business ethics

Managing Corporate Citizenship and Sustainability in the Age of Globalization

Fourth edition

ANDREW CRANE

DIRK MATTEN

OXFORD
UNIVERSITY PRESS

OUTLINE CONTENTS

2

Framing Business Ethics

CORPORATE RESPONSIBILITY, STAKEHOLDERS, AND CITIZENSHIP

Having completed this chapter you should be able to:

- Explain why corporations have social responsibilities.
- Explain corporate social responsibility in terms of its levels, strategies, and outcomes.
- Explain the stakeholder theory of the firm.
- Apply accurately the concepts of corporate citizenship, accountability, and transparency to the political role of corporation.
- Critically evaluate the implications of applying these theories and concepts to different international contexts.

Key concepts and skills:

Concepts

- Corporate social responsibility (CSR)
- Stakeholder theory
- Corporate citizenship
- Corporate accountability
- Corporate transparency

Skills

- Applying the CSR pyramid
- Designing a CSR strategy
- Stakeholder analysis
- Corporate citizenship analysis

■ Towards a framework for business ethics

In Chapter 1 we defined the subject of business ethics as 'the study of business situations, activities, and decisions where issues of right and wrong are addressed'. In order to address issues of right and wrong, the crucial starting point for businesses is the question of whether companies are actors that have to make decisions beyond simply producing goods and services on a profitable basis. After all, if companies provide us with great products that we want to buy, employ workers to produce them, and pay taxes to government, are they not already providing a sufficient contribution to society? It is the definition and justification of these potentially wider responsibilities that is the subject of this chapter.

We begin by addressing the fundamental nature of the modern corporation in order to answer the question of whether corporations can have a moral responsibility in the same way as individual people do. We then proceed to discuss key themes in the literature on the social role of business, namely corporate social responsibility, stakeholder theory, and corporate accountability. We finish the chapter by exploring the notion of corporate citizenship. We argue that although this is a new concept to have emerged from the literature, and it can be interpreted in a number of different ways, in its fullest sense it can be extremely useful for framing some of the problems of business ethics in the global economy that were raised in Chapter 1.

■ What is a corporation?

It may seem like an obvious question, but the practical and legal identification of the corporation within any given society has significant implications for how, and indeed whether, certain types of responsibility can be assigned to such an entity. Corporations are clearly not the same as individual people, and before we can decide what responsibilities they might have, we need to define exactly what they are and why they exist in the first place.

The corporation is by far the dominant form of business entity in the modern global economy. Although not all businesses (such as sole traders) are corporations, and many corporations (such as charities and universities) are not-for-profit businesses, we shall be concentrating primarily on business in the corporate form.

Key features of a corporation

So what is it that defines a corporation? A corporation is essentially defined in terms of legal status and the ownership of assets. Legally, corporations are regarded as independent from those who work in them, manage them, invest in them, or receive products or services from them. Corporations are separate entities in their own right. For this reason, corporations are regarded as having *perpetual succession*, i.e. as an entity, they can survive the death of any individual investors, employees, or customers—they simply need to find new ones.

This legal status leads to the second key defining feature of corporations. Rather than shareholders or managers owning the assets associated with a corporation, *the corporation owns its own assets*. The factories, offices, computers, machines, and other assets operated by, say, Samsung, are the property of Samsung, not of its shareholders. Shareholders simply own a share in the company that entitles them to a dividend and some say in certain decisions affecting the company. They could not, for instance, arrive at Samsung's HQ and try to remove a computer or a desk and take it home, because it is Samsung that owns that computer or desk, not the shareholder. Similarly, employees, customers, suppliers, etc., deal with and agree contracts with the corporation, not with shareholders.

The implications of this situation are significant for our understanding of the responsibilities of corporations:

- **Corporations are typically regarded as 'artificial persons' in the eyes of the law.** That is, they have certain rights and responsibilities in society, just as an individual citizen might.
- **Corporations are notionally 'owned' by shareholders, but exist independently of them.** The corporation holds its own assets, and shareholders are not responsible for the debts or damages caused by the corporation (they have limited liability).
- **Managers and directors have a 'fiduciary' responsibility to protect the investment of shareholders.** This means that senior management is expected to hold shareholders' investment in trust and to act in their best interests. As we shall see in Chapter 6, the exact nature of the duty this imposes on managers and how it is legally structured actually varies across different parts of the world.

This establishes a legal framework for corporations to be open to questions of responsibility in that a company is legally responsible for its actions in the eyes of the law. However, this is not quite the same as assigning a *moral* responsibility to corporations. After all, it is one thing to say that a person feels a sense of moral responsibility for their actions, and can feel pride or shame in doing the right or wrong thing, but clearly we cannot claim the same for inanimate entities such as corporations. Hence, we need to look a little more closely at the specific nature and responsibilities of corporations.

Can a corporation have social responsibilities?

In 1970, just after the first major wave of the business ethics movement in the US, the Nobel-Prize-winning economist Milton Friedman published an article that has since become a classic text, questioning the alleged social role of corporations. Under the provocative title 'The social responsibility of business is to increase its profits', he vigorously protested against the notion of social responsibilities for corporations. His arguments, which have been rehearsed by many corporate responsibility sceptics over the years (see for example Karnani 2010), boil down to three concerns:

- **Only human beings have a moral responsibility for their actions.** The first substantial point is that corporations are not human beings and therefore cannot assume true moral responsibility for their actions. Since corporations are set up by individual human beings, it is those human beings who have moral responsibility for the actions of the corporation.

- **It is managers' responsibility to act solely in the interests of shareholders.** The second concern is that as long as a corporation abides by the legal framework society has set up for business, the only responsibility of the managers of the corporation is to make profit, because it is for this task that the firm has been set up and the managers have been employed. Acting for any other purpose constitutes a betrayal of their special responsibility to shareholders and thus essentially represents a 'theft' from shareholders' pockets.
- **Social issues and problems are the proper province of the state rather than corporate managers.** The critics' third main point is that managers should not, and cannot, decide what is in society's best interests. This is the job of government. Corporate managers are neither trained to set and achieve social goals, nor (unlike politicians) are they democratically elected to do so.

We will deal with the second and third points shortly. First, however, we will examine the proposition that a company cannot be morally responsible for what it does, since its decisions are essentially those of individual people.

Can a corporation be morally responsible for its actions?

Is a corporation just a loose collection of individuals who work together under the same roof, or is it a distinct entity of its own which can actually assume moral responsibility for the rights and wrongs of its actions? We suggest four considerations that have contributed to a situation where most scholars, and indeed the wider public, would nowadays answer this question in the affirmative.

- **Legal identity.** Perhaps the strongest case for assigning responsibility to a corporation comes from the legal perspective because corporations have a distinct legal identity. Corporations enter into contracts, they are subject to a host of legal requirements, including paying taxes, ensuring the safety of their products and meeting environmental obligations. Corporations can sue other entities, and vice versa, and they can be subject to all sorts of legal prosecutions. Corporations can also claim a number of rights. Indeed, the scope of corporate rights in the US has been significantly enlarged in recent years through rulings that grant corporate rights to free speech under the First Amendment, including the ability to limitlessly fund political campaigns.[1]
- **Agency.** Corporations can also be said to decide and act independent of their members (Moore 1999). This argument is based on the idea that every organization has a *corporate internal decision structure* that directs corporate decisions in line with predetermined goals (French 1979). Such an internal decision structure is manifested in various elements—such as corporate policies and procedures—that, acting together, result in the majority of corporate actions being regarded as the result of corporate, not individual, decisions. This does not completely deny individual agency and there are still quite a number of decisions that can be directly traced back to individual actors. The crucial point is that corporations have an organized framework of decision-making that establishes an explicit or implicit *purpose* for these decisions.

- **Organizational culture.** A further argument supporting the moral dimension of corporate responsibility is the fact that all companies not only have an organized corporate internal decision structure, but also a set of beliefs and values that set out what is generally regarded as right or wrong in the corporation—namely, the *organizational culture* (Moore 1999). As we shall see in Chapter 4, these values and beliefs are widely believed to be a strong influence on the individual's ethical decision-making and behaviour. Hence, many of the issues discussed in this book for which corporations receive either praise or blame can be traced back to the company's culture. For example, the executive director of Ethisphere, which produces an annual list of the 'world's most ethical companies' argues that 'a culture of ethics is crucial to sustainable excellence' (Smith 2013).
- **Functional identity.** Finally, on a more general level we observe that corporations present themselves and interact with customers and other stakeholders as if they were distinct persons. Often associated with their brand, companies interact with customers as objects of affection (e.g. McDonalds' 'I'm lovin' it' slogan), or companionship (e.g. Jack Daniels' 'Become a friend of Jack' feature)—or just put up a human face as the brand to begin with, such as Colonel Sanders (Kentucky Fried Chicken) or Mr Clean (Procter & Gamble). As we will see later in this chapter, many corporations refer to themselves as corporate 'citizens' and espouse the aspiration to act as a good neighbour and partner with other members of society.

We can therefore conclude that corporations do indeed have some level of moral responsibility that is more than the responsibility of the individuals constituting the corporation. In the following sections, we will take a closer look at the second argument brought forward by Friedman (and many of his followers). This questions any social responsibilities a corporation might have beyond those that are based on the duty to produce profits for shareholders. In order to do so, we shall primarily discuss the two most influential concepts to have arisen from the business ethics literature to date: corporate social responsibility and stakeholder theory.

■ Corporate social responsibility

The systematic reasoning about a conceptual framework for corporate social responsibility (CSR) started in the US more than half a century ago (Carroll 2008). During this time many different concepts and principles have been aired and debated in relation to CSR. Such debates have focused on two key questions:

1. Why might it be argued that corporations have social as well as financial responsibilities?
2. What is the nature of these social responsibilities?

Let us look at each of these two questions in turn.

Why do corporations have social responsibilities?

This first question has raised enormous amounts of controversy in the past, but it is by now fairly widely accepted that businesses do indeed have responsibilities beyond simply making a profit. This is based on a number of distinct, but related, arguments, many of which tend to be couched in terms of *enlightened self-interest*, i.e. the corporation takes on social responsibilities insofar as doing so promotes its own self-interest. Such a 'business case for CSR', is commonly advanced using four main arguments (Davis 1973; Mintzberg 1983; Smith 2003; Kurucz et al. 2008):

- **Enhance (long-term) revenues**. Corporations perceived as being socially responsible might be rewarded with extra and/or more satisfied customers, while perceived irresponsibility may result in boycotts or other undesirable consumer actions. Just consider the commercial success that automotive companies Toyota and Tesla have had with hybrid and electric cars, respectively. Similarly, employees might be more attracted to, and committed to, corporations perceived as being socially responsible, giving such companies more effective workforces (Greening and Turban 2000).
- **Reduce costs**. CSR can reduce costs as it helps in saving energy, reducing waste and cutting out inefficiencies. Wal-Mart, for instance, is expected to have achieved savings of $1 billion by 2020 due to such CSR-related measures in particular with regard to enhancing its environmental performance.[2]
- **Manage risk and uncertainty**. Voluntarily committing to social actions and programmes may forestall legislation and ensure greater corporate independence from government (Moon and Vogel 2008). A more responsible approach to the safety of their offshore drilling might have saved BP the $20 billion it had to spend in the aftermath of the Deepwater Horizon Accident in the Gulf of Mexico in 2010. Furthermore, in the aftermath of the Rana Plaza factory collapse in 2013 in Bangladesh, many Western retailers with links to suppliers there feared damage to their brands and reputation.
- **Maintaining the social licence to operate**. A considerable driver for CSR in resource-based industries is the necessity for gaining and maintaining the consent of local communities, employees, and governments. Such actors can effectively provide or revoke a social licence to operate to business. More broadly, making a positive contribution to society might be regarded as a long-term investment in a safer, better-educated and more equitable community, which subsequently benefits the corporation by creating an improved and stable competitive context in which to do business (Porter and Kramer 2006).

These are primarily good *business* reasons why it might be advantageous for the corporation to act in a socially responsible manner. **Case 2** provides an example of American Apparel, a company that positions itself clearly as a responsible company in the fashion industry and that has reaped some success in doing so. In arguing against CSR, Friedman (1970) in fact does not dispute the validity of such actions, but rather says that when they are carried out for reasons of self-interest, they are not CSR at all, but merely profit-maximization 'under the cloak of social responsibility'. This may well be true, and to a large extent depends on the *primary motivations* of the decision-maker (Bowie 1991). It is not so much a matter of whether profit subsequently arises from social actions, but whether profit or altruism was the main reason for the action in the first place. However, corporate motives are difficult, sometimes impossible, to determine. Also, despite numerous academic studies, a direct relationship between social responsibility and profitability has been almost impossible to unambiguously 'prove'.[3] Even though the overall weight of evidence seems to suggest some kind of positive relationship, there is still the issue of causality (Orlitzky 2008). When successful companies are seen to be operating CSR programmes, it is just as reasonable to suggest that CSR does not contribute to the success, but rather the financial success frees the company to indulge in the 'luxury' of CSR.

Hence, in addition to these business arguments for CSR, it is also important to consider further *moral* arguments for CSR:

- **The externalities argument**: Externalities are the positive and social impacts of an economic transaction that are borne by those other than the parties engaging in the transaction. Corporations create a variety of externalities of one sort or the other. Whether through the provision of products and services, the employment of workers, or through their ubiquitous advertising—corporations cannot escape responsibility for these impacts, whether they are positive, negative, or neutral. Many regard corporations to have a moral responsibility to deal with, in particular, the negative externalities they cause, such as pollution, resource depletion, or community problems, insofar as these are not dealt with by governments.
- **The power argument**: Another important argument is that as powerful social actors, with recourse to substantial resources, corporations should use the power and resources responsibly in society. Some refer to this as the Spiderman maxim: 'with great power comes great responsibility'.
- **The dependency argument**: Corporations rely on the contribution of a much wider set of constituencies, or stakeholders in society (such as consumers, suppliers, local communities), rather than just shareholders, and hence have a duty to take into account the interests and goals of these stakeholders as well as those of shareholders.

Given this range of moral and business arguments for CSR, the case for CSR is on a reasonably secure footing, although as we shall discuss later in the chapter, there are also problems with this, particularly in terms of the accountability of corporations (see Implications of CC: corporate accountability and transparency, p. 76). Our next question though is: if corporations have some type of social responsibility, what form does that responsibility take?

VISIT THE ONLINE RESOURCE CENTRE for a short response to this feature

? THINK THEORY

Theories of CSR suggest there are both business and moral reasons for engaging in social initiatives. Go to the website of one or two companies of your choice and find the section dealing with social issues (the page may be headed CSR or sustainability, or perhaps corporate citizenship) and see what kinds of reasons the corporations give for their involvement in CSR. Is there a balance of business and moral reasons, or does one type of reason predominate? How do you explain this?

What is the nature of corporate social responsibilities?

Corporate social responsibility The attempt by companies to meet the economic, legal, ethical, and philanthropic demands of a given society at a particular point in time.

Probably the most established and accepted model of CSR that addresses our second question is the 'Four-part model of corporate social responsibility', as initially proposed by Archie Carroll (1979), and subsequently refined in later publications (e.g. Carroll 1991; Carroll and Buchholtz 2015). This model is depicted in **Figure 2.1**.

Carroll regards **corporate social responsibility** as a multilayered concept, which can be differentiated into four interrelated aspects—economic, legal, ethical, and philanthropic responsibilities. He presents these different responsibilities as consecutive layers

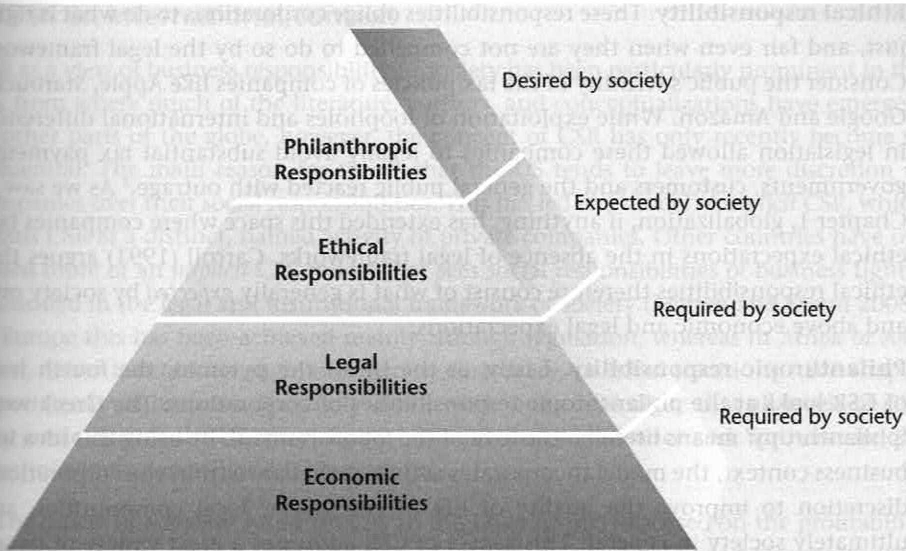

Figure 2.1 Carroll's four-part model of corporate social responsibility

Source: Adapted from Carroll, A.B. 1991. The pyramid of corporate social responsibility: toward the moral management of organizational stakeholders. *Business Horizons*: 42, Fig. 3.

within a pyramid, such that 'true' social responsibility requires the meeting of all four levels consecutively, depending on the expectations present in society at the time.

- **Economic responsibility**. Companies have shareholders who demand a reasonable return on their investments, they have employees who want good jobs, and they have customers who want their products to satisfy their needs. So the first responsibility of business is to be a well-functioning economic unit and to stay in business. This first layer of CSR is the basis for all the subsequent responsibilities, which rest on this (ideally) solid basis. According to Carroll (1991), the satisfaction of economic responsibilities is thus *required* of all corporations. In the extreme this leads to the idea that some large banks are 'too big to fail' because their basic economic functions are so vital to society that they should be 'bailed out' by governments and taxpayers when in trouble.
- **Legal responsibility**. The legal responsibility of corporations demands that businesses abide by the law and 'play by the rules of the game'. Laws, as we have seen in Chapter 1, are the codification of society's moral views, and therefore abiding by these standards is a necessary prerequisite for any further reasoning about social responsibilities. In some ways this may sound trivial if we talk about CSR, but the frequent news about court cases against corporations show that compliance with the law is by no means self-evident. Consider the scandals around mislabelled meat in Europe in 2013, faking of safety certificates in the Korean nuclear industry, or the massive $13 billion fine JP Morgan accepted in the US for misleading investors in mortgage-backed securities[4]—legal responsibilities appear to be an ongoing challenge in discharging CSR. As with economic responsibilities, Carroll (1991) suggests that the satisfaction of legal responsibilities is *required* of all corporations seeking to be socially responsible.

- **Ethical responsibility**. These responsibilities oblige corporations to do what is right, just, and fair even when they are not compelled to do so by the legal framework. Consider the public's scrutiny of the tax policies of companies like Apple, Starbucks, Google and Amazon. While exploitation of loopholes and international differences in legislation allowed these companies to legally avoid substantial tax payments, governments, customers and the general public reacted with outrage.[5] As we saw in Chapter 1, globalization, if anything, has extended this space where companies face ethical expectations in the absence of legal frameworks. Carroll (1991) argues that ethical responsibilities therefore consist of what is generally *expected* by society over and above economic and legal expectations.
- **Philanthropic responsibility**. Lastly, at the tip of the pyramid, the fourth level of CSR looks at the philanthropic responsibilities of corporations. The Greek word 'philanthropy' means literally 'the love of the fellow human'. By using this idea in a business context, the model incorporates activities that are within the corporation's discretion to improve the quality of life of employees, local communities, and ultimately society in general. This aspect of CSR addresses a great variety of issues, including things such as charitable donations, the building of recreation facilities for employees and their families, support for local schools, or sponsoring of art and sports events. According to Carroll (1991: 42), philanthropic responsibilities are therefore merely *desired* of corporations without being expected or required, making them 'less important than the other three categories'.

The benefit of the four-part model of CSR is that it structures the various social responsibilities into different levels, yet does not seek to explain social responsibility without acknowledging the very real demands placed on the firm to be profitable and legal. In this sense, it is fairly pragmatic.

However, its main limitation is that it does not adequately address the problem of what should happen when two or more responsibilities are in conflict. For example, the threat of plant closures and/or job losses often raises the problem of balancing economic responsibilities (of remaining efficient and profitable) with ethical responsibilities to provide secure jobs to employees. A typical example is a company that relocates its operations from the global North to a developing country. While this satisfies the economic level in terms of boosting profits for shareholders and providing employment for hitherto unemployed workers in the developing world, it can clash with ethical responsibilities in terms of abandoning long-standing ties to workers and communities in the North and exploiting lower environmental or social standards overseas.

☑ Skill check

Applying the CSR Pyramid. The pyramid of CSR is a useful tool for analysing the specific societal expectations that a corporation faces. Effective application of the pyramid enables a more refined and comprehensive analysis of relevant social responsibilities.