review*. Total "gross external damages" the six "criterion" air pollutants in 2002—sulfur dioxide, nitrogen oxides, volatile organic compounds, ammonia, fine particulate matter, and coarse particulate matter—was \$182 billion.

Since GDP was about \$10.5 trillion in 2002, the cost of air pollution was a bit under 2% of the total. The effects included in the model calculations are adverse consequences for human health, decreased timber and agriculture

yields, reduced visibility, accelerated depreciation of materials, and reductions in recreation services.

The sectors with the biggest air pollution costs measured in terms of “gross external damages” (GED) (counting the same six pollutants but again not counting carbon emissions) are utilities, agriculture/forestry, transportation, and manufacturing.

If one looks at the ratio of gross economic damages to value-added in the sector, agriculture/forestry and utilities lead the way by far with ratios above one-third. Manufacturing has fairly high gross external damages, but the GED/VA ratio for the sector as a whole is only 0.01.

To me, a lesson that emerges from these calculations is that the costs of air pollution and of burning fossil fuels are very high, both in absolute terms and compared to the value-added of certain industries, even without taking carbon emissions into account. Environmentalists who are discouraged by their inability to persuade more people of the risks of climate change might have more luck in reducing carbon emissions if they deemphasized that topic—and instead focused on the costs of these old-fashioned pollutants.

1.5 “Over-Regulated America”

“Over-regulated America: The home of laissez-faire is being suffocated by excessive and badly written regulation.” The Economist. Last modified February 8, 2012. <http://www.economist.com/node/21547789>.

Synthesis Questions

The most productive discussions and debates are those that open our eyes to different perspectives and different ways of thinking. While we may not change our initial opinions, we may emerge with an enhanced understanding of the perspectives of others, or of the complexity of a particular issue.

So we suggest that at the end of each chapter you answer a few questions in a way that allows you to “synthesize” your discussions and readings—by bringing together the strongest parts of each side of the argument—so as to arrive at a deeper, more nuanced understanding of the issues involved.

Clearly, the ethical role of corporations is a vast, complex topic and allows for a great diversity of opinions. Here are three initial synthesis questions for further reflection:

Synthesis Questions

1. Are corporations on the whole good for society?
2. Do you personally like or distrust corporations? Why?
3. How should society regulate corporations?

Endnotes

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3. Steven Pearlstein, “Two Can Play the Airline Bankruptcy Game,” *Washington Post*, 28 April 2012, accessed November 28, 2014, http://www.washingtonpost.com/business/steven-pearlstein-two-can-play-the-airline-bankruptcy-game/2012/04/27/gIQAJ239nT_story.html.
4. “The Estee Lauder Companies Breast Cancer Awareness Campaign,” accessed November 28, 2014, <http://bcacampaign.com/>.

5. "Norway Outlaws 'Green' Cars," *TerraPass*, September 11, 2007, accessed December 6, 2014

6. US Senator Patrick Leahy, "The Greenwashing of the Bush Anti-Environmental Record on the President's Earth Day Visits to Maine and Florida," (statement on the Senate floor, Washington, DC, April 26, 2004).

7. See Sebastian Bailey, "Business Leaders Beware: Ethical Drift Makes Standards Slip," *Forbes*, May 15, 2013, accessed December 6, 2014, <http://www.forbes.com/sites/sebastianbailey/2013/05/15/business-leaders-beware-ethical-drift-makes-standards-slip/>.

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