employment; consequently, any movement of any of these factors from home to abroad would result in an increase in foreign output abroad and a decrease in domestic output. Even if this assumption were realistic, it's still possible that gains in the host country will be greater or less than the losses in the home country.

Growth and employment effects are not a zero-sum game because MNEs may use resources that were unemployed or underemployed.

The argument that both home and host countries may gain from FDI rests on two assumptions: 1) resources aren't necessarily being fully employed and 2) capital and technology can't be easily transferred from one industry to another. Let's say, for example, that a soft-drink maker is producing at maximum capacity for the domestic market but is limited (say, by high transportation costs) in generating export sales. In addition, moving into other product lines or using its financial resources to increase domestic productivity aren't viable options.

Setting up a foreign production facility is appealing because it would allow the company to develop foreign sales without reducing resource employment in its home market. In fact, it may wind up hiring additional domestic managers to oversee international operations; perhaps it will also end up earning dividends and royalties from the foreign use of its capital, brand, and technology.

In recent years, many U.S. and European garment manufacturers have moved production operations to low-wage countries to realize cost advantages. In the process, they've shut down—or at least declined to expand—home-country operations. Thus overseas FDI in the garment-making industry has resulted in a loss of jobs in home countries while creating jobs abroad. The situation may be unfortunate, but the fact that it did come about may mean it was inevitable. In the absence of serious protection, argue some experts, home-country operations would have closed down because of competition from abroad, and jobs would have been lost anyway. Conversely, of course, host countries gain through the transfer of capital and technology. If that capital is used to acquire host-country operations that are going out of business, then the foreign investor may very well save host-country jobs and, through the import of technology and managerial ability, even create new jobs.

Critics, however, contend that MNEs often make investments that domestic companies could otherwise make, thereby locking out local entrepreneurs. Likewise, they say, foreign investors often bid up prices when competing with local companies for labor and other resources. Critics also claim that FDI destroys local entrepreneurship in ways that affect national development. Because entrepreneurs are inspired by the reasonable expectation of success, the collapse in several countries of small cottage industries, especially in the face of MNE efforts to consolidate local operations, may have played a role in undermining the competitive confidence of local businesspeople.

Many actions elicit universal agreement on what is right or wrong, but other situations are less clear.

Companies and those who work for them must act *responsibly* wherever they go. However, a look at ethical behavior tends to focus on individuals—those who finally make the decision of how to behave. But top management can determine the values a company espouses and to which employees must adhere. Such values are generally included in a Code of Conduct (discussed at the end of the chapter) and in the behavior of other individuals in the organization, especially peers and superiors. In order to ensure adherence to those values, management will try to hire individuals who are willing to work in the type of ethical environment it is trying to create. However, people still must make the decision about how they are going to act in any given situation.

There are three levels of moral development:

- Preconventional
- Conventional
- Postconventional, autonomous, or principled

The sections below will examine the cultural and legal dimensions of ethical behavior in a global context. First, though, let's briefly examine the broad foundations of ethical behavior. There are three levels of moral development:[8]

- Level 1, the *preconventional* level, where children learn what is right and wrong but don't necessarily understand *why* their behavior is right or wrong.
- Level 2, the *conventional* level, where we learn role conformity, first from our peers (including parents), then from societal laws. One could argue that company codes of conduct are also part of the *conventional* level of behavior in the narrow context of a company rather

than a society. However, behavior espoused by companies likely reflects the values of the company's home country.

- Level 3, the *postconventional, autonomous, or principled* level, where individuals internalize moral behavior, not because they are afraid of sanctions, but because they truly believe such behavior is right.

It is possible that behaviors under Level 2 and Level 3 are the same as long as individuals accept the laws where they live, or the codes of conduct of the companies they work for.[9]

Teleological Approach: Decisions are based on the consequences of the action.

Utilitarianism: An action is right if it produces the greatest amount of good.

Deontological Approach: Moral judgments are made and moral reasoning occurs independent of consequences.

When individuals confronted with ethical decisions enter the realm of moral reasoning, they examine their moral values, especially as related to Levels 2 and 3 above, and decide what to do. One method of doing so, the **teleological approach**, holds to the idea that decisions are based on the consequences of the action. **Utilitarianism**, a consequences-based theory of moral reasoning, means that "an action is right if it produces, or if it tends to produce, the greatest amount of good for the greatest number of people affected by the action. Otherwise, the action is wrong."[10] A second method, the **deontological approach**, asserts that we make moral judgments or engage in moral reasoning independent of consequences. It implies that actions are right or wrong *per se*.[11] In other words, ethics teaches that "people have a responsibility to do what is right and to avoid doing what is wrong."[12] When individuals engage in moral reasoning, they use one or the other of these methods, or possibly some mixture of the two.

When an individual moves abroad, moral reasoning becomes very complicated. Consequences may vary due to legal differences, and what is right or wrong may depend to an extent on local values. People need to figure out how make moral decisions—and so do the companies they work for. Two questions arise here: Why should companies and individuals care about ethical behavior? And what are the cultural and legal foundations of ethical behavior when it comes to adapting to a foreign environment?

WHY DO COMPANIES CARE ABOUT ETHICAL BEHAVIOR?

Why should companies worry about ethical behavior at all? From a business standpoint, ethical behavior can be instrumental in achieving one or both of two possible objectives:

1. To develop competitive advantage
2. To avoid being perceived as irresponsible

First, some argue that responsible behavior contributes to strategic and financial success because it fosters trust, which in turn encourages commitment.[13] For instance, GE's Ecomagination program reflects top managers' belief that by actively responding to social concerns about global warming, GE can gain a strategic advantage over competitors, perhaps developing an edge in emerging markets that are facing severe environmental problems.

NGOs are active in prodding companies to comply with certain standards of ethical behavior.

Second, companies are aware that more and more NGOs and other groups and individuals are becoming active in monitoring—and publicizing—international corporate practices. Governments also want to ensure that individual and corporate behavior is consistent with the best interests of the broader community and that laws are being duly followed. Even worse than perception is reality. Unethical behavior can result in serious sanctions against companies and legal action against individuals.

THE CULTURAL AND LEGAL FOUNDATIONS OF ETHICAL BEHAVIOR

RELATIVISM VERSUS NORMATIVISM

Values differ from country to country and between employees and companies.

Despite the cultural differences found among countries, as discussed in Chapter 2, it is tempting to assume that there is almost universal agreement on what's right and what's wrong when it comes to ethical and socially responsible behavior in business. In the real

CONCEPT CHECK

Recall from Chapter 2, pages 29-30, our discussion of "Cultural Awareness" and the various ways in which social and cultural distinctions can characterize a country's population. We also observed that companies doing business overseas need to be sensitive to internal diversity: They should remember that people in most nations are often members of multiple cultures and in some cases have more in common with certain foreign groups than with domestic groups.

world, however, managers face situations in which the whys and hows of applying cultural values are less than crystal clear. Everything that complicates dilemmas in the domestic business environment tends to complicate them even further in the international arena. So, does ethical behavior vary by country, or are there uniform values that everyone should share?

One point of view is to accept that there are significant differences from country to country that might affect our behavior. "When in Rome, do as the Romans do" is an oft-quoted expression that dates to the fourth century AD which implies that in different environments, one must adapt to local customs out of respect for them.[14]

Applying this expression in an international environment may depend on whether we assume that decisions are based on the consequences of our actions or on a strongly held view of right and wrong. **Relativism** holds that ethical truths depend on the values of a particular society and may vary from one society or country to another.[15] The implication is that it would not be appropriate to inject or enforce one's ethical values on another, or that a foreigner must adopt local values or morals whether or not they are consistent with the foreigner's own home values and beliefs.

Relativism: Ethical truths depend on the groups holding them.

In contrast, **normativism** holds that there are indeed universal standards of behavior that, although influenced by different cultural values, should be accepted by people everywhere. Even a pluralistic society such as the United States has a large core of commonly held values and norms.[16] However, people may adopt other values and norms as their own. The key is to distinguish between what is common to all and what is unique to the individual.

CONCEPT CHECK

In discussing "guidelines for cultural adjustment" on page 45 in Chapter 2, we demonstrate that successful accommodation to a host country's culture depends not only on that culture's willingness to accept anything foreign but also on the extent to which foreign firms and their employees are able to adjust to the culture in which they find themselves.

Companies and their employees struggle with the problem of how to implement their own ethical principles in foreign business environments: Do those principles reflect universally valid "truths" (the normative approach)? Or must they adapt to local conditions on the assumption that every place has its own "truths" and needs to be treated differently (the relative approach)?

Many individuals and organizations have laid out minimum levels of business practices that they say a company (domestic or foreign) must follow regardless of the legal requirements or ethical norms prevalent where it operates.[17] One could consider this as behavior based on principles of honesty and fairness, or "ordinary decency."[18]

Normativism: There are universal standards of behavior that all cultures should follow.

Managers need to exhibit ordinary decency—principles of honesty and fairness.

Dealing with *ethical dilemmas* is often a balancing act between *means* (the actions we take, which may be right or wrong) and *ends* (the consequences of our actions, which may also be right or wrong). Legal foundations for ethical behavior can provide guidance here, but legal justification is more rooted in the teleological approach to moral reasoning and moral behavior (consequences) than in the deontological approach (right vs. wrong behavior). However, there are good reasons to consider the law as a foundation of ethical behavior, just as there are limitations to using the law. Another concern is whose laws take precedence? Should the MNE only worry about local laws, or do they have to worry about the laws of the country where their headquarters are located? If there is a conflict between home country and host country laws, which laws take precedence?

Social responsibility requires human judgment, which is subjective and ambiguous.

CONCEPT CHECK

Note that on page 78 in Chapter 3 we define a country's legal system as the fundamental institution that creates a comprehensive legal network to regulate social interaction; its purpose is to stabilize political and social environments as well as to ensure a fair, safe, and efficient business environment.

LEGAL JUSTIFICATION: PRO AND CON

According to the legal argument, an individual or company can do anything that isn't illegal. However, there are five good reasons why this is inadequate:

1. Some things that are *unethical* are not *illegal*. Some forms of interpersonal behavior, for example, can clearly be wrong even if they're not against the law.

2. The law is slow to develop in emerging areas, and it takes time to pass and test laws in the courts. Moreover, because laws essentially respond to issues that have already surfaced, they can't always anticipate dilemmas that will arise in the future.
3. The law is often based on imprecisely defined moral concepts that can't be separated from the legal concepts they underpin.
4. The law often needs to undergo scrutiny by the courts. This is especially true of case law, in which the courts create law by establishing precedent.
5. The law simply isn't very efficient. "Efficiency" in this case implies achieving ethical behavior at a very low cost, and it would be impossible to solve every ethical behavioral problem with an applicable law.[19]

Legal justification for ethical behavior may not be sufficient because not everything that is unethical is illegal.

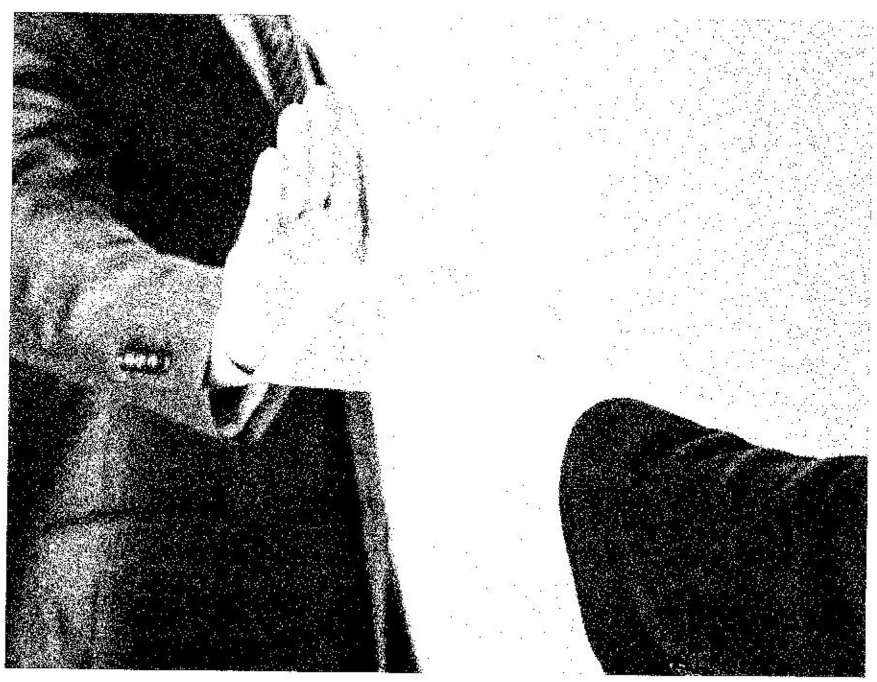
The law is a good basis for ethical behavior because it embodies local cultural values.

In contrast, there are also several good reasons for using the law to justify ethical behavior:

1. The law embodies many of a country's moral principles, making it an adequate guide for proper conduct.
2. The law provides a clearly defined set of rules, and following it at least establishes a good precedent for acceptable behavior.
3. The law contains enforceable rules that apply to everyone.
4. Because the law represents a consensus derived from widely shared experience and deliberation, it reflects careful and wide-ranging discussions.[20]

Bribery of public officials takes place to obtain government contracts or to get officials to do what they should be doing anyway.

Bribery is one facet of *corruption*. The determinants of corruption include cultural, legal, and political forces.[21] As defined by NGO Transparency International, corruption is "the abuse of entrusted power for private gain. When government officials are involved, bribes can be paid to obtain government contracts, or they can be as minor as trying to get government officials to do what they should be doing anyway. It can be grand, petty, and political depending on

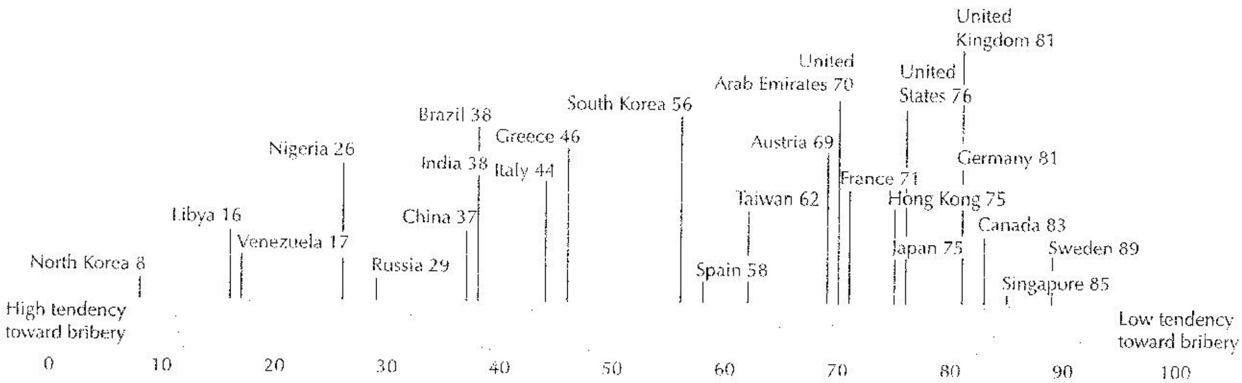


Rejecting the temptation to receive bribes comes from principled behavior reinforced by corporate standards of conduct that prohibit bribes.
Source: Maryna Pleshkun/Shutterstock

FIGURE 5-2 Where Bribes Are (and Are Not) Business as Usual

Transparency International asked country experts, nonresidents, and residents about the overall extent of corruption (frequency and/or size of bribes) in the public and private sectors. The scale runs from 0 to 100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. The figures include a sample of countries.

Source: Based on Transparency International, "TI Corruption Perceptions Index" (2015), transparency.org/cpi2015 (accessed February 15, 2016).



the amounts of money and the sector where it operates."[22] Bribes are payments or promises to pay cash or anything of value.

Bribes are payments or promises to pay cash or anything of value.

Figure 5.2 provides information on the Corruption Perceptions Index for 2015 by identifying the perceived levels of public-sector corruption for a small sample of countries. Although no country is free of corruption, it is depressing to note that the most corrupt countries tend to be in high-conflict regions, especially in Africa. Clearly poverty is an issue, although corruption and bribery occur at all income levels. Higher levels of corruption and bribery can also lead to or result from destabilized political environments, which can create problems for foreign investors as well as local companies. Transparency International not only publishes a Corruption Perceptions Index but also a Bribe Payers Index, which identifies which of the top 28 countries in the world are likely to have companies that pay bribes to do business abroad. In a recent survey, they reported that companies from Russia, China, Mexico, Indonesia, and the United Arab Emirates were most likely to pay bribes, either to foreign government officials or to other private sector companies.[23]

PETROBRAS: CORRUPTION IN BRAZIL WITH A GLOBAL TWIST

Corruption is a widespread phenomenon. Sometimes it occurs within a country involving local politicians and companies or between companies and individuals outside of the political system. But corruption can also involve foreign actors. A good example involves Petrobras, the Brazilian national oil company, which has resulted in the disclosure of at least $2 billion in bribes, kickbacks, and money laundering, involving payments to company executives, the ruling Brazilian Worker's Party, and more than 50 sitting politicians and numerous companies trying to secure lucrative contracts with Petrobras. The speaker of Brazil's lower house of Congress and a powerful senator close to Brazil's president are also being implicated. On the international side, British Engineering group Rolls-Royce was also accused of paying bribes to secure contracts.[24] Other foreign engineering companies are also being investigated for overinflating services and funneling bribes to Petrobras officials and political parties. The Petrobras corruption scandal is one of nine such scandals targeted by Transparency International for a campaign called "Unmask the Corrupt."

THE CONSEQUENCES OF CORRUPTION

Corruption affects company performance and local economies. Higher levels of corruption, for instance, correlate strongly with lower national growth rates and lower levels of per capita income.[25] Corruption can also erode the authority of governments that condone it, as is being seen in Brazil because of the Petrobras scandal. Over the years, bribery-based scandals have led to the downfall of numerous heads of state, with many government officials and business executives being imprisoned, fined, or forced to resign. President Dilma of Brazil was impeached in 2016 over the bribery scandals. Moreover, disclosures of corruption not only damage the reputations of companies and whole countries, they also compromise the legitimacy of MNEs in the eyes of local and global communities when they become involved in the scandals.[26] Finally, corruption is expensive, inflating a company's costs and bloating its prices. Nevertheless, it persists as one of the most challenging concerns in international business and politics in the world today.

WHAT'S BEING DONE ABOUT CORRUPTION?

Many efforts are underway to slow the pace of bribery as an international business practice at international and national levels. International efforts to combat bribery include those established by the OECD (Organization for Economic Cooperation and Development), the ICC (International Chamber of Commerce), and the United Nations through UNCAC (United Nations Convention against Corruption). The problem is that none of the conventions have the force of law behind them. They can identify key issues in corruption and shine the spotlight on offenders, but legal action under the control of national governments must be taken for the fight against corruption to be effective.

The OECD comprises 34 mostly high-income countries from around the world. Its Anti-Bribery Convention, signed in 1997 by the 34 member countries plus six nonmember countries (Argentina, Brazil, Bulgaria, Colombia, Russia, and South Africa), establishes legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides recommendations to the 40 signatory countries, which adopted the 2009 Anti-Bribery Recommendation. As shown in the case of Brazil, it's clear that the Convention isn't working as anticipated. Prior to the signing of the convention, only one country had made foreign bribery a crime, and most others treated foreign bribe payments as legitimate tax-deductible expenses. Of course, the member countries have to implement the recommendations into national law in order for them to have any weight. In addition, the countries have to do a better job of enforcement.[27] For example, a 2015 study by Transparency International found active enforcement in only 4 of the signatory countries, moderate enforcement in 6, and limited, little, or no enforcement in 29 countries.[28]

The European Commission confirmed its support for strong anticorruption measures within the EU in a 2007 communication to the European Council, Parliament, and Economic and Social Committee. This included the adoption of the UN's official definition of corruption and support for many of the policies contained within international agreements. The communication also sanctions the work of the Commission's office of antifraud (OLAF), which conducts the affairs of the EU relevant to corporate and individual corruption, as well as an internal auditing service that monitors the activities of all of the Commission's departments. The EU does not have specific anticorruption legislation, but it encourages member nations to adopt high standards and follow them. In its most recent Anti-Corruption Report, the EU noted that corruption costs the EU 120 billion euro per year, and that efforts to combat corruption are very uneven across the EU[29]—thus the importance of national legislation.

The Foreign Corrupt Practices Act is U.S. legislation that makes bribery illegal. It applies to domestic or foreign operations and to company employees as well as their agents overseas.

There are several ways the United States has gotten involved in foreign corruption. For example, the **Foreign Corrupt Practices Act (FCPA)** outlaws bribery payments by U.S. firms to foreign officials, political parties, party officials, and political candidates. The coverage of the FCPA was extended in 1998 to include bribery by foreign firms operating in any U.S. territory. The FCPA applies not only to companies registered in the United States but also to any foreign company quoted on any U.S. stock exchange.

Although it is legal to make payments to officials to expedite otherwise legitimate transactions (officially called *facilitating payments* but sometimes referred to as *speed money* or *grease money*), payments can't be made to officials who aren't directly responsible for the transactions in question. In 1988, an amendment to the FCPA actually excluded facilitating payments from the definition of *bribery*. Now, for example, payment to a customs official to clear legitimate merchandise is legal, whereas paying a government minister to influence a customs official is not.

The Justice Department can also fight against global corruption even when it doesn't affect government officials. For example, an estimated $150 million bribery scandal involving FIFA, the Swiss-based governing body of football (or soccer in the United States), was brought to light by the U.S. Justice Department because of income tax evasion in the United States by some of the parties, and because of the use of the U.S. financial system to facilitate the flow of funds. Even U.S.-based Nike was brought into the picture because of possible bribes paid to the Brazilian soccer federation. However, the allegations against Nike would not be prosecuted under the FCPA since it didn't involve a foreign government. The scandal became truly global, and the powerful head of FIFA was forced to resign.[30]

Sarbanes–Oxley legislation in the United States is helpful in combating corruption through more effective corporate governance, financial disclosure, and public accounting oversight.

Another major legislative effort in the United States is the Sarbanes–Oxley Act (SOX), which was passed in 2002 as a response to an epidemic of well-known corporate scandals. SOX toughened standards with regard to corporate governance, financial disclosure, and oversight of accounting and auditing practices. With its passage, the Justice Department began to use the FCPA more aggressively to combat bribery.

[illegible]

Companies that extract natural resources, generate air or water waste, or manufacture products such as autos that generate pollution need to be concerned with their environmental impact.

In this section, we refer to the environment more narrowly in the context of pollution, both air and water, and global warming. Although global warming is the dominant concern from a global perspective, pollution is important as well. Companies can create water pollution through disposal of industrial waste into water systems as well as the inefficient use of water, which results more in water shortage than in water pollution. There is a link between air pollution and global warming, but the dominant greenhouse gas (GHG) that causes global warming is carbon dioxide, whereas air pollution is more affected by ozone (also a GHG), sulphur dioxide, nitrogen oxide, and particulates. In modern times, China and India are famous for poor air quality. Even though the advanced industrial countries have seen a reduction in air pollution due to industrial decline and clean air policies, there are still major issues. The European Union estimates that more than 400,000 Europeans die prematurely each year due to air pollution and that health-related issues from air pollution cost 3–7 percent of GDP.[31] Even as the world struggles with global warming, they still have to fight against air pollution.

As we saw in our opening case, GE has come to see eco-responsibility as a matter of protecting not only the future of the environment but also its own future. Like GE, companies contribute to environmental damage in a variety of ways. Some, for example, contaminate the air, soil, or water during manufacturing, or make products such as automobiles or electricity that release fossil-fuel contaminants into the atmosphere.

In extracting natural resources, other companies also have a direct and unmistakable effect on the environment. But even in these cases the issue isn't necessarily clear-cut. Granted, although some resources (such as minerals, gas, and oil) may not be renewable, others (such as timber) are, and some observers even suggest that resources can never really become scarce. Why? Because as they become less available, prices go up and technology or substitutes compensate.

Sustainability involves meeting the needs of the present without compromising the ability of future generations to meet their own needs while taking into account what is best for the people and the environment.

WHAT IS "SUSTAINABILITY"?

Sustainability means meeting the needs of the present without compromising the ability of future generations to meet their own needs. In this section, we use sustainability from the perspective of environmental sustainability. Proponents of the concept argue that

Sustainability is no longer just good business practice. New businesses are emerging that are combining the idea of environmental responsibility and profitability.

sustainability considers what's best for both people and the environment. It is important that companies that affect the environment establish policies for responsible behavior toward the earth—a responsibility that has both cultural and legal ramifications.

But is it possible that sustainability is not only a good business practice, but also good business? GE has demonstrated that it makes good business sense to adopt a strong policy of sustainability, but it also has vast resources at its disposal. However, even born-global companies can adopt a sustainable strategy and generate export revenues at the same time.

GLOBAL WARMING AND THE PARIS AGREEMENT ON CLIMATE CHANGE

Global warming results from the release of greenhouse gases that trap heat in the atmosphere rather than allowing it to escape.

At the core of the United Nations Climate talks held in Paris in December 2015 is the concept that global climate change results from an increase in carbon dioxide and other gases that act like the roof of a greenhouse, trapping heat that would normally radiate into space, and thereby warming the planet. If carbon dioxide emissions aren't reduced and controlled, rising temperatures could have catastrophic consequences, including melting the polar ice cap, flooding coastal regions, shifting storm patterns, reducing farm output, causing drought, and even killing off plant and animal species.[32] The UN Framework Convention on Climate Change (UNFCCC) dates back to 1992 at the Rio Earth Summit. The **Kyoto Protocol**, which was signed in 1997, committed signatory countries to reducing the emissions to 5.2 percent below 1990 levels between 2008 and 2012. However, the Protocol did not include rapidly growing emerging economies like India and China who were two of the biggest polluters, the United States withdrew its support in 2001, and Canada withdrew from the Protocol in 2011.

The Paris Climate Agreement involving 187 countries targeted policies to reduce GHG emissions in order to keep the global average temperature to 2°C above pre-industrial levels.

However, the Paris Agreement changed everything. One hundred eighty-seven countries agreed to keep the increase in the global average temperature to 2°C above pre-industrial levels and try to achieve 1.5°. The countries also agreed to try to shoot for a target of zero net GHG emissions by the second half of the century.[33] That would involve moving away from fossil fuels for electricity and transportation, the two primary creators of GHG emissions, and moving more toward sustainable energy, such as solar and wind. To achieve this ambitious and improbable goal, all countries, including the emerging markets, intended to set national goals called "intended nationally determined contributions or INDCs." In addition, the developed countries agreed to provide $100 billion per year by 2020 to developing countries to help them adapt to climate change. The Paris Agreement discussed how to not only stabilize atmospheric concentration of GHG emissions, but also to avoid dangerous anthropogenic (human) interference with the climate. A big target of the latter concern is reducing deforestation and forest degradation in countries like Indonesia and Brazil. The problem is that shrinking forests contribute to GHG emissions, and their disappearance also eliminates a major natural way to sop up and store carbon dioxide.[34]

The success of the Paris Agreement to slow global warming has to come from two sources—the public sector and the private sector. The problem with the public sector is that countries still rely heavily on fossil fuels. India, for example, is the world's third largest producer of coal, behind China with 46.1 percent and the United States with 11.6 percent. However, India generates 71 percent of its electricity from coal. Even though it invests heavily in alternative energy, especially solar, it will take a while to replace coal. Given the drop in oil prices since mid-2015, the shift to solar and wind energy will require a significant amount of government subsidies. The second source is the private sector. Most large MNEs, as demonstrated by GE in the opening case, are responding to global concerns about the environment by setting their own goals and reporting progress to their stakeholders. Most annual reports are replete with information about the efforts of the companies to reduce their carbon footprint and respond to other environmental concerns. However, a major challenge will be enticing companies to invest heavily in the development of alternative sources of energy without government subsidies to fund growth and money from outside investors. If investors don't see a viable return from investing in alternative energy, they decide not to invest in the energy sector.

Finally, bear in mind that many MNEs, based in the United States or elsewhere, also have the task of adapting to different standards in different countries. A European-based MNE with operations in, say, the United States, Germany, and China, and a U.S.-based MNE with plants in the same countries are faced with a smorgasbord of regulatory environments. On the one hand, the *legal* approach to responsible corporate behavior says an MNE can settle for operating in accord with local laws. The *ethical* approach, on the other hand, urges companies to go beyond the law to do whatever is necessary and economically feasible to reduce GHG emissions, given that they still have multiple stakeholders to satisfy.

A major challenge facing MNEs today is the labor conditions of foreign workers, whether in their own offshore operations or their outsourced supply chains. They're especially critical in retail, clothing, footwear, electronics, and agriculture—industries in which MNEs typically outsource huge portions of production to independent companies abroad.

Should MNEs Accept Full Responsibility for the Unethical Behavior of Their Employees?

Point

Yes However, it is hard to know where the corruption begins and who knows what. On September 18, 2015, the U.S. Environmental Protection Agency announced that it was going to order German auto company, Volkswagen AG, one of the world's leading auto manufacturers and the largest in Europe, to recall over 500,000 vehicles in the United States because they were equipped with software that allowed them to evade emissions standards for reducing smog during testing. The software would recognize when a car was being tested and turn up emissions controls. Then when the car wasn't being tested, the software turned down the emissions controls, which resulted in better driving performance and fuel economy. It was estimated that in normal driving conditions, cars would emit up to 40 times the amount of pollutants allowed by U.S. government regulations. VW announced that the software designed to trick or "defeat" the emissions tests had been installed in millions of vehicles.[35] Eventually, this spread to certain models in Audi and Porsche, two other VW brands. How could this have happened? There were several very interesting dimensions to the case—different regulatory environments in Europe and the United States; VW's desire to increase its market share in the United States, especially in diesel cars; and the efforts of the regulators and VW itself to find out who knew what was going on.

One of the real ironies is that in its 2014 Sustainability Report, VW claimed that it was selling environmentally friendly products and meeting the guidelines for emissions of carbon dioxide, nitrogen oxide, and other pollutants. It also said it was in compliance with the Global Reporting Initiative (G4), the UN Global Compact, and the German Sustainability Code. PricewaterhouseCoopers, one of the leading global public accounting firms, certified that the Sustainability Report was accurate. Not only did VW claim that it was operating according to high standards, but it also had a program to make sure its employees understood what the company stood for.

Different legal and regulatory systems also contributed to differences between U.S. and German stakeholders. Given that VW is a German Company and therefore under the regulatory environment of the European Union, it claimed that even though it was violating U.S. regulatory guidelines, it was not violating European regulatory guidelines. Is it possible that the software was not illegal in Europe, even though it was in the United States? There are not only different standards in the United States and EU, but there are also different testing procedures. In the United States, California has a stringent antipollution regulatory environment, and VW realized it had to find a way to be successful there if it wanted to increase the sale of its diesel engines. Also, U.S. regulators conduct their own tests to see if auto manufacturers' claims are accurate, whereas European regulators leave the testing and verification to the manufacturers themselves.[36] In order to keep from losing its U.S. customers, VW offered payments to customers who had bought cars with the diesel engines that had the "defeat" software installed. Of course, the legal environment in the United States that allows for class-action suits probably had something to do with that. Class-action lawsuits are relatively unknown in Europe, and payments were not offered to European customers, especially since VW didn't feel it was violating any law in Europe.

Should MNEs Accept Full Responsibility for the Unethical Behavior of Their Employees?

Counterpoint

No VW obviously must take responsibility for installing the "defeat" software into some of the diesel models it is selling worldwide, but who is responsible for this happening? Wolfgang Hatz, the head of engines and transmissions for VW, is one of the key people in this scandal. He was also one of the first employees suspended by VW when the crisis broke in September 2015. One of his first concerns at VW was to figure out how to develop a diesel engine that would meet the stringent antipollution requirements set by the State of California. He was hired from the same position at Audi, one of VW's brands as well as Porsche. Hatz loved his cars, and he realized that to meet emission requirements VW would have to introduce more diesels into the United States. But how could they develop a car that would still be alluring and peppy, something that American drivers wanted? Diesels have better fuel economy and lower GHG emissions, but they also have higher smog-forming pollutants. One strategy being considered at VW was to build an alliance with Mercedes-Benz and BMW to develop new technologies, but Mr. Hatz and others at VW decided they wanted to develop a less expensive alternative. However, it was clear that this would not meet the emissions requirements. Rather than scale back their strategy to increase the sales of diesels in the U.S. market, someone decided to cheat.

But who was behind the scheme to introduce the "defeat" software? Was it Hatz? Was it Martin Winterkorn, the CEO who hired Mr. Hatz and who retired from VW just before the scandal hit? Or was it Matthias Muller, the current CEO of VW who has denied any knowledge of the software? An internal whistle-blower at VW was responsible for uncovering exaggerated carbon-dioxide and fuel economy claims, but

Counterpoint

the U.S. EPA uncovered the "defeat" software strategy for pollutants in the United States. VW decided to offer amnesty to anyone at VW who could shed any light on this subject. So far, a number of employees have stepped forward with some information, but we still don't know who is holding the smoking gun. Offering amnesty for information is relatively rare in these cases, but a similar thing happened in 2008 when the Siemens bribery scandal broke. In this case, it was determined that Siemens diverted funds filed under bogus consulting contracts into a network of "black accounts" for bribing officials in countries like Italy, Greece, Argentina, and Saudi Arabia. One thing that came out of the investigation is that Siemens had created a culture of corruption. Although the VW example doesn't involve bribery, it obviously involved corrupt behavior in the sense that somebody felt comfortable breaking regulatory guidelines in the United States and probably Europe in order to enhance sales. As noted by Hans-Dieter Potsch, VW's chairman, "There was a tolerance for breaking the rules. It proves not to have been a onetime error, but rather a chain of errors that were allowed to happen."[37]

Given what we know about VW's supposed commitment to a high level of corporate behavior, why didn't someone step forward and say "no!"

QUESTION

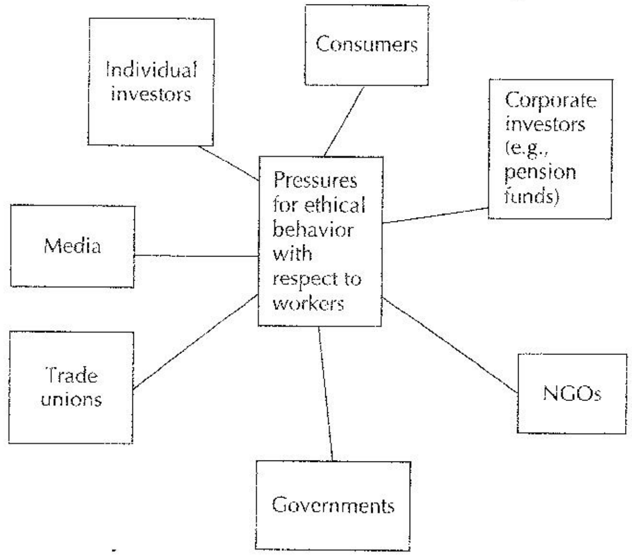
1. If you were an engineer working on the project to develop the software that would allow VW to avoid providing regulators and consumers accurate data about GHG and pollution emissions, would you have said "no"? Explain why or why not.

Major labor issues that MNEs get involved in through FDI or purchasing from independent manufacturers in developing countries are fair wages, child labor, working conditions, working hours, and freedom of association.

Figure 5.3 highlights the multiple pressures external stakeholders place on companies to encourage them to adopt responsible worker-related practices in their overseas operations. A more specific listing of worker issues was developed by the Ethical Trading Initiative (ETI), a British-based organization that focuses on MNEs' employment practices and whose standards are consistent with those adopted by the UN-based International Labor Organization. Its members include representatives from GAP Inc., Inditex, H&M, Marks & Spencer, The Body Shop International, and other companies, as well as from trade union organizations, NGOs, and governments. The objective of ETI is to get companies to adopt ethical employment policies and then monitor compliance with their overseas suppliers. ETI's trading initiative base code identifies the following issues:

1. Employment is freely chosen.
2. Freedom of association and the right to collective bargaining are respected.
3. Working conditions are safe and hygienic.
4. Child labor shall not be used.
5. Living wages are paid.
6. Working hours are not excessive.

FIGURE 5.3 Sources of Worker-Related Pressures in the Global Supply Chain



7. No discrimination is practiced.
8. Regular employment is provided.
9. No harsh or inhumane treatment is allowed.[38]

Although all issues identified by ETI are important, we focus on the one that, for a variety of good reasons, receives significant attention: *child labor.*

THE PROBLEM OF CHILD LABOR

Let's start by considering a couple of very brief cases:

- There are two arguments for the use of children in the Indian carpet industry: (1) they're better suited than adults to perform certain tasks, and (2) if they weren't employed, they'd be even worse off. In fact, children in India are often put to work because parents don't earn enough to support families; if parents can't pay off debts, their children are often *indentured* to creditors.
- In the 1990s, the impoverished Asian nation of Bangladesh was pressured to stop employing thousands of child workers or face U.S. trade sanctions. In this case, the plight of the children did in fact go from bad to worse. Between 5,000 and 7,000 young girls, for example, went from factory work to prostitution.[39]

According to the International Labor Organization (ILO), a UN institution, 168 million children between the ages of 5 and 17 are not legally working worldwide.[40] The challenge is that much of this data is not current or is difficult to get. However, the ILO has very specific guidelines describing what it considers child labor to be and what the worst forms of child labor are. In particular, the worst forms involve slavery and prostitution—illicit activities that are a danger to the health, safety, and morals of a child. ILO guidelines state that children who are at least 12–14 years old may be employed in "light" work that's not harmful to their health, is less than 14 hours a week, and doesn't interfere with school. All children under the age of 18 should be protected against the most abusive labor conditions.[41]

For MNEs, the basic challenge is negotiating a global labyrinth of business environments with different cultural, legal, and political rules than those they're used to at home. In addition, they typically rely on local suppliers who are subject to specifically local pressures.