3 Corporations

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Learning Objectives

After reading this chapter, you should be able to:

- Explain the nature and main features of corporations.
- Discuss the principal ways of punishing corporations.
- Assess the merits of various efforts to create an ethical corporate culture.
- Discuss the main threats to ethical corporate culture and how to combat them.

Chapter Outline

Introduction

When you think of the word "corporation," you most likely think of a concept that is relatively young. But corporations have actually existed for around 2,000 years. By medieval times, corporations had already been used for establishing churches, universities, and monasteries. They were also used for creating trade guilds, which were associations of craftspeople, somewhat like modern-day trade unions.

By the 15th century, corporations had become an important tool for funding colonial ventures as well. Establishing colonies in distant lands was a vastly expensive undertaking, but through the mechanism of incorporation, the investment costs could be covered by a number of people, not just a single investor. Thus, in 1606, the King of England granted a corporate charter to the Virginia Company to establish settlements along the Atlantic coast in North America, and investors held stock in that company. Unfortunately, its first settlement, Jamestown, was a disaster, with all but 61 of its first 500 settlers dying from disease and starvation. Thus, after 18 years of struggle, the king revoked the Virginia Company's corporate charter and took governmental control of its colonies.

Many early colonial corporate ventures like the Virginia Company were affiliated with governments and were intended to establish territorial monopolies for imports and exports. But with the movement toward free-market economics in the late 18th century, newer corporations became less affiliated with guilds and governments and more with private businesses. This is the model of the corporation that we have today.

Whether large or small, conducting business today typically means running a corporation—so much so that the terms *business* and *corporation* are almost synonymous. In this chapter, we will look at the defining characteristics of a corporation, methods of punishing those that break the law, the ethical character of corporate culture, and threats to ethical corporate culture.

3.1 The Nature of Corporations

The first issue to consider is the nature of the corporation itself. In this section, we discuss corporate structure, the four main features that define a corporation, shell corporations, and whether corporations can have moral responsibility in the way that people do.

Corporate Structure

Although the focus of this chapter is on corporations, a **corporation** is just one of five business structures recognized by the U.S. Internal Revenue Service, as shown in Table 3.1. Corporations are defined as legally recognized independent entities owned by shareholders. What separates corporations from other forms of business is that in corporations, the corporation itself, not its shareholders, holds legal liability for the company. This means that should the corporation go bankrupt or be sued, for example, the individual shareholders are not responsible for the corporation's losses beyond the extent of their own personal investment. Note that many of the issues we discuss in this chapter apply not just to corporations but to other forms of business as well.

Table 3.1: Business structures recognized by the U.S. Internal Revenue Service

Business structure	Definition
Corporation	A legally recognized independent entity owned by shareholders in which the corporation, and not the shareholders, holds legal liability
S Corporation	A legally incorporated business with no more than 100 shareholder owners
Sole Proprietorship	An unincorporated business owned by a sole proprietor himself or herself who holds legal liability
Partnership	A relationship existing between two or more persons who join to carry on a trade or business who jointly or separately hold legal liability
Limited Liability Company (LLC)	A form of a company that provides limited liability to its owners but is not incorporated and does not need to be organized for profit

The basic structure of a corporation consists of three main levels of authority:

1. **Shareholders (stockholders)** own the corporation by obtaining shares of stock in it.
2. The shareholders, in turn, elect a **board of directors** to manage the corporation.
3. The board then designates **officers** to operate the business, with the chief executive officer (CEO) at the top and various levels of managers beneath.

The board and officers of a corporation have a **fiduciary duty** to the shareholders: They are under a legal obligation to manage the company in a way that protects the shareholders' investment. Thus, the shareholders' drive to make a profit on an investment transfers down through the whole corporate hierarchy. In his book *The Corporation*, legal scholar Joel Bakan argued that corporations are so driven by self-interest and financial greed that they fit the personality profile of a psychopathic individual. He wrote:

> The corporation's legally defined mandate is to pursue, relentlessly and without exception, its own self-interest, regardless of the often harmful consequences it might cause to others. As a result, . . . the corporation is a pathological institution, a dangerous possessor of the great power it wields over people and societies. (Bakan, 2005, p. 1)

Undoubtedly, some corporations are as pathologically dangerous as Bakan maintained; the Enron Corporation is a poster child for that. Enron was a major energy company with natural gas pipelines stretching across the country, and ultimately became the largest energy trader in the world. At its peak it was seventh on the list of Fortune 500 companies, and for 6 years running, it was hailed as America's most innovative company by *Fortune* magazine. However, under the leadership of CEO Kenneth L. Lay, the company borrowed too much money for its projects and fraudulently hid billions of dollars of debt from its investors, all the while fooling everyone into thinking that it was a robust business. In California, it secretly restricted the supply of natural gas, which created blackouts and caused an 800% increase in natural gas prices. When Enron executives became aware that the company was about to collapse, they sold their personal shares of company stock while encouraging investors to buy more. News of Enron's problems soon became public, its stock prices fell to a fraction of their original value, and its subsequent bankruptcy became the largest up to that point in U.S. history. But although Enron may have brought corporate corruption to a new level, it is not clear that the nature of the corporation itself forces companies to systematically engage in unethical behavior.

Four Features of Corporations

There are four main features of a corporation:

1. creation by statute,
2. perpetual existence,
3. recognition as legal persons, and
4. limited liability.

All of these features have important implications. Let us look at each one in more detail.

Creation by Statute

The first feature of a corporation is its **creation by statute**. Corporations come into existence through the creation of a legal document called a *charter*, which in the United States is granted by an individual state. The person seeking the corporation draws up a charter and submits it to a state commission for approval.

Visions of America/Superstock

The U.S. Supreme Court case, *Dartmouth College v. Woodward* (1819), gave corporations greater independence from government control.

The fact that corporations come into existence through government action suggests that their very character and range of freedoms are shaped by what the government thinks is best, and that has changed over time. An early landmark U.S. Supreme Court case, *Dartmouth College v. Woodward* (1819), was responsible for giving greater independence to corporations outside of government control. The issue in that case had to do with Dartmouth College's right to appoint its own presidents and trustees, independent of influence by the state of New Hampshire. Dartmouth was granted a corporate charter prior to the American Revolution, when New Hampshire was a British colony. After U.S. independence, the New Hampshire legislature attempted to take administrative control of the college and appoint its president and trustees. The college challenged the state, and the Supreme Court sided with Dartmouth, allowing it to continue as a private institution.

Perpetual Existence

Second, corporations have **perpetual existence**, which means that, unlike mortal human beings, they can continue indefinitely and thus independently of the temporary lives of their managers and shareholders. Some corporations may be created to exist for only a limited period of time, but most are granted perpetual existence. The oldest currently existing corporation is the Stora Kopparberg Mining Company in Sweden, which obtained its charter in 1347.

In *Dartmouth College v. Woodward*, the Supreme Court argued that the fundamental justification for creating a corporation is perpetual existence—a kind of legal immortality—which prevents the "intricacies, the hazardous and endless necessity of perpetual conveyances for the purpose of transmitting it from hand to hand" (1819). The point is that a corporation has a life independent of the people who formed it, and can continue to exist perpetually even as the various members of the corporation come and go. Note that although their existence is perpetual, corporations may be dissolved at the direction of the state, a court, or the shareholders themselves.

Recognition as Legal Persons

Third, corporations are **legal persons** in the sense that they are nonhuman entities regarded by law as having the status of a person. They have what is called **legal standing**, which means that they can sue others and be sued by others, own property, and make contracts with others. It is legal personhood that also makes corporations legally accountable for wrongdoing, and thus capable of being punished for crimes. Without legal personhood, corporations could not be legally punished for wrongdoing any more than an unruly mob could be punished as a collective entity, beyond the actions of the individuals within that mob. Thus, corporations can be criminally convicted of fraud, manslaughter, and even human rights violations.

In the words of one Supreme Court justice, the corporation is “capable of being treated as a citizen of [the state which created it] as much as a natural person” (*Louisville, Cincinnati & Charleston R. Co. v. Letson*, 1844). Determining exactly how corporations can lay claim to their rights as persons and citizens is an ongoing challenge. A controversial Supreme Court case, *Citizens United v. Federal Election Commission* (2009), established that corporations’ rights to free speech entitled them to spend unlimited amounts of money in campaign contributions. In essence, it said that for corporations, money is speech.

The question this raises is whether there is an essential difference between corporate persons and natural persons that prevents them from having exactly the same rights in a meaningful way. Corporations cannot marry, vote, or hold public office in the way that natural persons can. And for critics of the court’s decision, money simply is not the same thing as speech, especially considering the vast wealth of corporations and the corrupting influence that money has in political campaigns. The harshest critics argue further that the very idea of corporate personhood is a horrible mistake, and corporations simply are not people.

Limited Liability

The fourth attribute of corporations is **limited liability**, which, as we discussed earlier, means that a stockholder cannot lose more than the amount that he or she invested. In normal circumstances, the corporation as a legal entity, not the shareholders themselves, is liable for payment of debts. In the event that the corporation fails, the shareholders can lose their investments, but they are not responsible for paying any remaining debts that the corporation owes to its creditors. The purpose of limited liability is that it encourages investment: People are more likely to invest in something when they know that their risk is limited.

Gerald Herbert/Associated Press

Stockholders in companies like BP, which was involved in the recent Gulf oil spill, are not liable for payment of debts of the corporations they invest in.

In unusual circumstances, however, shareholders may become liable for corporate debts if the corporation is used to commit fraud on people that it deals with, such as creditors. This may also occur if the shareholder runs the business as though the corporation did not exist, for example, by not holding meetings or not keeping corporate records. In these cases, to use a legal expression, the "corporate veil" is pierced, and the owners behind that veil are exposed.

Shell Corporations

One particularly odd issue surrounding the incorporation process involves what are called **shell corporations**—that is, corporations that exist on paper but have no active business operations or significant assets. Often these are used for legitimate purposes. For example, sometimes one company might set up a series of shell corporations and then sell them off the shelf to someone else as a way of simplifying the process of creating a corporation. The new owner can then change the corporate name and officers at any time.

However, shell companies can be abused. Enron made heavy use of shell companies: By transferring its accumulating debt to them, the company was able to hide its financial failures from investors and the public, thus creating the illusion that it was a healthy and vibrant company. More often, though, shell companies are created for purposes of tax avoidance. For example, a company based in California might conduct its international business through a shell company that is incorporated in a tax-haven country like Belize. The principal corporation in California can then avoid reporting the shell company's income to the U.S. government, and thereby avoid paying taxes on that income.

This practice is technically legal, and it is one that U.S. lawmakers hate but have difficulty combating. In fact, even within the United States, some states have themselves become tax havens because of their lax incorporation laws, and shell companies are flourishing there. For example, a small house in Cheyenne, Wyoming, is the official address of 2,000 shell companies (NPR Staff, 2011). All of these examples show how the laws that enable the creation of corporations can be manipulated for a wide range of potentially unethical business practices. In the worst cases, a shell corporation is created solely as a vehicle for wrongdoing and has no further redeeming value whatsoever as a business entity.

Moral Agency of Corporations

The status of corporations as legal persons makes them legally responsible for misdeeds, such as bribery, discrimination, unsafe working conditions, and false advertising. They can be charged with crimes and face penalties. However, it is common to hear people attack a company for being immoral, and the implication is that the business is morally responsible for its misconduct, not just legally responsible. That is, businesses are not merely legal persons but are also moral persons, or moral agents, who are morally responsible for their actions.

Take this next example, which appeared on a blog. A customer signed a contract with a home-security company and was told by the sales agent that it was for the duration of 2 years. At the close of the second year, the customer contacted the company saying that she did not want to renew the contract; the company said that the contract was for 3 years, not 2. The customer waited a year and repeated her request. The company responded that they require a 60-day notice for nonrenewal, and if they do not receive it, the customer is automatically renewed for another 3 years. The customer believed that the business was scamming her and, consequently, maintained that the company acted immorally (Samantha, 2009).

If this were a small, family-operated business, we could easily say that the business was immoral, since the fault would trace directly back to the family owners themselves: It is the owners who acted immorally through their business operations. Suppose, however, that the security company was a national chain with thousands of employees, each of whom was playing only a small and limited role in the operation of the business. Could we still say that this security company as a whole acted immorally in the same way that we commonly say that an individual human acted immorally?

The issue here is that of **corporate moral agency**, which concerns whether businesses are morally responsible for their actions, similar to how individual people are morally responsible for theirs. There are two main positions on this issue.

Position 1: Corporations Can Be Genuine Moral Agents

The first position is that corporations can be genuine moral agents. In the words of Peter French, the leading proponent of this view, "corporations can be full-fledged moral persons and have whatever privileges, rights and duties as are, in the normal course of affairs, accorded to moral persons" (1979). Corporations have what French has called a "corporate internal decision structure"—that is, a procedure for carrying out decisions—and this procedure has all the necessary elements to qualify as a "moral" decision-making process. It has two main components:

- It has a *responsibility flowchart*—similar to a corporate organizational chart—that shows the various management levels within the corporation's hierarchy, and who is responsible for what.
- The corporation has rules (usually within its bylaws) to determine whether a manager is making a decision on behalf of the corporation itself or merely making a personal decision. For example, if the unscrupulous home-security company described earlier were a large corporation, we would be able to identify which manager in the corporate hierarchy was responsible for the renewal scam, and whether that decision was a personal one or a corporate one.

With French's model of corporate moral agency, human beings are still the ones making the decisions, but those people are making choices for the corporation, not for themselves. Thus, the intention behind that decision is the intention of the corporation, not of the individual person.

Position 2: Corporations Cannot Be Moral Agents

The second and opposing position is that corporations cannot be moral agents. According to this view, the immoral actions of a corporation are attributable to the decisions of the individual actors within the corporation, not to the corporation as a whole. The leading proponent of this view, Manuel Velasquez, has argued that "corporate organization lacks the kind of causal powers and intentionality that an entity must possess to be morally responsible for what it does" (2003). According to Velasquez, to speak of a corporation as having intentions is only a metaphor, and nothing in the corporate internal decision-making structure can "transform a metaphorical intention into a real one," nor can it "create group mental states nor group minds in any literal sense." Human intentions, he has argued, are mental in character and can only occur within a conscious human mind. To talk about corporate "intentions" in a literal sense would mean that a corporation has a unified conscious mind, which is absurd, he argues. At best, Velasquez says, a corporation consists only of people with conscious minds who are disconnected from each other. Workers, not the abstract corporate group, are the ones that carry moral responsibility for their on-the-job decisions (Velasquez, 2003).

Issues at Stake

There are two issues at stake in this debate:

- Whether corporations can themselves be accused of being "immoral." If I rob a bank, I can justly be called an immoral person. But if a corporation intentionally defrauds consumers, can it also be called "immoral" in the same way? French says yes; Velasquez says no.
- Whether workers in corporations should be punished individually for their immoral decisions, beyond the punishment that the corporation receives. French says they should not; Velasquez says they should.

We should emphasize, though, that regardless of whether there is a moral justification for punishing corporations, from a purely legal standpoint corporations are in fact liable for punishment by the state. They are legal persons and, as such, have legal liability in the way that you and I do.

3.2 Punishing Corporations

The next issue concerns the types of punishments that governments can impose on corporations, and what society hopes to accomplish through those punishments. The issue of punishment in general is a complex one. Therefore, it will help if we start by looking at the methods and justifications for punishing individual people, and turn to corporations after that.

The ways in which society can punish individuals for crimes are varied. Suppose, for example, that you are caught shoplifting from a local store. A possible punishment would be paying a fine or serving a few weeks of community service. With some crimes, like drunk driving, judges can get creative and make you put an embarrassing sign on your car that says "I'm a convicted drunk driver." If your crime is even more severe, you might spend years in prison, or even be executed.

There is a wide range of punishments available for criminals in part because there are a variety of objectives society has for punishing them in the first place:

- There is **deterrence**, in which an offender is punished to set an example that might discourage others from committing similar crimes.

- There is **incapacitation**, in which, by being removed from society, an offender is prevented from committing further similar crimes.
- There is **rehabilitation**, in which, through reform techniques, changes are made to an offender's future behavior.
- There is **retribution**, in which punishment balances the scales of justice. An offender committed a crime, and this requires that the person be punished accordingly.
- Finally, there is **reparation**, in which an offender must repay a victim for the injury that the offense caused.

Six Types of Corporate Punishment

Let us now turn to the issue of punishing corporations. An immediate way of approaching the task is to hunt down the people within the corporate hierarchy who are responsible for a crime and punish them individually. This, in fact, occurs regularly. For example, former Enron president Jeff Skilling received a 24-year prison sentence for fraud and insider trading. In 2015, Eric Bloom, former CEO of Sentinel Management, was sentenced to 14 years for defrauding hundreds of investors of $665 million.

Louis Lanzano/Associated Press

Former WorldCom CEO Bernie Ebbers is seen leaving a New York Federal court. Ebbers is currently serving a 25-year prison sentence based on his involvement in and cover-up of an $11 billion accounting scandal that led the company to file for bankruptcy. *Time* magazine recently named Ebbers one of its "Top 10 Crooked CEOs."

However, merely going after the key players within a company is often not enough. In many cases, the causes of corporate misconduct are dispersed so widely within the company that there may be no one individual who intentionally committed an illegal act. Rather, it may only be the accumulated efforts of many blameless individuals that ultimately give rise to a corporate misdeed. More importantly, the status of corporations as legal persons makes a company itself liable to prosecution, in addition to any corrupt corporate executive who might be involved. But although a corporation is considered a legal person, it is not a giant human being. Thus, at least some of the penalties that we impose on individual people would not be appropriate for corporations. We cannot, for example, literally imprison a corporation. There are six basic types of punishment for corporations:

- fines,
- equity fines,

- corporate incapacitation,
- the corporate death penalty,
- corporate shaming, and
- community service orders.

We will examine each of these here.

Fines

Perhaps the most common way of punishing a corporation is through a **fine**, a payment of money imposed as a penalty for an offense. For example, the pharmaceutical company Johnson & Johnson was fined $2.2 billion for promoting psychiatric drugs for unapproved uses in children, seniors, and disabled patients—one of the largest settlements with a drug manufacturer in U.S. history. Although fines may be the usual way of punishing a corporation, there are several problems associated with this approach:

- If the company is large and the fine is small, it will be ineffective in rehabilitating an unethical company. The company may see the fine as just another cost of doing business. This leaves the public with the impression that corporate crime is permissible as long as the company merely pays the going price.
- If the company is small and the fine is large, the company may not be able to afford to pay it. And if the fine is lowered for that company, the cost will not serve as an effective deterrent for other companies.
- Corporate fines can harm innocent people associated with the company. A hefty fine can financially harm a company to the point that it must decrease employees' salaries or even lay employees off. In addition, fines might result in reduced dividends and stock value for shareholders. The company might also pass the costs of the fines on to consumers. A case in point is a sewer company in California that was fined $1.6 million when millions of gallons of raw sewage spilled from its treatment plant. According to the plant manager, one option for covering the fines was to increase fees to consumers. (Staats, 2008)

Equity Fines

Another type of corporate punishment is a variation on the fine. With an **equity fine**, the payment is made in shares of the company, not in money. The effect is that the value of the company is diluted in the market, which may serve as a greater deterrent to companies than monetary fines. The key advantage of equity fines is that they avoid forcing financially weak companies out of business, and thus protect innocent employees and creditors. This form of corporate punishment is not yet practiced in the United States or any other country, but the Scottish parliament has debated legislation allowing equity fines, and it remains a possible model for corporate punishment.

Corporate Incapacitation

Another form of punishment is **corporate incapacitation**. For this punishment, a court issues an order to restrain the activities of a corporation in some area of business. The court may temporarily restrict a company's commercial activity for some line of business, in some geographical area, or with some client. The court may temporarily revoke a company's operational license, or disqualify the company from obtaining specific contracts. It may also freeze the company's profits. The United States has these kinds of provisions for corporate incapacitation, the aim of which is to stop businesses from engaging in a practice that consistently operates outside the law (Walt & Laufer, 1992).

Corporate Death Penalty

Occasionally, a company commits a crime that is so egregious that, for punishment, it receives what is called a **corporate death penalty**. The company is forced to go out of business, such as by revocation of its corporate charter. This is what happened with the accounting firm Arthur Andersen. In 2002 it was convicted of obstruction of justice for shredding documents connected to its auditing of Enron. Because of the conviction—and the fact that convicted felons are not permitted to audit public companies—the company was forced to surrender its CPA license, thus forcing it to close its doors for good. Its conviction was overturned a few years later by the Supreme Court, but not before most of its employees lost their jobs.

The downside to the corporate death penalty is that it harms the vast majority of the workers who are innocent of wrongdoing—thousands of them, in the case of Arthur Andersen. The families of these workers suffer as well. The corporate death penalty can also be misused in political battles. For example, an Arizona law called the "Legal Arizona Workers Act" allows for the revocation of business licenses for companies that are discovered to have knowingly employed illegal immigrants. Although it is reasonable to punish a company when it breaks the law by hiring illegal immigrants, critics of the law argue that is excessive to impose upon that company the punishment of corporate death. The issue of illegal immigration is a controversial one that generates extreme opinions, and in this case, the Arizona law has used the corporate death penalty to achieve an ideological goal. Controversial as it is, the Constitutionality of Arizona's law was nevertheless upheld by the U.S. Supreme Court (*Chamber of Commerce v. Whiting*, 2011).

Corporate Shaming

Another option for punishment is **corporate shaming**, in which the government requires a guilty company to make a public announcement that threatens its reputation and social standing. For example, a Massachusetts ferryboat company was required to place an ad in the Boston Herald that stated, "Our company has discharged human waste directly into coastal Massachusetts waters." The Federal prosecutor in this case argued that the goal was to deter others, but a punishment such as this has the added benefit of satisfying the public "when it doesn't appear that the company has been punished sufficiently enough, by simply writing a check" (Tovia, 2010). The problem with corporate shaming is that the humiliation and embarrassment are projected onto innocent workers, not just the guilty ones. Further, the loss of prestige might contribute to the financial failure of the corporation and thus adversely affect innocent workers.

Community Service Order

A final type of punishment is a **community service order**, where, similar to community service punishments for individuals, a company must participate in some project that benefits the community in some way. For example, six New York bakeries were convicted of price fixing. As punishment, they were ordered to donate baked goods to charitable organizations for one year (*United States v. Danilow Pastry Co.*, 1983). One advantage to this approach is that, when a large number of unidentifiable people have been harmed by misconduct, community service is a way to distribute some benefit back to the wider community rather than to an individual victim. Also, community service orders do not put companies at risk that are in financial difficulty in the way that fines do, and thus they insulate innocent parties such as creditors and workers. This was one of the motivations for the order in the bakery price-fixing case. Community service punishment is sometimes criticized for being potentially image enhancing: The company might publicize its service activity in a way that increases its reputation as a socially responsible organization. Defenders, however, argue that the fact that the service is done under court order makes it less likely that the company will draw that kind of attention to itself.

What Would You Do?

You are a judge and before you is a case in which an auto dealership with 50 employees has been found guilty of false advertising. The dealership routinely advertises vehicles at low prices, but once customers are on the lot, it sells them at much higher ones. Your concern is that a hefty fine might force the dealership out of business and thus adversely affect the lives of the innocent employees.

1. Would you impose the fine or consider alternative forms of punishment, such as incapacitation, shaming, or a community service order? Be sure to state the rationale for your decision.
2. Suppose the dealership only switched prices for its customers who had above-average incomes. Would that make a difference in your decision? Why or why not?
3. What if dealership only switched prices for its customers who had *below*-average incomes? Would that make a difference in your decision? Why or why not?
4. What if all of the employees in the dealership knew about the scam, and they all received bonuses based on the higher selling prices? Would that make a difference in your decision? Why or why not?

Federal Sentencing Guidelines

The U.S. government punishes a wide range of corporate offenses. In 1991, it established guidelines for sentences imposed by Federal judges, known as the **Federal Sentencing Guidelines for Organizations (FSGO)**. The types of punishments imposed are wide-ranging, and individuals can serve jail terms and pay large fines, the costs of which the corporations themselves are not permitted to cover. The guidelines make use of a point system for determining the severity of an offense as well as increasing levels of fines that correspond to severity. Severity increases when the company has a history of such misconduct, when it obstructs justice during the investigation, and when "an individual within high-level personnel of the organization participated in, condoned, or was willfully ignorant of the offense" (U.S. Sentencing Commission, 2014). The guidelines encourage organizations to create compliance and ethics programs to prevent and detect illegal conduct, recommending that these programs include seven specific steps that are summarized in Figure 3.1.

Figure 3.1: Seven steps recommended by the U.S. Sentencing Commission for organizations to prevent and detect violations of the law

Organizations that create compliance and ethics programs will receive a reduced punishment if prosecuted for a crime in the future.

1. **Standards and Procedures:** Organizational implementation of compliance standards and procedures that are reasonably capable of reducing the prospect of criminal conduct.
2. **Oversight:** Assignment of high-level personnel to oversee compliance with such standards and procedures.
3. **Ethical Supervisors:** Due care in avoiding delegation to individuals whom the organization knows, or should know, have a propensity to engage in illegal activities.
4. **Training:** Communication of standards and procedures by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.
5. **Monitoring:** Establishment of monitoring, auditing, and reporting systems by creating and publicizing a reporting system whereby employees and other agents can report criminal conduct without fear of retribution.
6. **Punishment:** Enforcement of standards through appropriate mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense.
7. **Corrective Action:** Development of appropriate responses to offenses by taking all reasonable steps to respond appropriately and to prevent further similar offenses, including any necessary modification of programs (Federal Sentencing Guidelines, 2014).

Source: U.S. Sentencing Commission. (2014). *2014 Guidelines manual* (Chapter eight – Sentencing of organizations). Retrieved from http://www.ussc.gov/guidelines-manual/2014/2014-chapter-8#8b21

Corporations have a special incentive for creating compliance and ethics programs that include these seven steps: If in the future they are ever prosecuted for a crime, they will receive a reduced punishment. In this way, the government aims to build into corporations a procedure that will reduce the likelihood of their engaging in illegal conduct.

Consumer Retaliation

Another mechanism for punishing companies is initiated by the public rather than by the government. Just as the government keeps a watchful eye on businesses, so, too, do consumers. **Consumer retaliation** is when individual consumers or consumer groups express dissatisfaction with a company through some effort that harms it financially. Consumers can write letters of complaint to government agencies, file civil lawsuits against offending companies, and use every possible form of media, especially the Internet, to bring public attention to issues of corporate misconduct. We will examine many of these efforts in a Chapter 4, but one mechanism for consumer retaliation we can note here. This is the **consumer boycott**, when a group of people act together to abstain from buying from or dealing with a business. The word *boycott* is derived from a British land agent in Ireland, Charles Boycott, who himself was the target of a systematic boycott when, during a particularly bad growing season, he refused to lower the rent for farmers who leased land from him. The farmers moved off his property to other locations, and he had trouble finding people who would harvest his fields.

There are two important advantages to consumer boycotts as supplemental ways of punishing companies:

- Companies are often directly involved in shaping the laws that apply to their industry, and thus government-sanctioned punishments are not possible when the laws are lax to begin with. Boycotts fill that void by holding companies accountable when governments fail to do so.
- Even when the government does get involved by making tough laws, it often takes several years before the laws are passed and take effect. In the meantime, the company can continue with its practice. Boycotts—or even the threat of them—can hold companies accountable during this period of legislative limbo while keeping up public support for the proposed legislation.

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Adidas stopped using Kangaroo leather in its soccer shoes after a boycott by the animal rights group Viva.

A recent effective use of boycott was the efforts of the animal rights group Viva to get athletic sportswear company Adidas to stop using kangaroo leather in the manufacturing of its soccer shoes. In 1979, Adidas began using kangaroo skin, which has a tensile strength that is 10 times that of cowhide. The shoes were lighter and stronger than alternatives, and Adidas quickly dominated the market. In 1997, Viva launched its "Save the Kangaroo" boycott against Adidas, and its impact was soon felt, with Adidas receiving thousands of emails complaining about its use of kangaroo leather. Viva then began lobbying soccer superstar David Beckham, who had signed a $160 million lifetime endorsement deal with Adidas. After learning details of the controversial slaughter methods of kangaroos, Beckham switched to synthetic shoes in 2006. In 2012, Adidas announced that it cut back on its use of kangaroo leather in its shoes by 98% (Poulter, 2012). While not a complete elimination of kangaroo leather, it is a substantial reduction, and thus serves as a good example of the leverage that a well-organized boycott can have over a company.

3.3 Ethical Corporate Culture

From what we've seen so far, there are several motivations for corporations to abide by the law and avoid immoral behavior. There is the looming threat of criminal punishment, and all the bad publicity that goes along with it. There is the possibility of consumer retaliation, such as consumer boycotts. In this section we will look at mechanisms within the corporate structure itself that create an ethical corporate culture.

Stakeholders and Corporate Social Responsibility

An important concept in the creation of an ethical corporate culture is that of the **stakeholder**, which is any party who is affected by, or has a stake in, a business practice. This includes employees, suppliers, customers, creditors, competitors, governments, and communities, as well as shareholders. The stakeholder approach to responsible corporate conduct is that businesses should consider all stakeholders' interests, not just those of the shareholders. By considering the interests of the full range of stakeholders, companies will be less likely to exploit these groups for financial gain.

The challenge of the stakeholder theory is to prioritize the interests of the various stakeholders. Every stakeholder wants to carve into the financial pie, and there is not enough to go around for everyone. Shareholders seek to maximize their investments, employees want higher wages, governments want more taxes, and environmentalists want to see more eco-friendly policies. The stakeholders and their claims must be prioritized and, at a minimum, categorized into two groups: *primary stakeholders* and *secondary stakeholders*. Of necessity, the shareholders will be primary stakeholders—perhaps the only ones—since they are the ones who own the company and ultimately call the shots regarding corporate policy. While shareholders may be willing to give in to reasonable demands of secondary stakeholders, they are still investing in the company to make money, and are certainly not willing to hand it all away.

The stakeholder theory does not come with a built-in formula for prioritizing the competing interests of primary and secondary stakeholders. However, its greatest significance may be the growing popularity of the word *stakeholder* itself and its use throughout the business world today. Through its heavy use, the idea of social responsibility has become an integral part of normal business vocabulary. It is more than a faddish buzzword; the identification of stakeholders is often part of a company's strategic planning process.

What Would You Do?

You are the CEO of a coal company that uses the controversial technique of mountaintop removal. This involves bulldozing away the top of a mountain to get at the coal, then filling in surrounding valleys with the removed soil. Technically you are not breaking the law, but this method is both environmentally damaging and visually ugly. You could use underground mining, which is less harmful, but it would cut into your profits.

1. Who are the various stakeholders in this situation?
2. Which ones are primary, and which are secondary?
3. At what point might you find the profit loss from underground mining acceptable: a loss of 20%, 10%, 5%? Explain your answer.
4. Suppose that local residents set up picket lines daily at the entrance to the jobsite, and these are regularly featured in the news. How might that affect your assessment of how much profit loss would be acceptable for switching to an underground mining method?

Although stakeholder theory is a popular way of articulating the social mission of companies, it is not the only one. Another concept is the **triple bottom line (3BL)**, which is that successful companies must pursue three distinct values:

- people,
- the planet, and
- profit.

That is, there should be social benefit to workers and the community, environmental benefit through the implementation of sustainable ecological practices, and economic benefit only after all hidden environmental costs have been factored in.

Yet another similar concept is that of **corporate social responsibility (CSR)**—also called *corporate conscience* or *corporate citizenship*. This generally refers to a corporation's efforts to take responsibility for its effects on the environment and its impact on social welfare. It typically applies to efforts of companies that go beyond what is required by governmental regulations.

Since 1997, a consulting firm called the Reputation Institute has specialized in assessing public perceptions of corporate social responsibility among major companies worldwide. Figure 3.2 lists the recent top 10 spots. As you can see, some very recognizable companies hold these positions.

Figure 3.2: Reputation Institute's top 10 ranked companies for Corporate Social Responsibility

Organizations are ranked based upon public perceptions of their citizenship, governance, and workplace.

1. Google
2. BMW
3. The Walt Disney Company
4. Microsoft
5. Daimler
6. Lego
7. Apple
8. Intel
9. Rolls-Royce
10. Rolex

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The rankings were based on more than 60,000 interviews, and they only reflect the general public's *perception* of the companies, not what those companies' citizenship policies or actions are. The odds are slim that the people interviewed had any detailed knowledge about the companies' actual activities. Their perceptions were likely guided by product-name recognition, company advertising, news stories, and personal experience with the product.

Nevertheless, the Reputation Institute maintains that corporate reputation is "an emotional bond that ensures who uses your products, who recommends you" (Reputation Institute, 2015). Therein lies the problem: If the goal is to increase public perception, a company can often achieve this more inexpensively through a sophisticated marketing strategy than through engaging in costly social projects. This is particularly common with claims about environmental responsibility: Virtually every company attempts to project itself as eco-friendly, regardless of how environmentally harmful its business operations are. The term **greenwashing** refers to pretended efforts at environmental responsibility and, more broadly, at corporate responsibility. Coca-Cola, for example, has been accused of greenwashing with the introduction and promotion of its "plantbottle," which it says contains up to 30% plant material. Although the company uses this to project itself as environmentally friendly, there is no evidence that the plantbottle reduces CO_2 emissions.

In a sense, the Corporate Social Responsibility Index exacerbates this problem, since it tells companies how successfully they are competing in the battle for public perception. A better index is one that ranks the *actual* performance of companies in key areas of social responsibility, rather than simply public perceptions of their performance.

Akira Suemori/Associated Press

This group, called the "Greenwash Guerrillas," took part in a mock cleaning job at the National Portrait Gallery in London. The group was criticizing the gallery for its hosting of the BP Portrait Award ceremony, claiming that doing so helped the oil company "greenwash" its public image.

One such effort is an index provided by *Corporate Responsibility Magazine*. However, this index has a built-in bias because much of its data comes directly from the websites of the companies that it is evaluating, and such corporate websites are at bottom public relations tools that help shape their image. Thus, even this index encourages companies to publically exaggerate or misrepresent their social responsibility.

There is yet a deeper problem with corporate social responsibility in that the very concept of it may be an illusion. Robert Reich argues that corporate social responsibility "is founded on a false notion of how much discretion a modern public corporation has to sacrifice profits for the sake of certain social goods"; this misleads people to think that businesses are doing more for the public good than they actually are (Reich, 2008). The reality, according to Reich, is that the international business environment today is "super-competitive," and this makes companies resist doing anything that hurts the bottom line. For Reich, the solution to the ethical problems of companies must come from laws enacted through the democratic process that will constrain business conduct. Talk of corporate responsibility makes for good press and reassures the public, but it delays governmental regulation that will make the real change.

Although companies may sometimes overstate or fake commitment to social responsibility, consumers take it seriously; one poll indicated that 79% of Americans take corporate social responsibility into account when making purchasing decisions. It was an important factor for 36%. The same study showed that 71% consider corporate social responsibility with investment decisions. And 12% went so far as to say that they would purchase stock in socially responsible companies even if it meant accepting lower financial returns (Verschoor, 2001).

Mission Statements and Codes of Ethics

There are concrete ways within the corporate structure to mark out ethical boundaries for employees. The most common ways are through mission statements and codes of ethics.

Mission Statements

A **mission statement** is a short account of the company's fundamental purpose, and many companies use them as a way of broadcasting their commitment to ethical standards. Here, for example, is one of PepsiCo's recent mission statements:

> Our mission is to be the world's premier consumer products company focused on convenient foods and beverages. We seek to produce financial rewards to investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. And in everything we do, we strive for honesty, fairness and integrity. (2015)

In the first sentence, PepsiCo indicates its main product line and how it sees itself in the world market. The second sentence describes its financial success. In the third sentence we see the ethical component: All company conduct aims for honesty, fairness, and integrity. Here is the ethical part of a few company mission statements:

- Microsoft: "Microsoft is committed to deepening the trust of customers, partners, governments, and communities. We strive to meet or exceed legal, regulatory, and ethical responsibilities worldwide and to hire and reward employees who share our values, work with integrity, and adhere to our Standards of Business Conduct." (2015)
- Starbucks Corporation: "With our partners, our coffee and our customers at our core, we live these values: Creating a culture of warmth and belonging, where everyone is welcome. Acting with courage, challenging the status quo and finding new ways to grow our company and each other. Being present, connecting with transparency, dignity and respect. Delivering our very best in all we do, holding ourselves accountable for results. We are performance driven, through the lens of humanity." (2015)
- Target Brands, Inc.: "We believe in being an active citizen and good neighbor in our communities. We give our time, talent and business strengths to make our communities strong, healthy and safe. We invest in career development and well-being of our team. And from the start, we've given 5 percent of our income, a commitment that does not waver based on the economic climate." (2015)

Socially progressive companies often have even more aggressive ethical agendas in their mission statements. For example, Just Us Coffee Roasters Co-op's mission statement includes the slogan "people and the planet before profits" (n.d.). This suggests that, among the various stakeholders in that business, the shareholders are secondary to society and the environment. Although this is not typical of corporate stakeholder priorities, it does show that corporations do not always need to place profits above all else. It is a question of how a company defines its mission.

Codes of Ethics

While mission statements are designed to be short, businesses commonly have more detailed **corporate codes of ethics** that express principles of conduct within the organization to guide decision making and behavior. Codes of ethics vary in length and detail, but the more meticulous ones typically have five parts:

1. *A letter from the CEO endorsing the code and explaining why it is important*. Heads of companies know that they must lead by example and that hopes of creating a moral climate must begin with them. One way to do this is for the CEO to publicly stand behind the company's ethical code. Here are key passages from four CEO letters of endorsement:
   - Nike: "This Code of Ethics is vitally important. It contains the rules of the game for Nike, the rules we live by and what we stand for. Please read it. And if you've read it before, read it again." (2011)
   - General Dynamics: "Please read the Blue Book [on ethics policy] carefully. It reminds each of us of our shared responsibilities to our shareholders, our customers, our business partners, and to each other. It calls on us to do the right thing and to seek guidance if needed." (2013)
   - The Coca-Cola Company: "The Code of Business Conduct is our guide to appropriate conduct. Together with other Company guidelines, such as our Workplace Rights Policy, we have set standards to ensure that we all do the right thing. Keep the Code with you and refer to it often." (2009)

   In each of these cases, the CEO stresses the need for employees to take the company's ethical code seriously.
2. *A general statement of values*. The values listed are often varied but may include honesty, quality, integrity, respect for all people, building strong relationships, taking care of employees, giving back to the community, excellence in customer service, strong shareholder returns, wise use of assets, environmental responsibility, respect for human rights, and keeping promises.
3. *A statement of commitment towards the company's different stakeholders*. This usually includes employees, customers, suppliers, shareholders, and society at large.
4. *Company policies on a range of ethical issues that arise on the job*. These include drug and alcohol use, safe working conditions, employee privacy, discrimination, sexual harassment, workplace violence, conflicts of interest, accepting gifts, insider trading, bribery, and price fixing.
5. *A discussion on how the code is carried out within the organization, and punishments for code violation*. The administrative implementation of the code sometimes is assigned to an **ethics officer** within the company; this person holds workers accountable to the company's ethical standards. Punishments for code violations may include letters of warning, counseling, loss of employment, and, in extreme cases, legal charges.

In addition to these five points, many codes include an intuitive guide for employees to test their decisions, such as the following from Allstate:

> Ask yourself the following questions when you face a decision that involves ethics:
>
> - Is it legal?
> - Does it comply with this Code and with policies that apply to the situation?
> - How will it affect others—consumers, competitors, shareholders, other employees, agencies, the community, and you?
> - How will it look to others? Innocent actions sometimes can give the appearance of wrongdoing.
> - How would you feel if this decision was made public?
> - Should you ask for advice before acting?
>
> If you are still uncertain, ask your manager or contact another resource listed in this Code. (Allstate, n.d.)

Codes of ethics are not a perfect solution to the problems of immoral business conduct. Many of the principles advanced are too general to be of much guidance, such as the values of honesty, quality, and integrity, which are listed in many such codes. And sometimes they seem to be mere public relations tools to make an unscrupulous company appear to be committed to ethical principles. Before its collapse in 2001, for example, Enron's published statement of corporate values included the following:

- Respect: We treat others as we would like to be treated ourselves. We do not tolerate abusive or disrespectful treatment. Ruthlessness, callousness, and arrogance don't belong here.
- Integrity: We work with customers and prospects openly, honestly, and sincerely. When we say we will do something, we will do it; when we say we cannot or will not do something, then we won't do it. (Enron, n.d.)

From what we now know of Enron's activities, the claims of respect and integrity are laughable. There are certainly other companies today that, like Enron, behave shamefully while at the same time making grandiose claims about their ethical standards. Nevertheless, many companies do take their codes seriously, and look to them to safeguard against criminal charges by the government, lawsuits by customers, and bad publicity by the media, all of which can financially cripple a company.

3.4 Threats to Ethical Corporate Culture

We turn finally to an examination of aspects of corporate culture that can undermine a company's commitment to moral integrity and social responsibility. We will consider four such factors:

- the profit motive,
- strategic misrepresentation,

- groupthink, and
- organizational schizophrenia.

None of these is immoral in and of itself, and to some degree all of them are even facts of life when running a business. But if left unchecked, they can create moral and legal problems.

The Profit Motive

Several times so far we have seen that a company's motive to make profits can conflict with its sense of social responsibility. Shareholders expect to see a return on their investments, and the corporate officers have a fiduciary duty to oblige them, to the point that the officers might neglect the interests of all other stakeholders.

Not only is this a possible outcome, but economist Milton Friedman famously argued that this is exactly how it should be: Businesses should stay away from social responsibility and keep focused on making profits. He did not advocate that businesses violate the law when pursuing profits, but only that they avoid taking positive steps toward social causes beyond what the law requires. "Few trends," he argued, "could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as possible" (Friedman, 1970, SM17).

According to Friedman, it is contrary to the nature of a well-run corporation to advocate social responsibility, since it amounts to a hidden social tax. That is, it places an extra financial cost on consumers for some social benefit that has no direct connection with the product that they are purchasing. Suppose that a corporate executive refrains from increasing the price of a product, to help prevent inflation; spends vast amounts of money on reducing pollution beyond what the law requires, to help improve the environment; or hires an underqualified unemployed person, to help reduce poverty. "In each of these cases, the corporate executive would be spending someone else's money for a general social interest" (Friedman, 1970, SM17). It would also mean reduced returns for shareholders, higher prices for customers, or lower wages for employees. This, argues Friedman, makes the socially minded executive an unelected civil servant who, in many cases, will not be properly educated about which actions will indeed promote social benefit. In this way, Friedman believes, it is subversive to a free society. The only responsibility of a business, then, is to increase its profits, so long as it stays within the bounds of the law by engaging in "open and free competition without deception or fraud" (1970).

Friedman's argument against corporate social responsibility is a rather extreme one that is hard to defend. Here are just two problems with it:

- Business money spent on social causes is unlike a tax in at least one important way. Taxes imposed by governments are mandatory, but no one's association with a socially responsible corporation is mandatory. Consumers can choose to spend their money elsewhere; workers can choose to be employed elsewhere; shareholders can choose to invest elsewhere. Since these are free associations, it is difficult to see how such corporate social responsibility is subversive to a free society. On the contrary, it is part of a free society to experiment with company policies, and find creative ways to attract customers, employees, and investors.

- Many consumers will be attracted to corporations with strong social agendas, which will increase company profits. For example, Ben & Jerry's is a case in point. When the company first began manufacturing ice cream, it adopted a unique social mission:

  > to operate the company in a way that actively recognizes the central role that business plays in the structure of society by initiating innovative ways to improve the quality of life locally, nationally, and internationally. (Ben & Jerry's, n.d.)

Gareth Davies/Getty Images Entertainment/Getty Images

Ben Cohen and Jerry Greenfield of Ben & Jerry's have a social mission that seeks to rid society of injustices. Here they are at the announcement that their ice cream has gone 100% fair trade.

The company professes to have a "progressive, nonpartisan social mission" that aims to eliminate injustices locally and globally, and supports nonviolent ways to achieve peace and justice (Ben & Jerry's, n.d.). At one point in its history, the company donated an unusually high percentage of its profits to philanthropic causes—7.5%, as compared with the norm of 1%. In 2001, Ben & Jerry's was purchased by Unilever, the world's third largest consumer goods company, and from the start its new parent company said it was "determined to nurture its commitment to community values" (Press Office Unilever London, 2000).

Ben and Jerry's and its parent company do not see eye to eye on all issues, and a case in point is their respective views on legal requirements for labeling foods made with GMO ingredients. Ben and Jerry's supports such laws while Unilever is against them. Unilever nevertheless permits Ben and Jerry's to voice its view, and, in fact, in 2014 Ben and Jerry's CEO stood publically alongside Vermont's governor as the governor signed U.S.'s first law requiring labeling of foods made with GMO ingredients. (Boyle, 2014)

Strategic Misrepresentation

Another component of corporate culture that can lead to flawed decisions is **strategic misrepresentation**, which is the intentional and systematic distortion or misstatement of facts for the purpose of gaining a financial advantage. A simple example is with automobile dealers: Suppose that a dealer knows very well what the weaknesses are with the vehicles being sold but intentionally conceals those problems from customers. If the dealer were completely truthful, customers would simply go elsewhere. Businesses routinely exaggerate the value of their products, the quality of their customer service and satisfaction, and their overall financial health.

Although strategic misrepresentation is undoubtedly common in business negotiations, some have argued that it is simply part of the nature of doing business, and it cannot be eliminated.

Nor should we try to eliminate it. Albert Carr championed this view in an influential essay titled “Is Business Bluffing Ethical?” In some situations, he argued, bluffing one’s opponents is a normal part of the game. In poker, for example, a player strategically tries to get opponents to think that his or her hand of cards is either stronger or weaker than it actually is. So, too, in business. In fact, Carr argued, if a businessperson feels obligated to always tell the truth, he or she “is ignoring opportunities permitted under the rules and is at a heavy disadvantage in his [or her] business dealings” (1968).

Most executives are compelled from time to time to be deceptive when negotiating with dealers, labor unions, government officials, and even other departments within their own companies. According to Carr, “Falsehood ceases to be falsehood when it is understood on all sides that the truth is not expected to be spoken” (1968). For example, a criminal does not lie when he or she pleads “not guilty,” even when he or she committed the crime, since this is just a part of the judicial process. In the workplace, similar kinds of acceptable deception can occur from the moment we fill out our job applications and exaggerate our strengths while downplaying our weaknesses. When our bosses ask for our opinion, we often say “yes” when we really believe “no.” There is no place for the Golden Rule in business, and “a good part of the time the businessman is trying to do unto others as he hopes others will not do unto him” (Carr, 1968).

A famous case illustrates Carr’s position. Some years ago, the founder of the computer software company Borland wanted to place an advertisement in *Byte* magazine to help launch its products. He needed good credit terms with *Byte* to pay for the ads, but his company was not established enough to qualify for them. He then plotted to trick *Byte* into believing that Borland was larger than it was and had venture capital financing, which it really did not. When the sales representative for *Byte* visited the new company to inspect it, Borland’s founder had paid actors on hand to look like employees, had office phones ring continuously, and had a pretend advertising plan in plain view for the sales representative to see (Bhide & Stevenson, 1990). Borland got the credit to place the ad, and shortly after, the company became a major player in the software industry. In short, Carr and others have reasoned that deception is part of the rules of the business game. Since we do not morally condemn poker players for attempting to deceive opponents with their poker faces, by analogy we should not condemn businesses for doing what is necessary, even when it involves going contrary to our common moral intuitions.

The problem with this line of reasoning is that strategic misrepresentation is acceptable only when the rules are clearly known to everyone involved. Poker players know the rules of the game beforehand, and join the game in full knowledge of those rules. And in many instances the rules are very clear in business. Consumers know that advertisers will remain silent about the drawbacks of their products and exaggerate their qualities. In labor negotiations, businesses and labor unions both bluff about how far they are willing to bend the rules.

However, in other situations, the rules of business require complete honesty, and when businesses strategically misrepresent themselves, they are on the side of wrong and can be held legally responsible for their conduct. For example, to enhance its financial image, General Motors claimed in a national advertisement that it had repaid a bailout loan it received from the U.S. government “in full, with interest, five years ahead of schedule” (Tapscott, 2010). This claim conveyed the impression that GM had paid off all its government loans, and with its own money. In point of fact, however, neither of these statements was true. It paid off its loan with money it had received from a second government bailout loan. Thus, it still owed the government money, and it did not use its own money to pay back the loan. As a consequence, GM was sued for deceptive advertising. This was a case of strategic misrepresentation that violated the rules of the game.

What is fundamentally wrong about Carr's position is that, just because strategic misrepresentation is a socially accepted practice in some business situations, it is not necessarily acceptable in every case. A businessperson who rushes into strategic misrepresentation could easily make misleading claims that cross the line of legality. It is all a matter of knowing what the rules of the game are—and when they do not allow for misrepresentation.

Groupthink and Organizational Schizophrenia

Within the field of industrial-organizational psychology, there are a few concepts that describe how decisions are made in group environments and how these can sometimes lead to bad choices. We'll look at two in this section: *groupthink* and *organizational schizophrenia*.

Groupthink

Groupthink refers to the practice of thinking or making decisions as a group in a way that discourages creativity or individual responsibility. Group members become so focused on arriving at a decision as a cohesive unit that they set aside their private ethical concerns. In criminal courts of law, juries by their very nature face this problem. Twelve people are instructed by a judge to reach a unanimous decision, and they must do so to assure the success of the judicial process. To reach a unanimous decision, though, some jury members must give in to the views of the whole; it is only the most stubborn members who resist to the end and thereby create a hung jury.

The same thing happens within businesses. Suppose, for example, that an appliance company manufactures a new microwave oven, and in research and development there is some indication that the unit might overheat and catch fire. The evidence isn't conclusive, and it only happens with one test model operating in an extreme situation. Members of the research team have to decide whether the product is ready to move forward into production. Suppose further that there is pressure within the company to bring out new products within specified time frames. When the research team makes its final judgment, the group as a whole, influenced by that pressure, may decide that the unit falls within the limits of acceptable risk and is thus ready to go. Individually,

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Did groupthink contribute to the recent housing collapse and economic crisis in the United States?

some of the members might feel that production of the unit should be delayed until more testing can be done. But they agree anyway, since the consensus of the group is to move forward. It is only later, when customers are injured and the product is recalled for being a fire hazard, that the flawed nature of the group's decision-making process becomes evident.

The groupthink phenomenon is helpful for understanding how it is that many unethical business decisions can be made, whether with regard to product safety, discriminatory hiring practices, or shady bookkeeping. Each member of the group may personally have a high level of moral integrity. But when making tough decisions in a competitive business market, they may set their personal moral convictions aside in favor of a group consensus. Perhaps the group as a whole feels that the action falls into a moral gray area that is within the limits of acceptable risk. Perhaps the group as a whole is more interested in the benefits of the proposed course of action than an impartial analysis of its costs. In any event, members of the group end up making unethical choices that they would not in their private lives.

One analysis of the groupthink phenomenon describes four symptoms of it:

- The group feels that it is invulnerable to harm. It is in a position to make an authoritative decision and, perhaps influenced by a track record of previous successes, it ignores the possible negative consequences of its decision.
- The group members are unanimous in their beliefs—or at least in the expressed views of each member—and thus have the confidence to move forward with their decision.
- If there are dissenters, pressure is put on them to accept the views of the group.
- Someone in the group functions as a kind of "mind guard" who filters out information that is inconsistent with the group's view. (Levy, 2010)

One way to combat the groupthink phenomenon is to watch out for these four symptoms when making group decisions, and, if they do appear, actively seek out unspoken or minority viewpoints.

Organizational Schizophrenia

Another component of industrial-organizational psychology is **organizational schizophrenia**, in which tension exists between competing goals or values within a corporation. The organization presents mixed messages to its employees about what is important, and the employees are left to work out a course of action on their own. The term *schizophrenia* is borrowed from the field of psychology and refers to a psychological disorder in which a person is motivated by contradictory or conflicting principles. The use of the term in industrial-organizational psychology applies more generally to any set of competing agendas in an organization when there is no clear resolution between the two.

Some organizations are by their very nature schizophrenic. For example, pharmaceutical companies have an important social mission to improve people's health, on the one hand, yet at the same time have an obligation to shareholders to make a profit. For this reason, pharmaceutical companies are regularly called out in the media for allowing profits to overtake their social responsibility. For example, in 2011 Pfizer ended its research on antibiotic resistant bacteria, an area that, while of critical concern in world health, is financially unprofitable. In a more general way, this same tension is present in virtually all businesses: Employees are instructed to behave ethically, yet at the same time their jobs require them to maximize profits. When the pressure to maximize profits is too great, it may obscure ethical responsibilities, such as the duty to manufacture microwave ovens that do not catch on fire.

But the two goals of ethics and profit do not have to be in a schizophrenic relationship. They can be compatible when the boundaries of ethical behavior are clearly indicated to employees. It is much like playing a sport: There is the playing field where the principal activity occurs (analogous to maximizing profits) and there are boundaries beyond which players cannot stray (analogous to ethical boundaries). When employees have clear knowledge of where those ethical boundaries are, such as through corporate codes of ethics, they can safely do their part to maximize profits.

Conclusion

Corporations have come a long way since the founding of Jamestown by the Virginia Company. In the 400 or so years since that time, they have become independent of governmental affiliation, have gained the status of legal persons, and have greatly proliferated in number. It is precisely these changes that led Bakan to depict corporations as psychopaths with personality traits of irresponsibility, manipulation, grandiosity, superficiality, lack of empathy, and the inability to feel remorse. But even Bakan has recognized that a corporation's psychopathic behavior will ultimately lead to its own destruction, as happened with Enron. Thus, for a corporation to avoid a self-created downfall, at some point it must stop short of Enron-like behavior and take into account the wider interests of its various stakeholders.

We have seen that within corporate culture, there are mechanisms already in place for reinforcing socially responsible behavior, such as through codes of ethics and the seven steps of ethical compliance included in the Federal Sentencing Guidelines for Organizations. There are also warning signs for when companies become ethically at risk. The issue becomes whether a corporation is willing to take seriously these aspects of ethical corporate culture. There will always be companies like Enron, but the goal is to make their occurrences few and far between.

Summary & Resources

Chapter Summary

We began this chapter looking at the nature of corporations, and their four main features. That is, corporations are created by the states in which they are chartered, they can continue to exist indefinitely, they are regarded by the law as having the status of a person, and shareholders' liability is limited to the amount of money that they invest. Shell corporations, which exist on paper but have no active business operations, can manipulate the laws that create corporations and exist solely for unethical or illegal purposes, such as tax havens. A critical issue with the nature of corporations is whether they are moral agents, which are morally responsible for their actions beyond the responsibility individual corporate employees have. Peter French argued that they are moral agents, but Manuel Velasquez argued that they are not.

This chapter also explored how corporations are punished. Punishment in general is typically justified on five grounds, all of which apply to corporations as well as individual people: deterrence, incapacitation, rehabilitation, retribution, and reparation. Just as there are different forms of punishment for individual people, there are also different ways of punishing corporations. Six of these are monetary fines, equity fines, corporate incapacitation, the corporate death penalty, corporate shaming, and community service orders. The selection of an appropriate corporate punishment often hinges on whether it will harm innocent people, such as employees, customers, and creditors, and also whether the punishment is severe enough to have a real impact on the corporation's conduct. The U.S. government established the Federal Sentencing Guidelines for Organizations (FSGO), which guide Federal judges in imposing punishments on corporations. These guidelines also recommend steps for corporations to follow to maintain high standards of ethics and thus avoid illegal conduct. In addition to governmentally imposed punishments, consumers can also retaliate against unethical companies through boycotts and civil lawsuits.

The creation of an ethical culture within corporations often focuses on three notions: the stakeholder, the triple bottom line, and corporate social responsibility. Many corporations express their commitment to ethical standards within their mission statements and, in a more detailed way, through a corporate code of ethics.

A common criticism of these public statements is that they can be insincere efforts to make a company appear to be more ethical than it really is. Even in sincere efforts to create an ethical corporate climate, four things can hamper those efforts. First is the profit motive itself, which can incline companies to minimize their social responsibility in their efforts to increase profits. Second is strategic misrepresentation, in which a corporation intentionally misstates facts to gain a financial advantage. Third is groupthink, which occurs when employees set aside their ethical convictions in the process of building group consensus. Fourth is organizational schizophrenia, which occurs when management sends conflicting messages to employees about the corporation's ethical priorities.

Discussion Questions

1. The Supreme Court argued that perpetual existence is one of the main benefits of creating corporations. As tragic as death is for natural persons, it nevertheless makes way for younger generations of people to put their mark on the world. Might there be a similar benefit if corporations were required to die after, say, 100 years of existence? What might the disadvantages be if such a policy were enacted?
2. One issue of corporate moral agency involves whether corporations can be accused of being immoral—beyond the immoral conduct of their employees. Peter French and Manuel Velasquez have taken opposing views on this. Explain their views and discuss which of the two you believe is correct.
3. Some codes of ethics include an intuitive guide for employees to assess their decisions. Look at the guide presented from Allstate in the chapter. Are all of the questions that are asked helpful for guiding ethical choices (such as "Is it legal?")? Are there other questions that you think should be on the list?
4. Milton Friedman argued that businesses' only responsibility is to make profits, and they should avoid all efforts at social responsibility. Explain the rationale for his position, and discuss whether you agree.
5. Albert Carr defended strategic misrepresentation as a normal part of the business game. Think of an example in which you believe Carr is correct and another example in which you believe that strategic misrepresentation is wrong.

Key Terms

board of directors Group of individuals elected by corporation shareholders to manage the corporation.

community service order A corporate punishment in which a company must participate in some project that benefits the community in some way.

consumer boycott When a group of people act together to abstain from buying from or dealing with a business.

consumer retaliation When individual consumers or consumer groups express dissatisfaction with a company through some effort that harms it financially, e.g., boycotts, complaints to government agencies, or civil lawsuits.

corporate codes of ethics Detailed accounts of the principles of conduct within organizations that guide decision making and behavior.

corporate death penalty A corporate punishment in which a company is forced to go out of business, such as by the revocation of its corporate charter.

corporate incapacitation A corporate punishment in which a court issues an order to restrain the activities of a corporation in some area of business.

corporate moral agency The concept that businesses are morally responsible for their actions, similar to how individual people are morally responsible for theirs.

corporate shaming A corporate punishment in which the government requires a guilty company to make a public announcement that threatens its reputation and social standing.

corporate social responsibility (CSR) A corporation's efforts to take responsibility for its effects on the environment and its impact on social welfare.

corporation A legally recognized independent entity owned by shareholders in which the corporation, and not the shareholders, holds legal liability.

creation by statute The legal concept that corporations come into existence through the creation of a legal document called a charter.

deterrence A justification of punishment in which an offender is punished to set an example that might discourage others from committing similar crimes.

equity fine A corporate punishment in which a fine payment is made in shares of the company, not in money.

ethics officer An administrator within a company who holds workers accountable to the company's ethical standards.

Federal Sentencing Guidelines for Organizations (FSGO) U.S. government guidelines for sentences imposed by Federal judges, which include restitution, remedial orders, community service, fines, and jail terms.

fiduciary duty A legal duty to act solely in another party's interests.

fine A payment of money imposed as a penalty for an offense.

greenwashing A term referring to pretended efforts at environmental responsibility and, more broadly, at corporate responsibility.

groupthink The practice of thinking or making decisions as a group in a way that discourages creativity or individual responsibility.

incapacitation A justification of punishment in which removing an offender from society prevents the offender from committing similar crimes.

legal person A nonhuman entity regarded by law as having the status of a person.

legal standing The legal concept that a person can sue others and be sued by others, own property, and make contracts with others.

limited liability The legal concept that a stockholder cannot lose more than the amount that he or she invested.

mission statement A short account of a company's fundamental purpose, which may include a statement of ethical standards.

officers Individuals designated by a corporation's board of directors to operate the business, with the chief executive officer (CEO) at the top and various levels of managers below.

organizational schizophrenia Tension between competing goals or values within a corporation.

perpetual existence The legal concept that corporations can continue indefinitely and independently of the temporary lives of their managers and shareholders.

rehabilitation A justification of punishment in which, through reform techniques, changes are made to an offender's future behavior.

reparation A justification of punishment in which an offender must repay the victim for the injury that the offense caused.

retribution A justification of punishment in which punishment balances the scales of justice; a crime requires a punishment.

shareholders (stockholders) Those who own a corporation by obtaining shares of stock in it.

shell corporations Corporations that exist on paper but have no active business operations or significant assets.

stakeholder Any party who is affected by, or who has a stake in, a business practice, including employees, suppliers, customers, creditors, competitors, governments, communities, and shareholders.

strategic misrepresentation The intentional and systematic distortion or misstatement of facts for the purpose of gaining a financial advantage.

triple bottom line (3BL) The view that successful companies must pursue three distinct values: people, the planet, and profit.

Business Ethics Case Study 3.1: The Chick-fil-A Same-Sex Marriage Controversy

In 2012, Dan Cathy—CEO of fast-food chain Chick-fil-A—ignited a firestorm of protest when he made comments critical of same-sex marriage. In a news story for *Baptist Press,* he was quoted as saying that his company was "guilty as charged" in its "support of the traditional family," and in a radio interview he said that "we are inviting God's judgment on our nation when we shake our fist at him and say, 'We know better than you as to what constitutes a marriage.'" The company's founder also started a charitable organization called the WinShape Foundation, which had donated over $5 million to anti-gay groups since 2003.

What followed was a clash over the issue between liberal and conservative politicians, journalists and activists. LGBT advocacy groups organized a boycott of the restaurant chain. Former governor and presidential candidate Mike Huckabee responded by organizing a Chick-fil-A Appreciation Day, where supporters flooded into restaurant locations creating record-breaking sales. Gay rights activists retaliated by holding a same-sex "Kiss Day," where gay couples would kiss each other at outlets across the country.

Chick-fil-A is one of many major companies whose owners attempt to integrate their religious beliefs into their business practice. Other such companies include Tyson Foods, which has 115 chaplains on hand to counsel employees and their families. The clothing retailer Forever 21 sells religious-themed T-shirts, while Mary Kay cosmetics pushes the theme that God is their business partner. Interstate Batteries indicates that one of their purposes is to glorify God and that their employees may participate in biblically based opportunities that are woven throughout their work experience, while In-N-Out Burger prints biblical chapter and verse references on its paper containers.

Chick-fil-A's integration of religion into their corporate culture is at least as unreserved as these. The first Chick-fil-A was opened in 1967 by founder Truett Cathy—father of the current CEO—who from the start integrated his Southern Baptist religious convictions into his business model. The company's corporate purpose is "To glorify God by being a faithful steward of all that is entrusted to us and to have a positive influence on all who come into contact with Chick-fil-A." All franchises must be closed on Sundays so that employees can attend church. The franchise owners are carefully selected in a lengthy interview process; they look for operators that share the same Christian values and prefer ones who are involved in church. During the interviews, they ask personal questions about religion and marital status; while these questions are not technically against Federal guidelines, most employers shy away from them to avoid discrimination lawsuits. During training and organizational retreats, employees are expected to join in group prayers. According to a *Forbes* magazine story titled "The Cult of Chick-fil-A," a prospective franchise owner who is Muslim stated that he was fired after refusing to participate in one such group prayer to Jesus Christ; he sued the company, and they settled out of court. A third of the franchise owners have participated in Christian relationship-building retreats sponsored by the company.

Considering how boldly the Cathy family infused their Southern Baptist value system into their corporate culture, it is not surprising that their views on family values became a matter of public controversy. But the company backpedaled quickly, and almost immediately issued the following statement: "The Chick-fil-A culture and service tradition in our restaurants is to treat every person with honor, dignity and respect—regardless of their belief, race, creed, sexual orientation or gender. . . . Going forward, our intent is to leave the policy debate over same-sex marriage to the government and political arena."

Business Ethics Case Study 3.1: The Chick-fil-A Same-Sex Marriage Controversy (*continued*)

The company stopped contributing to organizations that their critics have called anti-gay, and, in a recent interview, Dan Cathy said that he regrets making his company a symbol in the same-sex marriage debate and that Chick-fil-A has no place in the culture wars. "Every leader goes through different phases of maturity, growth and development and it helps by (recognizing) the mistakes that you make," he said. "And you learn from those mistakes. If not, you're just a fool. I'm thankful that I lived through it and I learned a lot from it."

There is an important lesson to be learned from the Chick-fil-A controversy. It was not the purely religious component of their corporate culture that got them into trouble. Holding group prayers, glorifying God, and advocating church attendance are not normal corporate practices, but they are understandable in a country where 45% of the population identify themselves as born-again Christians.

We could imagine and appreciate how companies in predominately Buddhist countries might embrace their own religious expressions in a way that parallels Chick-fil-A's religious commitment. What got Chick-fil-A into trouble, though, was advocating a controversial moral position that, while perhaps common among Southern Baptists today, is not the central message of that denomination's theology. The lesson is this: Stay on topic and you'll be fine; stray into divisive secondary issues and you'll invite trouble.

Discussion Questions

1. Conservative churches often say behaviors such as tobacco use, drinking alcoholic beverages, recreational drug use, premarital sex, and adultery are sinful. Suppose that Dan Cathy said that, as a Christian company, Chick-fil-A was against these behaviors and God's judgment would be on our nation if we did not stop them. Would this have provoked the same kind of controversy as his comments about same-sex marriage? Explain.
2. Consider the Muslim franchise operator who was fired for refusing to join in a group prayer to Jesus. Presumably, the company knew in advance that he was Muslim and hired him anyway. How could the company have better handled that situation?
3. With all the personal restrictions imposed by the home office, would you personally want to be a Chick-fil-A franchise owner? Explain.
4. Do you believe it is ever appropriate for businesses to require their employees to participate in religious activities? Why or why not?

Sources: Associated Press (2014), The Barna Group (2006), Bhasin & Hicken (2012), Chick-fil-A (2012), O'Connor (2012), Schmall (2007), "What Dan Cathy Said" (2012).