ELEVENTH EDITION

MORAL ISSUES IN BUSINESS

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had more than a handful of or employees—and today dominate America's, even the world's, economic, political, and social life. This book isn't the place to analyze why a people committed to an individualistic social philosophy and a free-competition market economy allowed vast oligopolistic organizations to develop. Rather, the concern here is with the problem of applying moral standards to corporate organizations and with understanding their social responsibilities. After a brief review of the history of the corporation, this chapter looks at the following specific topics:

1. The debate over whether corporations are moral agents and can be meaningfully said to have moral responsibilities
2. The controversy between the narrow view and the broader view of corporate responsibility
3. Three key arguments in this debate: the invisible-hand argument, the let-government-do-it argument, and the business-can't-handle- it argument
4. The importance of institutionalizing ethics within corporations and how this may be done

THE LIMITED-LIABILITY COMPANY

If you ask a lawyer for a definition of **corporation**, you will probably get something like the following: A corporation is a thing that can endure beyond the natural lives of its members and that has incorporators who may sue and be sued as a unit and who are able to consign part of their property to the corporation for ventures of limited liability. **Limited liability** is a key feature of the modern corporation. The members of the corporation—unlike the members of a partnership or the proprietors of a business—are financially liable for the debts of the organization only up to the extent of their investments.

In addition to the limited liability of their members, corporations differ from partnerships in two ways.

Limited-liability companies—corporations—differ from partnerships and other forms of business association in two other ways as well. *First,* a corporation is not formed simply by an agreement entered into among its first members. An organization becomes incorporated by being publicly registered or in some other way having its existence officially acknowledged by the law. *Second,* unlike a partner, who is automatically entitled to his or her share of the profits of a partnership as soon as they are ascertained, the shareholder in a corporation is entitled to a dividend from the company's profits only when it has been "declared." Under U.S. law, dividends are usually declared by the directors of a corporation.

When we think of corporations, we naturally think of giants such as General Motors, ExxonMobil, Microsoft, and Wal-Mart, which exert enormous influence over our economy and society. But the local independently owned convenience store may be a corporation, and historically the concept of a corporation has been broad enough to encompass churches, trade guilds, and local governments. Corporations may be either *for-profit* or *nonprofit* organizations. Princeton University, for example, is a nonprofit corporation. Safeway, Lockheed Martin, McDonald's, and other companies, by contrast, aim to make money for shareholders. Corporations may be privately owned or owned (wholly or in part) by the government. Almost all U.S. corporations are privately owned; but Renault of France, for example, was once a publicly owned, for-profit corporation. A small group of investors may own all the outstanding shares of a privately owned, profit-making corporation (a **privately held company**). Mars, Bechtel, Chrysler, and Enterprise Rent-A-Car are examples. Or stock may be traded among the general public (a **publicly held company**).

All companies whose stocks are listed on the New York and other stock exchanges are publicly held corporations.

In 1911 Nicholas Murray Butler, president of Columbia University, declared that "the limited liability corporation is the single greatest discovery of modern times. . . . Even steam and electricity are far less important . . . and . . . would be reduced to comparative impotence without it."[3] Many business theorists and historians still agree with that assessment. But several stages mark the evolution of the corporation. The corporate form itself developed during the early Middle Ages, and the first corporations were towns, universities, and ecclesiastical orders. They were chartered by government and regulated by public statute. As corporate bodies, they existed independently of the particular individuals who constituted their membership at any given time. By the fifteenth century, the courts of England had evolved the principle of limited liability—thus setting limits, for example, on how much an alderman of the Liverpool Corporation might be required to pay if the city went bankrupt. During the medieval period, however, the law did not grant corporate status to purely profit-making associations. In those days, something besides economic self-interest had to be seen as uniting the members of the corporation: religion, a trade, shared political responsibilities.

Summary 5.1
Corporations are legal entities, with legal rights and responsibilities similar but not identical to those enjoyed by individuals. Business corporations are limited-liability companies—that is, their owners or stockholders are liable for corporate debts only up to the extent of their investments.

This state of affairs changed during the Elizabethan era, as the actual incorporation of business enterprises began. European entrepreneurs were busy organizing trading voyages to the East and to North America. The East India Company, which epitomizes the great trading companies of this period, was formed in 1600, when Queen Elizabeth I granted to a group of merchants the right to be "one body corporate" and bestowed on it a trading monopoly to the East Indies. In the following decades, numerous other incorporated firms were granted trading monopolies and colonial charters. Much of North America's settlement, in fact, was initially underwritten as a business venture.

Although the earliest corporations typically held special trading rights from the government, their members did not pool capital. Rather, they individually financed voyages using the corporate name and absorbed the loss individually if a vessel sank or was robbed by pirates. But as ships became larger and more expensive, no single buyer could afford to purchase and outfit one, and the loss of a ship would have been ruinous to any one individual. The solution was to pool capital and share liability. Thus emerged the prototype of today's corporations.[4]

In the nineteenth century, government loosened restrictions on corporate charters.

The first instance of the corporate organization of a manufacturing enterprise in the United States occurred in 1813, but only after the Civil War did the movement toward the corporate organization of business gain steam.[5] The loosening of government restrictions on corporate chartering procedures in the nineteenth century marks this final stage of corporate evolution. Until the mid-1800s, prospective corporations had to apply for charters—in England to the Crown, and in the United States to state government. Charters were custom-crafted; each one was an individual act of legislation. Charters were often burdened with precise terms or limited to specific business objectives, all in the name of promoting the public good. (For example, a corporation might be chartered for the sole purpose of shipping freight between two cities, or a charter might designate where the new corporation could begin and end its proposed railroad line.) Critics of the incorporation system charged that it fostered favoritism, corruption, and unfair monopolies. Gradually, the old system of incorporation was replaced by the system we know today, in which corporate status is granted essentially to any organization that fills out the forms and pays the fees.

Two ideas were behind this change.

Lurking behind this change were two important theoretical shifts. *First,* underlying the old system was the mercantilist idea that a corporation's activities should advance some specific public purpose. But Adam Smith and, following him, Alexander Hamilton, the first U.S. secretary of the treasury, challenged the desirability of a direct tie between business enterprise and public policy. They believed that businesspeople should be encouraged to explore their own avenues of enterprise, and that the "invisible hand" of the market would direct their activities in a socially beneficial direction more effectively than any public official could.

Second, when nineteenth-century reformers argued for changes in incorporation procedures, they talked not only about government favoritism and the advantages of a laissez-faire approach but also about the principle of a corporation's right to exist.[6] Any petitioning body with the minimal qualifications, they asserted, has the right to receive a corporate charter. By contrast, the early Crown-chartered corporations were clearly creations of the state, in accordance with the legal-political doctrine that corporate status was a privilege bestowed by the state as it saw fit. The reformers, however, argued that incorporation is a by-product of the people's right of association, not a gift from the state.

Summary 5.2
What we know as the modern business corporation has evolved over several centuries, and incorporation is no longer the special privilege it once was.

Even though the right of association supports relaxed incorporation procedures, the state must still incorporate companies and guarantee their legal status. Corporations must be recognized by the law as a single agent in order to enjoy their rights and privileges. To a large extent, then, the corporation remains, as Chief Justice John Marshall put it in 1819, "an artificial being, invisible, intangible, and existing only in the contemplation of the law."[7]

Corporations are clearly legal agents. They can enter into contracts, own property, and sue and be sued. But are they also moral agents? And whereas corporations have definite legal responsibilities, what, if any, social and moral responsibilities do they have?

CORPORATE MORAL AGENCY

Some time ago, the citizens of Massachusetts were asked in a referendum whether they wanted to amend the state constitution to allow the legislature to enact a graduated personal income tax. Predictably enough, they said no.

What made this otherwise unremarkable exercise of the initiative process noteworthy was that the First National Bank of Boston and four other businesses in the state wanted to spend money to express opposition to the referendum. The Massachusetts Supreme Judicial Court said they could not, that banks and business corporations were prohibited by law from spending corporate funds to publicize political views that did not materially affect their property, business, or assets. However, the U.S. Supreme Court in a 5-to-4 decision (*First National Bank of Boston v. Bellotti*)[8] struck down the Massachusetts court's decision and thereby defined the free-speech rights of corporations for the first time.

Writing for the majority, Justice Lewis Powell said: "If the speakers here were not corporations, no one would suggest that the state could silence their proposed speech. It is the type of speech indispensable to decision making in a democracy, and this is no less true because the speech comes from a corporation rather than from an individual." In a dissenting opinion, however, Justice Byron R. White said that states should be permitted to distinguish between individuals and corporations. "Ideas which were not a product of individual choice," said White, "are entitled to less First Amendment protection."

Some view the *Bellotti* decision as a blow to consumers and citizens, but there was legal precedent for the ruling because prior Supreme Court decisions had extended other constitutional rights to corporations—for example, to due process (Fourteenth Amendment), against unreasonable searches and seizures (Fourth Amendment), to a jury trial (Seventh Amendment), to freedom from double jeopardy (Fifth Amendment), and to compensation for government takings (Fifth Amendment). Still, in holding that the First Amendment applies not just to individual citizens but also to business corporations, the Court further blurred the distinction between real persons and artificial or legal persons. However, in doing so, it has laid a basis for claiming not only that corporations enjoy the same moral and political rights as citizens but also that, because of this, corporations bear the same responsibilities that individual human beings do. In other words, if corporations have the same rights that moral agents have, then, like individuals, they can and should be held morally responsible for their actions.

Case like *Bellotti* have blurred the distinction between individuals and corporations.

The problem, of course, is that they are not human beings. Or, to quote Lord Thurlow, an eighteenth-century lawyer, how can you "expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked?"[9] But although corporations are not people, they are collective entities that in some sense really exist, and they have an identity above and beyond the people whom they comprise at any given time. And the law recognizes them as "persons." Do they have moral obligations just as individual human beings do? Can they be held morally responsible, not just legally liable, for the things they do? The answer to these questions hangs on another question, namely: Does it make sense to view corporations as moral agents—that is, as entities capable of making moral decisions? If so, then corporations can be held morally responsible for their actions. They—and not just the individual human beings who make them up—can be seen as having moral obligations and as being blameworthy for failing to meet those obligations. They can, accordingly, be praised or blamed, even punished, for the decisions they make and the actions and policies they undertake.

If corporations are moral agents, then they can be seen as having obligations and as being morally responsible for their actions, just as individuals are.

The task of determining whether corporations can make moral decisions is anything but simple. Immediately, we must ponder whether it makes sense to say that any entity other than an individual person can make decisions in the first place, moral or otherwise.

Can Corporations Make Moral Decisions?

Corporate internal decision (CID) structures amount to established procedures for accomplishing specific goals. For example, consider ExxonMobil's system, as depicted by Anthony J. Parisi:

> All through the Exxon system, checks and balances are built in. Each fall, the presidents of the 13 affiliates take their plan for the coming year and beyond to New York for review at a meeting with the management committee and the staff vice presidents. The goal is to get a perfect corporate fit. Some imaginary examples: The committee might decide that Exxon is becoming too concentrated in Australia and recommend that Esso Eastern move more slowly on that continent. Or it might conclude that if the affiliates were to build all the refineries they are proposing, they would create more capacity than the company could profitably use. One of the affiliates would be asked to hold off, even though, from its particular point of view, a new refinery was needed to serve its market.[10]

The implication here is that any decisions coming out of ExxonMobil's annual sessions are formed and shaped to effect corporate goals, "to get a perfect corporate fit." Metaphorically, all data pass through the filter of corporate procedures and objectives. The remaining distillation constitutes the decision. Certainly the participants actively engage in decision making. But in addition to individual persons, the other major component of corporate decision making consists of the framework in which policies and activities are determined.

The CID structure lays out lines of authority and stipulates under what conditions personal actions become official corporate actions. Some philosophers have compared the corporation to a machine or have argued that because of its structure it is bound to pursue its profit goals single-mindedly. As a result, they claim, it is a mistake to see a corporation as being morally responsible or to expect it to display such moral characteristics as honesty, considerateness, and sympathy. Only the individuals within a corporation can act morally or immorally; only they can be held responsible for what it does.

Others have argued in support of **corporate moral agency**. The CID structure, like an individual person, collects data about the impact of its actions. It monitors work conditions, employee efficiency and productivity, and environmental impacts. Professors Kenneth E. Goodpaster and John B. Matthews argue that as a result, there is no reason a corporation cannot show the same kind of rationality and respect for persons that individual human beings can. By analogy, they contend, it makes just as much sense to speak of corporate moral responsibility as it does to speak of individual moral responsibility.[11] Thomas Donaldson agrees. He argues that a corporation can be a moral agent if moral reasons enter into its decision making and if its decision-making process controls not only the company's actions but also its structure of policies and rules.[12]

Summary 5.3
The question of corporate moral agency is whether a corporation is the kind of entity that can make moral decisions and bear moral responsibility for its actions. Philosophers disagree about whether corporate internal decision (CID) structures make it reasonable to see corporations as morally responsible agents.

Philosopher Peter French arrives at the same conclusion in a slightly different way.[13] The CID structure, says French, in effect absorbs the intentions and acts of individual persons into a "corporate decision." Perhaps no corporate official intended the course or objective charted by the CID structure, but, French contends, the corporation did. And he believes that these corporate intentions are enough to make corporate acts "intentional" and thus make corporations "morally responsible." Professor of philosophy Manuel Velasquez demurs. An act is intentional, says Velasquez, only if the entity that formed the intention brings about the act through its bodily movements. But it is only the people who make up the corporation who carry out the acts attributed to it. Velasquez concludes that only corporate members, not the corporation itself, can be held morally responsible.[14]

The debate over corporate moral agency bears on the question of **corporate punishment**. Whether or not corporations are moral actors, the law can fine them, monitor and regulate their activities, and require the people who run them to do one thing or another. But one can talk in a literal sense about "punishing" corporations only if they are entities or "persons" capable of making moral decisions. And even if they are, not all the usual goals and methods of punishment make sense when applied to corporations. If corporations are moral agents, then the law can deter them with the threat of punishment, and it can force them to make restitution. Punishment can, perhaps, even rehabilitate a corporation, viewed as a moral agent. Retribution, as a goal of punishment, however, seems to have little application to corporations. And obviously corporations cannot be jailed for breaking the law. Even imposing fines on them can be problematic. Financial penalties stiff enough to have an impact can easily injure innocent parties, for example, if they lead to layoffs, plant closures, or higher prices for consumers.

Vanishing Individual Responsibility

Some might argue that regardless of whether corporations as artificial entities can properly be held morally responsible, the nature and structure of a modern corporate organization allows nearly everyone in it to share moral accountability for what it does. In practice, however, this **diffusion of responsibility** can mean that no particular person or persons are held morally responsible. For example, does responsibility for an injury caused by a defective product fall on the shoulders of the worker who last handled the product, the foreman overseeing the running of the assembly line, the factory supervisor, the quality control team, the engineers who designed and tested the equipment, the regional managers who decided to produce the item, or the company's CEO, whose office is in another city? Indeed, each of these individuals may have been following established procedures and decision-making guidelines. Inside a corporation it may often be difficult, even impossible, to assign responsibility for a particular outcome to any single individual because so many different people, acting within a given CID framework, contributed to it in small ways.

Assigning individual responsibility for corporate outcomes is difficult.

This masking of moral accountability may not seem so surprising. After all, in situations that don't involve corporations, assigning praise and blame can also be problematic. But it raises the troubling possibility that the size and impersonal bureaucratic structure of the corporation may so envelop its members that it becomes vacuous to speak of individual moral agency. This, in turn, raises the specter of actions without actors in any moral sense—of defective products, broken laws, or flouted contracts, without any morally responsible parties.

There are two ways to escape this uncomfortable conclusion. *One* is to attribute moral agency to corporations just as we do to individual persons. *The other,* not necessarily incompatible with the first, is to realize that these days too many people are willing, even eager, to duck personal responsibility—"it's not my job," "there's nothing I can do about it," "I was just following procedure"—by submerging it in the protoplasmic CID structures of the modern corporation. Perhaps until CID structures are reconstituted to deal explicitly with non-economic matters, we can expect more of the same evasion of personal responsibility.

This raises the possibility of actions for which no one is responsible. There are two ways to escape this conclusion.

The issue of corporate moral agency undoubtedly will continue to exercise scholars. Meanwhile, the inescapable fact is that corporations are increasingly being accorded the status of biological persons, with all the rights and responsibilities implied by that status. Before it was gobbled up by another corporation, Continental Oil Company expressed in an in-house booklet the public perception and its implications as follows:

> No one can deny that in the public's mind a corporation can break the law and be guilty of unethical and amoral conduct. Events . . . such as corporate violation of federal laws and failure of full disclosure [have] confirmed that both our government and our citizenry expect *corporations* to act lawfully, ethically, and responsibly.
>
> Perhaps it is then appropriate in today's context to think of Conoco as a *living corporation*; a sentient being whose conduct and personality are the collective effort and responsibility of its employees, officers, directors, and shareholders.[15]

Summary 5.4
Individual responsibility can tend to vanish inside large, impersonal corporations. One response is to attribute moral agency to the corporation itself. Another is to refuse to let individuals duck their personal responsibility.

Today many companies and many of the people inside them accept without hesitation the idea that corporations are moral agents with genuinely moral, not just legal, responsibilities.

This point was illustrated recently when Colonial Pipeline of Atlanta published full-page advertisements in several newspapers headlined "We Apologize." The company used the ads to take responsibility for having spilled oil into the Reedy River of South Carolina three years before. True, the ads were part of a plea agreement with the U.S. Justice Department for having violated the Clean Water Act (the company also agreed to pay a $7 million fine). Yet the company's words had ethical overtones. As Laura Nash of Harvard Divinity School comments, they put "moral emotion into what is essentially a legal statement" because "the word 'apologize' . . . admits a sense of shame and humility."[16] Shame and humility were evident, too, when in 2004 the world saw photographs of Charles Prince, the chief executive of Citigroup, and Douglas Petersen, Citibank Japan CEO, bowing their heads at a press conference in Tokyo in a public act of remorse for Citigroup's illegal actions in Japan.

Assuming it makes sense to talk of the moral responsibilities of corporations, what are they?

If, then, it makes sense to talk about the social and moral responsibilities of corporations, either in a literal sense or as a shorthand way of referring to the obligations of the individuals that make up the corporation, what are these responsibilities?

Summary 5.5
Despite continuing controversy over the concept of corporate moral agency, the courts and the general public find the notion of corporate responsibility useful and intelligible—either in a literal sense or as shorthand for the moral obligations of individuals in the corporation.

RIVAL VIEWS OF CORPORATE RESPONSIBILITY

In 1963 Tennessee Iron & Steel, a subsidiary of United States Steel, was by far the largest employer, purchaser, and taxpayer in Birmingham, Alabama. In the same city at the same time, racial tensions exploded in the bombing of an African American church, killing four black children. The ugly incident led some to blame U.S. Steel for not doing more to improve race relations, but Roger Blough, chairman of U.S. Steel, defended his company:

> I do not either believe that it would be a wise thing for United States Steel to be other than a good citizen in a community, or to attempt to have its ideas of what is right for the community enforced upon the community by some sort of economic means. . . .
>
> When we as individuals are citizens in a community we can exercise what small influence we may have as citizens, but for a corporation to attempt to exert any kind of economic compulsion to achieve a particular end in the racial area seems to me quite beyond what a corporation can do.[17]

Not long afterward, Sol M. Linowitz, chairman of the board of Xerox Corporation, declared in an address to the National Industrial Conference Board: "To realize its full promise in the world of tomorrow, American business and industry—or, at least, the vast portion of it—will have to make social goals as central to its decisions as economic goals; and leadership in our corporations will increasingly recognize this responsibility and accept it."[18] Thus, the issue of business's corporate responsibility was joined. Just what responsibilities does a corporation have? Is its responsibility to be construed narrowly as merely profit making? Or more broadly to include refraining from harming society and even contributing actively and directly to the public good?

Summary 5.6
The debate over corporate responsibility is whether it should be construed narrowly to cover only profit maximization or more broadly to include acting morally, refraining from socially undesirable behavior, and contributing actively and directly to the public good.

The Narrow View: Profit Maximization

As it happened, the year preceding the Birmingham incident had seen the publication of *Capitalism and Freedom,* in which economist Milton Friedman (1912–2006) forcefully argued the **narrow view of corporate responsibility:** that business has no social responsibilities other than to maximize profits:

> The view has been gaining widespread acceptance that corporate officials . . . have a social responsibility that goes beyond serving the interest of their stockholders. . . . This view shows a fundamental misconception of the character and nature of a free economy. In such an economy, there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud. . . . Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.[19]

Although from Friedman's perspective the only responsibility of business is to make money for its owners, obviously a business may not do literally anything whatsoever to increase its profits. Gangsters pursue profit maximization when they ruthlessly rub out their rivals, but such activity falls outside what Friedman referred to as "the rules of the game." Harvard professor Theodore Levitt echoed this point when he wrote, "In the end business has only two responsibilities—to obey the elementary canons of face-to-face civility (honesty, good faith, and so on) and to seek material gain."[20]

Summary 5.7
Proponents of the narrow view, such as Milton Friedman, contend that diverting corporations from the pursuit of profit makes our economic system less efficient. Business's only social responsibility is to make money within the rules of the game. Private enterprise should not be forced to undertake public responsibilities that properly belong to government.

What, then, are the rules of the game? Obviously, elementary morality rules out deception, force, and fraud, and the rules of the game are intended to promote open and free competition. The system of rules in which business is to pursue profit is, in Friedman's view, one that is conducive to the laissez-faire operation of Adam Smith's "invisible hand" (discussed in Chapter 4). Friedman, a conservative economist, believed that if the market is allowed to operate with only the minimal restrictions necessary to prevent fraud and force, society will maximize its overall economic well-being. Pursuit of profit, he insisted, is what makes our system go. Anything that dampens this incentive or inhibits its operation will weaken the ability of the "invisible hand" to deliver the economic goods.

Because the function of a business organization is to make money, the owners of corporations employ executives to accomplish that goal, thereby obligating these managers always to act in the interests of the owners. According to Friedman, to say that executives have *social* responsibilities beyond the pursuit of profit means that at least sometimes they must subordinate owner interests to some social objective, such as controlling pollution or fighting inflation. They are then spending stockholder money for general social interests—in effect, taxing the owners and spending those taxes on social causes. But taxation is a function of government, not private enterprise; executives are not public employees but employees of private enterprise. The doctrine that corporations have social responsibilities beyond profit making thus transforms executives into civil servants and business corporations into government agencies, thereby diverting business from its proper function in the social system.

Friedman was critical of those who would impose on business any duty other than that of making money, and he was particularly harsh with business leaders who take a broader view of their social responsibilities: They may believe that they are defending the free-enterprise system when they give speeches proclaiming that profit isn't the only goal of business or affirming that business has a social conscience and takes seriously its responsibility to provide employment, refrain from polluting, eliminate discrimination, and so on. But these business leaders are shortsighted; they are helping to undermine capitalism by implicitly reinforcing the view that the pursuit of profit is wicked and must be regulated by external forces.[21]

Friedman acknowledged that corporate activities often are described as an exercise of "social responsibility" when, in fact, they are intended simply to advance the company's self-interest. For example, it might be in the long-term self-interest of a corporation that is a major employer in a small town to spend money to enhance the local community by helping to improve its schools, parks, roads, or social services, thereby attracting good employees to the area, reducing the company's wage bill, or improving worker morale and productivity. By portraying its actions as dictated by a sense of social responsibility, the corporation can generate goodwill as a by-product of expenditures that are entirely justified by self-interest. Friedman had no problem with a company pursuing its self-interest by these means, but he rued the fact that "the attitudes of the public make it in the self-interest [of corporations] to cloak their actions in this way."[22] Friedman's bottom line was that the bottom line is all that counts, and he firmly rejected any notion of corporate *social* responsibility that would hinder a corporation's profit maximization.

The Broader View: Corporate Social Responsibility

Critics of the narrow view believe that businesses have other obligations besides making a profit.

The rival position to that of Friedman and Levitt is simply that business has obligations in addition to pursuing profits. The phrase "in addition to" is important. Advocates of the **broader view of corporate responsibility** do not as a rule believe there is anything wrong with corporate profit. They maintain, rather, that corporations have other responsibilities as well—to consumers, to employees, to suppliers and contractors, to the surrounding community, and to society at large. They see the modern corporation as a social institution that should consider the interests of all the groups it has an impact on. Sometimes called the **social entity model** or the **stakeholder model**, this broader view maintains that a corporation has obligations not only to its stockholders but also to all the other constituencies that affect or are affected by its behavior—that is, to all parties that have a stake in what the corporation does or doesn't do. Years ago, the chairman of Standard Oil of New Jersey expressed the basic idea this way: "The job of management is to maintain an equitable and working balance among the claims of the various directly affected interest groups . . . stockholders, employees, customers, and the public at large."[23]

If the adherents of the broader view share one belief, it is that corporations have responsibilities beyond simply enhancing their profits because, as a matter of fact, they wield such great social and economic power in our society and with that power must come social responsibility. As professor of business administration Keith Davis put it:

> One basic proposition is that *social responsibility arises from social power.* Modern business has immense social power in such areas as minority employment and environmental pollution. If business has the power, then a just relationship demands that business also bear responsibility for its actions in these areas. Social responsibility arises from concern about the consequences of business's acts as they affect the interests of others. Business decisions do have social consequences. Businessmen cannot make decisions that are solely economic decisions, because they are interrelated with the whole social system. This situation requires that businessmen's thinking be broadened beyond the company gate to the whole social system. Systems thinking is required.
>
> Social responsibility implies that a business decision maker in the process of serving his own business interests is obliged to take actions that also protect and enhance society's interests. The net effect is to improve the quality of life in the broadest possible way, however quality of life is defined by society. In this manner, harmony is achieved between business's actions and the larger social system. The businessman becomes concerned with social as well as economic outputs and with the total effect of his institutional actions on society.[24]

Proponents of the broader view, such as Davis, stress that modern business is intimately integrated with the rest of society. Business is not some self-enclosed world, like a private poker party. Rather, business activities have profound ramifications throughout society, and their influence on our lives is hard to escape. Business writer John Kay makes this point with reference to General Electric: "The company's activities are so extensive that you necessarily encounter them daily, often without knowing you are doing so. GE's business is our business even if we do not want it to be."[25]

As a result, although society permits and expects corporations to pursue their economic interests, they have other responsibilities as well. Thus, for example, it is wrong for corporations to raid the pension funds of their employees, as many have done,[26] or to evade taxes through creative accounting or by re-incorporating in tax havens such as Bermuda,[27] even if doing so is legal and enhances the bottom line. "We reasonably expect that GE should care that its engines are safe," writes John Kay, "not just that they comply with FAA procedures; that if there is a problem with its medical equipment the company will try to put it right, not cover it up; that GE financial statements are true and fair and not just compliant with accounting standards."[28]

Melvin Anshen has cast the case for the broader view of corporate responsibility in a historical perspective.[29] He maintains that there is always a kind of "social contract" between business and society. This contract is, of course, only implicit, but it represents a tacit understanding within society about the proper goals and responsibilities of business. In effect, in Anshen's view, society always structures the guidelines within which business is permitted to operate in order to derive certain benefits from business activity. For instance, in the nineteenth century, society's prime interest was rapid economic growth, which was viewed as the source of all progress, and the engine of economic growth was identified as the drive for profits by unfettered, competitive, private enterprise. That attitude was reflected in the then-existing social contract. Today, however, society has concerns and interests other than rapid economic growth—in particular, a concern for the quality of life and for the preservation of the environment. Accordingly, the social contract is in the process of being modified. In particular, Anshen writes, "it will no longer be acceptable for corporations to manage their affairs solely in terms of the traditional internal costs of doing business, while thrusting external costs on the public."

Summary 5.8
Defenders of the broader view maintain that corporations have responsibilities that go beyond making money because of their great social and economic power. Business is governed by an implicit social contract that requires it to operate in ways that benefit society. In particular, corporations must take responsibility for the unintended side effects of their business transactions (externalities) and weigh the full social costs of their activities.

In recent years we have grown more aware of the possible deleterious side effects of business activity, or what economists call **externalities:** the unintended negative (or in some cases positive) consequences that an economic transaction between two parties can have on some third party. Industrial pollution provides the clearest illustration. Suppose a factory makes widgets and sells them to your firm. A by-product of this economic transaction is the waste that the rains wash from the factory yard into the local river, waste that damages recreational and commercial fishing interests downstream. This damage to third parties is an unintended side effect of the economic transaction between the seller and the buyer of widgets.

Defenders of the new social contract, like Anshen, maintain that externalities should no longer be overlooked. In the jargon of economists, externalities must be "internalized"—that is, the factory should be made to absorb the cost, either by disposing of its waste in an environmentally safe (and presumably more expensive) way or by paying for the damage the waste does downstream. On the one hand, basic fairness requires that the factory's waste no longer be dumped onto third parties. On the other hand, from the economic point of view, requiring the factory to internalize the externalities makes sense, for only when it does so will the price of the widgets it sells reflect their true social cost. The real production cost of the widgets includes not only labor, raw materials, machinery, and so on, but also the damage done to the fisheries downstream. Unless the price of widgets is raised sufficiently to reimburse the fisheries for their losses or to dispose of the waste in some other way, then the buyer of widgets is paying less than their true cost. Part of the cost is being paid by the fishing interests downstream.

Advocates of the broader view believe that business must internalize its externalities and consider the social costs of its activities.

Advocates of the broader view go beyond requiring business to internalize its externalities in a narrow economic sense. Keith Davis, for example, maintains that in addition to considering potential profitability, a business must weigh the long-range social costs of its activities as well. Only if the overall benefit to society is positive should business act:

> The expectation of the social responsibility model is that a detailed cost/benefit analysis will be made prior to determining whether to proceed with an activity and that social costs will be given significant weight in the decision-making process. Almost any business action will entail some social costs. The basic question is whether the benefits outweigh the costs so that there is a net social benefit. Many questions of judgment arise, and there are no precise mathematical measures in the social field, but rational and wise judgments can be made if the issues are first thoroughly explored.[30]

Stockholders and the Corporation

When asked, most Americans say that a corporation's top obligation is to its employees; others say it is to the community or the nation, but only 17 percent think stockholders deserve the highest priority.[31] In fact, even a majority of managers rejects a profit-only philosophy of corporate management.[32] Advocates of the narrow view, however, believe that those attitudes reflect a misunderstanding of the proper relationship between management and stockholders. Stockholders own the company. They entrust management with their funds, and in return management undertakes to make as much money for them as it can. As a result, according to proponents of the narrow view, management has a fiduciary duty to maximize shareholder wealth, a duty that is inconsistent with any social responsibility other than the relentless pursuit of profit.

The narrow view holds that management's responsibility to maximize shareholder wealth outweighs any other obligations.

The managers of a corporation do indeed have a **fiduciary responsibility** to look after the interests of shareholders, a duty that is clearly violated by corporate executives who take advantage of their position to enrich themselves at company expense with extravagant bonuses, stock options, and retirement packages or to waste corporate money on jets, apartments, private parties, and various personal services that lack any plausible business rationale. But it doesn't follow from this, as proponents of the narrow view maintain, that the corporation should be run entirely for the benefit of stockholders, that their interests always take priority over the interests of everyone else. To the contrary, argue critics of the narrow view, management has fiduciary responsibilities to other constituencies as well—for example, to employees, bondholders, and consumers. The duty to make money for shareholders is real, but it doesn't trump all of a company's other responsibilities. Indeed, it's debatable whether

most shareholders believe that it does. Many of them may want the company they "own" to act in a morally responsible manner—say, by not contributing to environmental pollution or by treating employees with respect—even if that means less profit.

Against that point of view, however, Milton Friedman argued, "The whole justification for permitting the corporate executives to be selected by the shareholders is that the executive is an agent serving the interests of his principal."[31] This justification disappears, he believed, when executives expend corporate resources in ways that don't necessarily enhance the bottom line. They are then acting more like public servants than like employees of a private enterprise. But even if one agrees with Friedman that stockholders select corporate managers to act as their agents and advance their interests, this doesn't prove that those executives are bound to act solely to increase shareholder wealth, ignoring all other moral considerations. Undertaking to look after other people's interests or promising to try to make money for them creates a genuine obligation, but that obligation is not absolute. It doesn't eliminate all other moral responsibilities. By analogy, promising to meet someone at a certain time and place for lunch creates an obligation, but that obligation doesn't override one's duty to assist someone having a heart attack. And something that it would be immoral for you to do (such as making a dangerous product) doesn't become right just because you're acting on behalf of someone else or promised him that you would do it.

Friedman believed that if executives "impose taxes on stockholders and spend the proceeds for 'social' purposes, they become 'civil servants,' and thus should be selected through a political process."[34] He considered such a proposal absurd or, at best, socialistic. Yet others contend that corporations are too focused on profits, and they fear the damage to society when firms are willing to sacrifice all other values on the altar of the bottom line. They don't think it absurd at all that corporations should take a broader view of their social role and responsibilities. They see nothing in the management-stockholder relationship that would morally forbid corporations from doing so.

Summary 5.9
Advocates of the narrow view stress that management's fiduciary duty to the owners (stockholders) of a corporation takes priority over any other responsibilities and obligates management to focus on profit maximization alone. Critics challenge this argument. They also point out that the assumption that stockholders own or control the corporation is dubious.

Who Controls the Corporation? According to the narrow view of corporate responsibility, stockholders own the corporation and select managers to run it for them. That model may make sense for some small firms or when venture capitalists invest in a start-up company, but it doesn't accurately reflect modern corporate reality. To begin with, most stockholders purchase shares in a company from current stockholders, who acquired their shares the same way. Very few investors put their money directly into a corporation; rather, they buy secondhand shares that were initially issued years before. They pick companies that look profitable or seem likely to grow or whose products or policies appeal to them, or they may simply be following the advice of their broker. And they are generally prepared to resell their shares, perhaps even the same day they bought them, if it is profitable to do so. Stockholders have no legal obligation to the company. They are a far-flung, diverse, and ever-changing group. They come and go, and rarely, if ever, have direct contact with the managers of the company or even know or care who they are.

For those reasons, then, it's implausible to see stockholders in, say, Home Depot or Procter & Gamble as being genuine owners or proprietors of the company. "A share of stock," write two legal experts, "does not confer ownership of the underlying assets owned by the corporation. Instead, it provides the holder with a right to share in the financial returns produced by the corporations' business." A share of stock is a financial instrument, more akin to a bond, than to a car or building.[35]

Stockholders do not really own or control the companies whose shares they hold.

Few economists or business theorists believe that stockholders are really in charge of the companies whose shares they hold or that they select the managers who run them. As long ago as 1932, Adolf Berle and Gardiner Means showed that because stock ownership in large corporations is so dispersed, actual control of the corporation has passed to management.[36] Today, as most business observers acknowledge, management handpicks the board of directors, thus controlling the body that is supposed to police it. "The CEO puts up the candidates; no one runs against them, and management counts the votes," says Nell Minow of Corporate Library, a corporate watchdog website. "We wouldn't deign to call this an election in a third-world country."[37] Even in those rare cases when shareholders put up their own candidates, such proxy fights are expensive and the incumbent management has the corporate coffers at its disposal to fight them.

As a result, the board of directors typically rubber-stamps the policies and recommendations of management. That's why it's not too surprising that in 2000 the directors of Enron ignored shareholder interests and approved paying out $750 million in executive compensation—$140 million of it to its chairman—when the company's entire net income was only $975 million. The Enron example is extreme, but since the 1990s the share of corporate net income going to top management has doubled; that's money that otherwise would have ended up in shareholders' pockets.[38] And how else to explain the fat payouts to CEOs when their companies do poorly or are acquired by other corporations[39] or the lavish retirement packages that boards bestow on former CEOs. These often include a million-dollar annual pension, an expensive apartment, a car and driver, and free use of the company aircraft.[40] True, in the past couple of decades, institutional investors like pension funds and large mutual funds have increased their sway over corporate policies, but it's still exceedingly difficult for shareholders to change policies they don't like, because the voting rules are rigged in management's favor.[41] The upshot is simple, according to Michael Jensen, professor emeritus at Harvard Business School: "The CEO has no boss." That, he says, is "the major thing wrong with large public corporations in the United States."[42]

DEBATING CORPORATE RESPONSIBILITY

We can pursue the debate over corporate responsibility further by examining three arguments in support of the narrow view: the invisible-hand argument, the let-government-do-it argument, and the business-can't-handle-it argument. Advocates of the broader view of corporate responsibility reject all three.

The Invisible-Hand Argument

Adam Smith claimed that when each of us acts in a free-market environment to promote our own economic interests we are led by an invisible hand to promote the general good. Like-minded contemporary thinkers such as Friedman advance the same **invisible-hand arguments.** They point out that corporations, in fact, were chartered by states precisely with utility in mind. If businesses are permitted to seek self-interest, their activities will inevitably yield the greatest good for society as a whole. To invite corporations to base their policies and activities on anything other than profit making is to politicize business's unique economic function and to hamper its ability to satisfy our material needs.

As Roberto C. Goizueta, former CEO of Coca-Cola, argues, "businesses are created to meet economic needs." When they "try to become all things to all people, they fail. . . . We have one job: to generate a fair return for our owners."[43] Accordingly, corporations should not be invited to fight racial prejudice or global warming, to contribute to the local community, or to improve working conditions or enhance the lives of employees, except insofar as these activities increase profits.

Yet this argument allows that corporations may still be held accountable for their actions. To the degree that they fulfill or fail to fulfill their economic role, they can be praised or blamed. And they can rightly be criticized for breaking the law or violating the rules of the game—for example, by shady accounting practices that mislead investors about company assets. But corporations should not be held morally responsible for non-economic matters; to do so would distort the economic mission of business in society and undermine the foundations of the free-enterprise system.

The invisible-hand argument, however, runs up against the fact that modern corporations bear about as much resemblance to Smith's self-sufficient farmers and craftspersons as today's military bears to the Continental militia. Given the sway they have over our economy and society, the enormous impact they have on our lives, our communities, and our environment, today's gigantic corporations are more like public enterprises than private ones. They constitute powerful economic fiefdoms, far removed from the small, competitive producers of classical economics. Perhaps within a restricted area of economic activity, when the parties to the exchange are roughly equal, then each pursuing self-interest can result in the greatest net good. But in the real world of large corporations, the concept of an invisible hand orchestrating the common good often stretches credulity. For example, California deregulated its electricity market to promote competition and give the invisible hand room to operate. But the result was a disaster. Instead of cheaper energy, the state got power blackouts and soaring prices as energy companies adroitly and greedily manipulated the market. Each time the state tried to make the market work better, energy sellers devised new ways to exploit the system. The state government only stanched the crisis by a costly intervention that has basically put it in the power business.[44]

The invisible-hand argument seems economically unrealistic. In addition, corporations today find it in their interest to acknowledge values other than profit.

The invisible-hand argument in favor of the narrow view of corporate responsibility is thus open to criticism as theoretically unsound and economically unrealistic. Moreover, in practice the argument is complicated by the fact that corporations today find themselves in a social and political environment in which they are pressured by public opinion, politicians, the media, and various activist groups to act—or at least be perceived to be acting—as responsible corporate citizens, as socially conscious enterprises that acknowledge other values besides profit and that seek to make a positive contribution to our society. Few if any corporations can afford to be seen as exploiters of foreign labor, as polluters of the environment, or as indifferent to consumer welfare or the prosperity of our communities. Companies today religiously guard their name and their brands against the slander that they care only about profits. And the larger the corporation, the more susceptible it is to the demand that it behave with a developed sense of moral responsibility, and the more it needs to guard its image and to take steps to assure the public that it is striving to make the world a better place.

Admittedly, this is in part a matter of public relations, but it's also true that business success in today's world, requires companies to respond to society's demand that they act as morally responsible agents. For purely self-interested reasons, even corporations that take a very narrow view of their responsibilities may have to behave as if they held a broader view. For example, in a world in which 88 percent of young people believe that companies have a responsibility to support social causes and 86 percent of them say that they switch brands based on social issues, a world in which 72 percent of job seekers prefer to work for a company that supports social causes,[45] corporate philanthropy promotes the bottom line. Moreover, almost all studies indicate that socially responsible corporate behavior is positively correlated with financial success and that the most profitable companies treat their consumers, employees, and business partners ethically.[46] Ironically, then, this gives companies a self-interested reason not merely to pretend to have a broad sense of social responsibility but, rather, to become the kind of company that really does want to make a positive mark in the world. Of course, whether we are talking about individuals or about corporations, there's no guarantee that acting morally will always pay off, and indeed if that is one's only motivation for doing the right thing, then one can hardly be said to be acting morally. But there's little reason for either individuals or companies to believe that acting selfishly or sacrificing moral values to profits will pay off for them in the long run.

The Let-Government-Do-It Argument

According to the narrow view of corporate responsibility, business's role is purely economic, and corporations should not be considered moral agents. Some adherents of this view, however, such as economist and social critic John Kenneth Galbraith (1908–2006), reject the assumption that Smith's invisible hand will solve all social and economic problems or that market forces will moralize corporate activities. Left to their own self-serving devices, Galbraith and others warn, modern corporations will enrich themselves while impoverishing society. If they can get away with it, they will pollute, exploit workers, deceive customers, and strive to eliminate competition and keep prices high through oligopolistic practices. They will do those things, the argument continues, because as economic institutions they are naturally and quite properly profit motivated.

What is profitable for corporations, however, is not necessarily useful or desirable for society. How is the corporation's natural and insatiable appetite for profit to be controlled? Through government regulation. Proponents of the **let-government-do-it argument** believe that the strong hand of government, through a system of laws and incentives, can and should bring corporations to heel. "I believe in corporations," Teddy Roosevelt once proclaimed. "They are indispensable instruments of our modern civilization; but I believe that they should be so supervised and so regulated that they shall act for the interests of the community as a whole."[47]

"Do not blame corporations and their top executives" for things like layoffs or urge them to acknowledge obligations beyond the bottom line, writes the economist Robert Reich, secretary of labor under President Clinton. "They are behaving exactly as they are organized to behave." He pooh-poohs moral appeals and rejects the idea that CEOs should seek to balance the interests of shareholders against those of employees and their communities. Rather, Reich says, "if we want corporations to take more responsibility" for the economic well-being of Americans, then government "will have to provide the proper incentives."[48]

The let-government-do-it argument rejects broadening corporate responsibility just as much as the invisible-hand argument does.

This advice sounds realistic and is intended to be practical, but the let-government-do-it argument rejects the notion of broadening corporate responsibility just as firmly as the invisible-hand argument does. The latter puts the focus on the market. Galbraith's and Reich's argument puts it on the *visible* hand of government. The two positions agree, however, in thinking it misguided to expect or demand that business firms do anything other than pursue profit.

Critics of the let-government-do-it argument contend that it is a blueprint for big, intrusive government. Moreover, they doubt that government can control any but the most egregious corporate immorality. They fear that many questionable activities will be overlooked, safely hidden within the labyrinth of the corporate structure. Lacking intimate knowledge of the goals and subgoals of specific corporations, as well as of their daily operations, government simply can't anticipate a specific corporation's moral challenges. Rather, it can prescribe behavior only for broad, cross-sectional issues, such as bribery, price-fixing, and unfair competition.

Finally, is government a credible custodian of morality? If recent experience has taught anything, it is that government officials are not always paragons of virtue. Looked at as another organization, government manifests many of the same structural characteristics that test moral behavior inside the corporation. Furthermore, given the awesome clout of corporate lobbyists, one wonders whether, as moral police, government officials will do anything more than impose the values and interests of their most generous financiers. Can we seriously expect politicians to bite the hand that feeds them?

The Business-Can't-Handle-It Argument

Some argue that business is the wrong group on which to place broad social responsibilities for two reasons.

In support of the narrow view of corporate responsibility, some maintain that it is misguided to encourage corporations to address nonbusiness matters. According to the **business-can't-handle-it argument**, corporations are the wrong group to be entrusted with broad responsibility for promoting the well-being of society. They are not up to the job for two reasons: (1) They lack the necessary expertise. (2) In addressing non-economic matters, they inevitably impose their own materialistic values on the rest of society.

Corporations Lack the Expertise Those who develop the first point contend that business can't handle the job—that it is the wrong group to rely on to promote the well-being of society—because corporate executives lack the moral and social expertise to make other-than-economic decisions. To assign them non-economic responsibilities would be to put social welfare in the hands of inept custodians. Thus, business analyst Walter Goodman writes, "I don't know of any investment adviser whom I would care to act in my behalf in any matter except turning a profit."[49] In his view, corporate leaders lack the moral insight or social know-how that a broader view of corporate responsibility would seem to require of them.

Against that, however, one can argue that we don't normally restrict the moral responsibilities of individuals, professional bodies, or other organizations to matters that fall within the narrow confines of their business or other expertise. We see nothing wrong, for example, with physicians advocating AIDS awareness or trying to promote the use of seat belts in automobiles, or with a teachers union involving itself in a campaign to combat the use of illegal drugs. And ordinary citizens may sometimes have a duty to educate themselves about, and do what they can to address, social issues that fall outside their usual sphere of knowledge and activity. What, if anything, asks the critic, makes the social role of the corporation unique, so that its responsibilities and those of its employees should be confined solely to profit making?

The argument that corporations aren't up to addressing social issues because they lack the necessary expertise runs up against the fact that, often, it is only business that has the know-how, talent, experience, and organizational resources to tackle certain problems. If society, for example, wants to eradicate malaria in Africa or increase longevity at home, to reduce diesel engine emissions or retard global warming, to improve agricultural productivity while lowering the risks from pesticides, or to see that inner-city youth learn entrepreneurship or that community groups have the business skills necessary for success, then society will need the assistance of business. To take a specific illustration, Citibank supports microfinance programs in Mexico and India, intended to give poor rural women the tiny loans they need, say, to buy a sewing machine and start their own business. True, as a Citigroup executive says, "there is not going to be a huge short-term profit" for the company.[50] But who is better able to help these women than a company like Citigroup?

Summary 5.10
Three arguments in favor of the narrow view are the invisible-hand argument, the let-government-do-it argument, and the business-can't-handle-it argument. Finding flaws in each of these arguments, critics claim there is no solid basis for restricting corporate responsibility to profit making.

Corporations Will Impose Their Values on Us Others argue that corporations are the wrong group to address social issues, that business can't handle the assignment, for a different reason. They fear that if permitted to stray from strictly economic matters, corporate officials will impose their materialistic values on all of society. Broadening corporate responsibility will thus "materialize" society instead of "moralizing" corporate activity. More than fifty years ago, Harvard professor Theodore Levitt expressed this concern:

> The danger is that all these things [resulting from having business pursue social goals other than profit making] will turn the corporation into a twentieth-century equivalent of the medieval church. . . . For while the corporation also transforms itself in the process, at bottom its outlook will always remain materialistic. What we have then is the frightening spectacle of a powerful economic functional group whose future and perception are shaped in a tight materialistic context of money and things but which imposes its narrow ideas about a broad spectrum of unrelated noneconomic subjects on the mass of man and society. Even if its outlook were the purest kind of good will, that would not recommend the corporation as an arbiter of our lives.[51]

This argument seems to assume that corporations do not already exercise enormous discretionary power over us. But as Keith Davis points out, business already has immense social power. "Society has entrusted to business large amounts of society's resources," says Davis, "and business is expected to manage these resources as a wise trustee for society. In addition to the traditional role of economic entrepreneurship, business now has a new social role of trusteeship. As trustee for society's resources, it serves the interests of all claimants on the organization, rather than only those of owners, or consumers, or labor."[52]

As Paul Camenisch notes, business is already using its privileged position to propagate, consciously or unconsciously, a view of humanity and the good life.[53] Implicit in the barrage of advertisements to which we are subjected daily are assumptions about happiness, success, and human fulfillment. In addition, corporations or industry groups sometimes speak out in unvarnished terms about social and economic issues. For example, ExxonMobil disputes the notion that fossil fuels are the main cause of global warming and lobbies against the Kyoto Protocol capping global-warming emissions, while drug companies such as Eli Lilly, Procter & Gamble, and Bristol-Myers Squibb contribute

to conservative think tanks that seek to reduce the regulatory powers of the U.S. Food and Drug Administration.

The point here is that business already promotes consumerism and materialistic values. It doesn't hesitate to use its resources to express its views and influence our political system on issues that affect its economic interests. If corporations take a broader view of their responsibilities, are they really likely to have a more materialistic effect on society, as Levitt suggests, than they do now? It's hard to believe they could. Levitt's view implies that there is some threat to society's values when corporations engage in philanthropy or use their economic and political muscle for other than purely self-interested ends. But society's values are not endangered when Sara Lee donates 2 percent of its pretax profits (nearly $13 million) to charitable causes, mostly cultural institutions and organizations serving disadvantaged people,[54] or when General Mills gives away 3 percent of its domestic pretax earnings ($45 million) to community organizations, donates food to people in need, and helps inner-city companies to get up and running.[55] And where is the "materialization of society" if, instead of advertising on a silly situation comedy that reaches a large audience, a corporation spends the same amount underwriting a science program with fewer viewers solely out of a sense of social responsibility?

INSTITUTIONALIZING ETHICS WITHIN CORPORATIONS

The criticisms of these three arguments in support of the narrow view of corporate responsibility have led many people inside and outside business to adopt the broader view—that the obligations of the modern business corporation extend beyond simply making money for itself. Society grants corporations the right to exist and gives them legal status as separate entities. It does this not to indulge the profit appetites of owners and managers but, as Camenisch says, as a way of securing the necessary "goods and services to sustain and enhance human existence."[56] In return for its sufferance of corporations, society has the right to expect corporations not to cause harm, to take into account the external effects of their activities, and whenever possible to act for the betterment of society.

Society permits corporations to exist and, in turn, expects them to act in a socially responsible way.

The list of corporate responsibilities goes beyond such negative injunctions as "Don't pollute," "Don't misrepresent products," and "Don't bribe." Included also are affirmative duties like "See that your product or service makes a positive contribution to society," "Improve the skills of your employees," "Seek to hire the disabled," "Give special consideration to the needs of historically disadvantaged groups," "Contribute to the arts and education," "Locate plants in economically depressed areas," and "Improve working conditions." This class of affirmative responsibilities includes activities that are not intrinsically related to the operations of the corporation—responsibilities that each of us, whether individuals or institutions, has simply by virtue of our being members of society. Precisely how far each of us must go to meet these responsibilities depends largely on our capacity to fulfill them, which, of course, varies from person to person, institution to institution. But given their considerable power and resources, large corporations seem better able to promote the common good than most individuals or small businesses.

How corporations are to promote the common good cannot be answered very specifically; methods will depend on the type of firm and its particular

To make ethics a priority, corporations should do four things.

circumstances. Proponents of broadening corporate responsibility probably would agree that the first step is for corporations to expand their moral horizons and make ethical conduct a priority. How to do this? At least four actions seem called for:

Summary 5.11
To become more socially responsible, companies need to expand their moral horizons and make ethical conduct a priority. Doing so will require them to acknowledge the critical importance of ethics, to encourage morally responsible conduct by their employees, to recognize the pluralistic nature of our social system, and to be open to public discussion and review.

1. Corporations should acknowledge the importance, even necessity, of conducting business morally. Their commitment to ethical behavior should be unequivocal and highly visible, from top management down.
2. Corporations should make a real effort to encourage their members to take moral responsibilities seriously. This commitment would mean ending all forms of retaliation against those who buck the system and rewarding employees for evaluating corporate decisions in their broader social and moral contexts.
3. Corporations should end their defensiveness in the face of public discussion and criticism. Instead, they should actively solicit the views of stockholders, managers, employees, suppliers, customers, local communities, and even society as a whole. Corporations should invite outside opinions and conduct a candid ethical audit of their organizational policies, priorities, and practices.
4. Corporations must recognize the pluralistic nature of the social system of which they are a part. Society consists of diverse, interlinked individuals and groups, all vying to maintain their autonomy and advance their interests. The actions of any one group invariably affect the interests of others. As part of society, corporations affect many groups, and these groups and the individuals they comprise affect corporations. Failing to realize this, corporations can lose sight of the social framework that governs their relationship with the external environment.

Undoubtedly, other general directives could be added to this list. Still, if corporate responsibility is to be expanded, then something like the preceding approach seems basic.

Limits to What the Law Can Do

Critics of the let-government-do-it argument question Galbraith's and Reich's view that society should not expect business to behave morally but rather should simply use government to direct business's pursuit of profit in socially acceptable directions. This issue is worth returning to in the present context. All defenders of the broader view of corporate responsibility believe that more than laissez faire is necessary to ensure that business behavior is socially and morally acceptable. Yet there is a tendency to believe that law is a fully adequate vehicle for this purpose.

Stone gives three reasons why there are limits to what we can achieve through law.

Law professor Christopher Stone has argued, however, that there are limits on what the law can be expected to achieve.[57] Three of his points are particularly important. *First,* many laws, such as controls on the disposal of toxic waste, are passed only after there is general awareness of the problem; in the meantime, damage has already been done. The proverbial barn door has been shut only after the horse has left.

Second, formulating appropriate laws and designing effective regulations are difficult. It is hard to achieve consensus on the relevant facts, to determine what remedies will work, and to decide how to weigh conflicting values. In addition, our political system gives corporations and their lobbyists significant input into the writing of laws. Not only that, but the specific working regulations and day-to-day interpretation of the law require the continual input of industry experts. This is not a conspiracy but a fact of life. Government bureaus generally have limited time, staffing, and expertise, so they must rely on the cooperation and assistance of those they regulate.

Third, enforcing the law is often cumbersome. Legal actions against corporations are expensive and can drag on for years, and the judicial process is often too blunt an instrument to use as a way of managing complex social and business issues. In fact, recourse to the courts can be counterproductive, and Stone argues that sometimes the benefits of doing so may not be worth the costs. Legal action may simply make corporations more furtive, breeding distrust, destruction of documents, and an attitude that "I won't do anything more than I am absolutely required to do."

People in business need to acknowledge that obeying the law is not their only obligation because the law alone cannot guarantee responsible business behavior.

What conclusion should be drawn? Stone's argument is not intended to show that regulation of business is hopeless. Rather, what he wants to stress is that the law cannot do it alone. We do not want a system in which businesspeople believe that their only obligation is to obey the law and that it is morally permissible for them to do anything not (yet) illegal. With that attitude, disaster is just around the corner. More socially responsible business behavior requires, instead, that corporations and the people within them not simply respond to the requirements of the law but also hold high moral standards—and that they themselves monitor their own behavior.

Ethical Codes and Economic Efficiency

Summary 5.12
Corporations and the people who make them up must have high moral standards and monitor their own conduct because there are limits to what the law can do to ensure that business behavior is socially and morally acceptable.

It is, therefore, important that corporations examine their own implicit and explicit codes of conduct and the moral standards that are being propagated to their employees. As mentioned earlier in this chapter and in Chapter 1,[58] there is no necessary trade-off between profitability and ethical corporate behavior. Indeed, the contrary appears to be true: The most morally responsible companies are consistently among the most profitable companies. Yet ethical behavior in the business world is often assumed to come at the expense of economic efficiency. Defenders of the broader view, such as Anshen, as well as defenders of the narrow view, such as Friedman, seem to make this assumption. Anshen believes that other values should take priority over economic efficiency, whereas Friedman contends business should concern itself only with profit and, in this way, maximize economic well-being. In his important essay "Social Responsibility and Economic Efficiency," Nobel Prize–winning economist Kenneth Arrow has challenged this assumption.[59]

Ethics and efficiency aren't necessarily in opposition. Normal business activity requires some degree of ethics, and focusing only on profit maximization is socially inefficient in two situations.

To begin with, says Arrow, any kind of settled economic life requires a certain degree of ethical behavior, some element of trust and confidence. Much business, for instance, is conducted on the basis of oral agreements. In addition, Arrow points out, "there are two types of situation in which the simple rule of maximizing profits is socially inefficient: the case in which costs are not paid for, as in pollution, and the case in which the seller has considerably more knowledge about his product than the buyer."

The first type of situation relates to the demand that corporations "internalize their externalities." In the second situation, in which the buyer lacks the expertise and knowledge of the seller, an effective moral code, either requiring full disclosure or setting minimal standards of performance (for example, the braking ability of a new automobile), enhances rather than diminishes economic efficiency. Without such a code, buyers may purchase products or services they don't need. Or because they don't trust the seller, they may refrain from purchasing products and services they do need. Either way, from the economist's point of view the situation is inefficient.

An effective professional or business moral code—as well as the public's awareness of this code—is good for business. Most of us, for example, have little medical knowledge and are thus at the mercy of doctors. Over hundreds of years, however, a firm code of ethical conduct has developed in the medical profession. As a result, people generally presume that their physician will perform with their welfare in mind. They rarely worry that their doctor might be taking advantage of them or exploiting them with unnecessary treatment. By contrast, used-car dealers have historically suffered from a lack of public trust.

Summary 5.13
All settled economic life requires trust and confidence. The adoption of realistic and workable codes of ethics in the business world can actually enhance business efficiency. This is particularly true when there is an imbalance of knowledge between the buyer and the seller.

For a code to be effective it must be realistic, Arrow argues, in the sense of connecting with the collective self-interest of business. And it must become part of the corporate culture, "accepted by the significant operating institutions and transmitted from one generation of executives to the next through standard operating procedures [and] through education in business schools."

For both Arrow and Stone, then, the development of feasible and effective business and professional codes of ethics must be a central focus of any effort to enhance or expand corporate responsibility. The question is how to create a corporate atmosphere conducive to moral decision making.

Corporate Moral Codes

There are several steps companies should take to institutionalize ethics.

What can be done to improve the organizational climate so individual members can reasonably be expected to act ethically? If those inside the corporation are to behave morally, they need clearly stated and communicated ethical standards that are equitable and enforced. This development seems possible only if the standards of expected behavior are institutionalized—that is, only if they become a fixture in the corporate organization. To institutionalize ethics within corporations, Professor Milton Snoeyenbos suggests that top management should (1) articulate the firm's values and goals, (2) adopt a moral code applicable to all members of the company, (3) set up a high-ranking ethics committee to oversee, develop, and enforce the code, and (4) incorporate ethics training into all employee-development programs.[60]

The company's code of ethics should not be window dressing or so general as to be useless. A **corporate moral code** should set reasonable goals and subgoals, with an eye on blunting unethical pressures on subordinates. In formulating the code, the top-level ethics committee should solicit the views of corporate members at all levels regarding goals and subgoals, so that the final product articulates "a fine-grained ethical code that addresses ethical issues likely to arise at the level of subgoals."[61] Moreover, the committee should have full authority and responsibility to communicate the code and decisions based on it to all corporate members, clarify and interpret the code when the need arises, facilitate the code's use, investigate grievances and violations of the code, discipline violators and reward compliance, and review, update, and upgrade the code.

To help employees in ethically difficult situations, a good corporate ethics program must be user friendly. It should provide a support system with a variety of entry points, one that employees feel confident about using.[62] In addition, part of all employee-training programs should be devoted to ethics. At a minimum, this should include study of the code, review of the company's procedures for handling ethical problems, and discussion of employer and employee responsibilities and expectations. Snoeyenbos and others believe that institutionalizing ethics

within the corporation in these ways, when supplemented by the development of industry-wide codes of ethics to address issues beyond a particular firm, will go far toward establishing a corporate climate conducive to individual moral decision making.

Corporate Culture

Summary 5.14
To improve organizational climate so we can reasonably expect individuals to act morally, corporations need to institutionalize ethics. Among other things, this involves articulating their values and goals, adopting a moral code, setting up an ethics committee, and including ethics training in their employee-development programs. Attention to corporate culture is also crucial to the successful institutionalization of ethics inside an organization.

During the past two decades, organizational theorists and writers on business management have increasingly emphasized "corporate culture" as the factor that makes one company succeed while another languishes. Although intangible in comparison with things like sales revenue and profit margin, corporate culture is often the key to a firm's success. According to one study, 30 percent of the difference in performance between companies can be attributed to differences in culture, but only 5 percent to differences in strategy.[63]

What is **corporate culture**? One writer describes it as "the shared beliefs top managers have in a company about how they should manage themselves and other employees, and how they should conduct their business(es). These beliefs are often invisible to the top managers but have a major impact on their thoughts and actions."[64] Another writer puts it this way: "Culture is the pattern of shared values and beliefs that gives members of an institution meaning and provides them with rules for behavior in their organization."[65] W. Brooke Tunstall, an assistant vice president of AT&T, provides a fuller definition. He describes corporate culture as "a general constellation of beliefs, mores, customs, value systems and behavioral norms, and ways of doing business that are unique to each corporation, that set a pattern for corporate activities and actions, and that describe the implicit and emergent patterns of behavior and emotions characterizing life in the organization."[66]

Corporate culture may be both explicit and implicit. The formal culture of a corporation, as expressed in idealized statements of values and norms, should also be distinguished from the informal culture that shapes beliefs, values, and behavior. In addition, there may be multiple and overlapping cultures within an organization because employees have different backgrounds, work in different divisions of the organization, and may be subject to different systems of rewards and sanctions.

Management must pay attention to the values and behavior reinforced by its corporate culture.

Organizational theorists emphasize the importance of monitoring and managing corporate culture—beginning with an attempt to understand each corporation's distinctive culture—to prevent dysfunctional behavior and processes. As one consultant puts it, "A corporation's culture is what determines how people behave when they are not being watched."[67] If management does not make explicit the values and behavior it desires, the culture will typically develop its own norms, usually based on the types of behavior that lead to success within the organization. Thus, the desired values must be communicated and transmitted throughout the organization. Conduct congruent with them must be rewarded and conduct inconsistent with them sanctioned. Overlooking behavior that contradicts the desired norms can have the effect of encouraging and even rewarding it.

William Donaldson, former chairman of the U.S. Securities and Exchange Commission, emphasizes the importance of ethical leadership, of the example set by upper management. "The tone is set at the top," he says. "You must have an internal code that goes beyond the letter of the law to encompass the spirit of the company. Does that concept exist in all companies? No. All you have to do is look at executive compensation to recognize that we still have a long way to go."[68]

These points are crucial when it comes to corporate social responsibility. Management needs to understand the real dynamics of its own organization. At Sears, for example, new minimum work quotas and productivity incentives at its auto centers created a high-pressure environment that led employees to mislead customers and sell them unnecessary parts and services, from brake jobs to front-end alignments.[69] At Fannie Mae, an "earnings-at-any-cost culture" led to accounting fraud.[70] Thus, it is necessary for socially responsible executives to ask: How do people get ahead in the company? What conduct is actually rewarded, what values are really being instilled in employees? Andrew C. Sigler, chairman of Champion International, stresses this point: "Sitting up here in Stamford, there's no way I can affect what an employee is doing today in Texas, Montana, or Maine. Making speeches and sending letters just doesn't do it. You need a culture and peer pressure that spells out what is acceptable and isn't and why. It involves training, education, and follow-up."[71]

Internal or external corporate responsibility audits can help close the gap between stated values, goals, and mission, on the one hand, and reality on the other.[72] Another aspect of follow-up is strict enforcement. Chemical Bank, for instance, fired employees for violations of the company's code of ethics even when nothing illegal was done. Xerox dismissed people for minor manipulation of records and the padding of expense accounts. (By contrast, some of the nation's most prestigious stock brokerage firms have employed salespeople with long records of violating securities laws).[73] In a recent but typical year, General Electric investigated 1,338 cases in which concerns had been raised internally about employee integrity. It dismissed 125 employees and took disciplinary action against 243 others for legal or ethical violations.[74] Executives at both Xerox and General Mills also emphasize that civic involvement is a crucial part of corporate ethics. As one General Mills executive puts it: "It's hard to imagine that a person who reads to the blind at night would cheat. . . ."[75]

Johnson & Johnson is widely seen as a model of corporate responsibility, especially because of its decisive handling of the Tylenol crisis of 1982, when seven people in the Chicago area died from cyanide-laced Extra-Strength Tylenol capsules. The company immediately recalled 31 million bottles of Tylenol from store shelves across the nation and notified 500,000 doctors and hospitals about the contaminated capsules. A toll-free consumer hotline was set up the first week of the crisis, and consumers were offered the opportunity to replace Tylenol capsules with a free bottle of Tylenol tablets. Johnson & Johnson was also open with the public instead of being defensive about the deaths. Accurate information was promptly released, and domestic employees and retirees were kept updated on developments. The chairman of the company appeared on the talk show *Donahue* and on *60 Minutes* to answer questions about the crisis, and other executives were interviewed by *Fortune* and the *Wall Street Journal*.

Despite the setback—the recall alone cost Johnson & Johnson $50 million after taxes—Tylenol rebounded within a year, in large part because the public never lost faith in Johnson & Johnson. Despite this happy ending, many companies fail to emulate Johnson & Johnson's example. A case in point is the RC2 Corporation, which makes Thomas the Tank Engine and other toy trains. In 2007 the public learned that many of the company's trains were made with lead paint, which can cause brain damage if a child ingests it. RC2, however, declined to issue refunds to unhappy parents but asked them to return the affected toys—at their own expense—in order to receive replacement trains and a free bonus gift. Unbelievable as it may seem, one of the toy trains that RC2 mailed out as a gift (a gray boxcar called Toad) was also made with lead paint. Even worse, RC2 executives hid from public view throughout this whole sorry episode, never explaining why their safety checks had failed or why they deserved to be trusted in the future.[76]

In the case of Johnson & Johnson, the company credits its sixty-year-old, one-page statement of values, known as the Credo, with enabling it to build the employee trust necessary for maintaining a firm corporate value system. The Credo acknowledges the company's need to make a sound profit while addressing its obligations to provide a quality product, to treat its employees fairly and with respect, and to be a good corporate citizen, supporting the community of which it is a member. The Credo is "the most important thing we have in this company," says chairman Ralph Larsen.

Creating and maintaining a morally sound corporate culture is an ongoing task, and even Johnson & Johnson hasn't always been able to live up to its own values. In 1995, for instance, the company agreed to pay $7.5 million in fines and costs after admitting that wayward employees had shredded papers to hinder a federal probe into the marketing of an acne cream. "There was no excuse," admits Larsen. "But it is a huge undertaking to spread our values around the world."[77]

STUDY CORNER

Key Terms and Concepts

broader view of corporate responsibility
business-can't-handle-it argument
CID structures
corporate culture
corporate moral agency
corporate moral code
corporate punishment
corporation
diffusion of responsibility
externalities
fiduciary responsibility
invisible-hand argument
let-government-do-it argument
limited liability
narrow view of corporate responsibility
privately held company
publicly held company
social entity (stakeholder) model
stockholders

Points to Review

- three ways corporations differ from partnerships
- privately held vs. publicly held companies
- historical evolution of the corporation
- two theoretical shifts that led to the relaxing of incorporation procedures
- significance of the Supreme Court's *Bellotti* decision
- whether the CID structure is compatible with, or rules out, corporate moral responsibility
- the concept of corporate punishment
- problem of vanishing individual responsibility and two responses to it
- Milton Friedman's view of corporate responsibility
- Melvin Anshen's idea of a social contract between business and society
- how both fairness and economics support the internalizing of externalities
- criticisms of the invisible-hand argument
- difference between the let-government-do-it and the invisible-hand arguments
- two versions of the business-can't-handle-it argument
- four things companies can do to become more socially responsible
- three limits to what we can expect the law to do
- two situations in which the rule of maximizing profits is socially inefficient
- what top management should do to institutionalize ethics inside the company
- the importance of creating a morally oriented corporate culture