

# LAW, ETHICS, BUSINESS

## *An Introduction*

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*Law must be stable, and yet it cannot stand still.*

— ROSCOE POUND

*Neither fire nor wind, birth nor death, can erase our good deeds.*

— BUDDHA

*Business has become, in the last half century, the most powerful institution on the planet. The dominant institution in any society needs to take responsibility for the whole.... Every decision that is made, every action that is taken, must be viewed in light of that kind of responsibility.*

— DAVID KORTEN

Law is not a static phenomenon, yet in certain ways it appears bounded and clear cut. Where it holds jurisdictional authority, law provides a set of rules for behavior. When these rules are broken, behavior is punishable. If you have been driving carelessly and hit another car, you might pay money damages. If you are caught stealing, you might go to jail. If you are caught polluting, you may be forced to stop. The creation of law and the delivery of sanctions for rule breaking are contested processes. How law is made, how it is enforced, and how it is interpreted are always in dispute, constantly changing, and responsive to the power relations that surround it. Still, we can identify its purposes: law both sets behavioral standards and sets up a system for compliance with them. Within the reach of a legal system, we are on notice that we must meet its standards or risk penalty. Chances are we were not directly involved in the making of the rules—we may even disagree strongly with them—but we understand that the legal system shadows us anyway. It may be the closest we can get to a shared reality.

Ethics, on the other hand, presents a menu of options, often disconnected from official sanctions.<sup>1</sup> While law concerns what we *must* do, ethics concerns what we *should* do. Suppose you work for an advertising agency and have just been offered a chance to work on a new ad campaign for a certain fast-food chain. Burgers, fries, and sodas are legal products. Under the First Amendment of the U.S. Constitution, fast-food companies have the legal right to get their messages out to consumers. But you may believe that their ads are particularly attractive to children, who are at risk of becoming accustomed and even addicted to the empty calories

<sup>1</sup> We distinguish ethics from “professional ethics,” which are binding on those with professional licenses for the practice of law or accounting, for example. Indeed, licensing authorities have enforcement powers not unlike those of legal authorities to sanction those who violate their professional codes of ethics.

that make them fat and unhealthy. Although no law requires it, you may feel you should decline to participate in the campaign. Or suppose a company manufactures a pesticide that can no longer be sold in the United States because the Environmental Protection Agency has banned its primary ingredient, but that *can* be sold in places like India or Africa, where environmental regulations are far less stringent. Legally, the company is free to sell its pesticide overseas; but should it?

Ethical preferences are not preselected for us by legislators or by judges; they involve critical consciousness, engaging each of us in a process of bringing reason and emotion to bear on a particular situation. The right way to behave is not necessarily a matter of aligning our actions with the norm—a community or religious norm, for instance—although it may be. Yet we struggle to carve out some form of consensus on ethics, especially in areas where law does not seem to cover the significant bases. In the above examples, where the law allows people to profit in the marketplace by selling highly dangerous products, we may want to say that certain “shoulds” are universally compelling.

The question of what should be done in a given situation, of the right way to live our lives, is complicated by divergent and overlapping cultural inputs. Within the borders of the United States, and in the global marketplace, we are confronted with a kaleidoscopic array of ethical traditions. Does this mean that there can be no such thing as consensus, no agreement about what is good behavior?

Then there is the “business environment.” Ever since Dutch and English explorers proved that private, entrepreneurial settlements across the oceans could be more robust than the projects of mere kings and queens, private investment has been setting the pace of economic expansion on the planet. European hegemony around the world was largely spear-headed in the seventeenth century by profit-seeking joint stock companies. In the mid-nineteenth century, the Union victory in the American Civil War showed that Northern capitalism could produce more guns, bullets, and blankets than the slave economy of the agrarian South. The defeat of fascism and the dissolution of the USSR in the twentieth century demonstrated the resources that the market economy could muster against competing systems.

Today, almost half of the 100 largest economies in the world are multinational corporations. Comparing corporate revenues to the gross domestic product of nations, Wal-Mart, BP, Exxon Mobil, and Royal Dutch/Shell all generated more income than Saudi Arabia, Norway, Denmark, Poland, South Africa, and Greece in 2005.<sup>2</sup> The largest 200 companies in the world account for more than one-fourth of the world’s economic activity. By 2002, they had twice the economic clout of the poorest four-fifths of humanity. Business has powerful effects on our natural environment. It strongly affects what we eat, how we transport ourselves, what our communities look like, and how we take care of ourselves when we are sick. In many ways, the impact of global business has been beneficial. Multinationals provide new jobs, pay higher taxes, and produce new or less expensive goods and services. They introduce technology, capital, and skills to their host countries and raise the standard of living. On the other hand, multinationals have been blamed for hastening the collapse of traditional ways of life; for taking advantage of weak and/or corrupt governments in some of the countries where they do business; for questionable safety, environmental, and financial practices; for addicting the world to unsustainable technologies while blocking technologies antithetical to their interests; and for intensifying the disparities between rich and poor.

As bearers of a diverse set of cultural achievements, we need to find points of agreement, both in legal and ethical terms, as to how human societies can best flourish. And as participants in the global economy, we need to discover ways of tempering the tremendous power of the market, of shaping it to allow the planet and its inhabitants to thrive.

<sup>2</sup> [http://news.mongabay.com/2005/0718-worlds\\_largest.html](http://news.mongabay.com/2005/0718-worlds_largest.html)

In this chapter we introduce values—and a tension between values—that will thread throughout this book. On the one hand, the value of maximizing individual freedom of choice, our right to believe and to act as autonomous beings; on the other hand, the value of building community, our duty as interdependent social beings to care about and for one another. We start with a case about the law of rescue. We then present a basic toolkit for ethical analysis, as we move from individual decision making to decision making in the corporate or organizational setting.

## Freedom versus Responsibility: A Duty to Rescue?

In this first case, a man is sued for failing to do anything to rescue his drowning friend. While we only know the story as told by the widow—the case is dismissed before the facts can be fully investigated by both sides in a trial setting—we can see how, in this kind of scenario, the law views the conflict between freedom and responsibility.

### YANIA v. BIGAN

Supreme Court of Pennsylvania, 1959

155 A.2d 343

**JONES, Benjamin R., Justice.** ☀

... On September 25, 1957 John E. Bigan was engaged in a coal strip-mining operation in Shade Township, Somerset County. On the property being stripped were large cuts or trenches created by Bigan when he removed the earthen overburden for the purpose of removing the coal underneath. One cut contained water 8 to 10 feet in depth with side walls or embankments 16 to 18 feet in height; at this cut Bigan had installed a pump to remove the water.

At approximately 4 p.m. on that date, Joseph F. Yania, the operator of another coal strip-mining operation, and one Boyd M. Ross went upon Bigan's property for the purpose of discussing a business matter with Bigan, and, while there, [were] asked by Bigan to aid him in starting the pump. Bigan entered the cut and stood at the point where the pump was located. Yania stood at the top of one of the cut's side walls and then jumped from the side wall—a height of 16 to 18 feet—into the water and was drowned.

Yania's widow [sued], contending Bigan was responsible for Yania's death.

She contends that Yania's descent from the high embankment into the water and the resulting death were caused "entirely" by the spoken words ... of Bigan delivered at a distance from Yania. The complaint does not allege that Yania slipped or that he was pushed or that Bigan made any physical impact upon Yania. On the contrary, the only inference deducible from the ... complaint is that Bigan ... caused such a mental impact on Yania that the latter was deprived of his ... freedom of choice and placed under a compulsion to jump into the water. Had Yania been a child of tender years or a person mentally deficient then it is conceivable that taunting and enticement could constitute actionable negligence if it resulted in harm. However, to contend that such conduct directed to an adult in full possession of all his mental faculties constitutes actionable negligence is ... completely without merit.

[The widow then claims] that Bigan ... violated a duty owed to Yania in that his land contained a dangerous condition, i.e. the water-filled cut or trench, and he failed to warn Yania of such condition.... Of this condition there was neither concealment nor failure to

warn, but, on the contrary, the complaint specifically avers that Bigan not only requested Yania and Boyd to assist him in starting the pump to remove the water from the cut but “led” them to the cut itself. If this cut possessed any potentiality of danger, such a condition was as obvious and apparent to Yania as to Bigan, both coal strip-mine operators. Under the circumstances herein depicted Bigan could not be held liable in this respect.

Lastly, [the widow claims] that Bigan failed to take the necessary steps to rescue Yania from the water. The mere fact that Bigan saw Yania in a position of peril in the water imposed upon him no legal, although a moral, obligation or duty to go to his rescue unless Bigan was legally responsible, in whole or in part, for placing Yania in the perilous position. “[The deceased] voluntarily placed himself in the way of danger, and his death was the result of his own act.... That his undertaking was an exceedingly reckless and dangerous one, the event proves, but there was no one to blame for it but himself. He had the right to try the experiment, obviously dangerous as it was, but then also upon him rested the consequences of that experiment, and upon no one else; he may have been, and probably was, ignorant of the risk which he was taking upon himself, or knowing it, and trusting to his own skill, he may have regarded it as easily superable. But in either case, the result of his ignorance, or of his mistake, must rest with himself and cannot be charged to the defendants.” The law imposes on Bigan no duty of rescue.

Order [dismissing the complaint] affirmed.

## QUESTIONS

1. What happened in this case? If Yania couldn’t swim, why did he jump?
2. Identify each of the arguments made by Yania’s widow. For each, explain how the judge dealt with it.
3. According to the judge, Bigan would have been liable in this case under certain circumstances that did not apply here. What are those circumstances?
4. Suppose you could revise the law of rescue. Would you hold people responsible for doing something to help others in an emergency? If so, what circumstances would trigger a duty to rescue? How much would be required of a rescuer?

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## Justifying the “No Duty to Rescue” Rule

*The men who wrote the Bill of Rights were not concerned that government might do too little for the people, but that it might do too much to them.*

— RICHARD POSNER<sup>3</sup>

The ruling in *Yania v. Bigan* is still valid. While there are some exceptions, in general, in the U.S. legal system, we do not have a duty or responsibility to rescue those who are endangered.

There are both philosophical and practical reasons against imposing a duty to rescue. Traditionally, our society has tended to grant maximum leeway to individual freedom of choice. Requiring that people help one another in emergencies would infringe on that freedom by forcing people to act when they might choose not to. Further, imposing an affirmative duty to rescue presupposes that there is agreement that rendering assistance is always the right thing to do. Is there really such consensus? Opinions, beliefs, and concepts of the right way to

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<sup>3</sup> *Jackson v. City of Joliet*, 715 F. 2d 1200, 1203 (7th Cir. 1983), in which Judge Richard Posner explains why someone in need of emergency assistance has no constitutional right to it.

behave in a given situation might vary radically between individuals and between cultures, particularly as they mix and clash in our diverse society. If we are to grant genuine respect to each person's freedom of conscience, shouldn't we insist on legal enforcement of "right" behavior only when it is unavoidable? Shouldn't we reserve punishment or liability for the times when people actively injure others, and allow rescue to be a matter of personal choice? In a sense, those who do not choose to rescue are not behaving badly; rather, they are merely doing nothing. As U.S. Supreme Court Justice Oliver Wendell Holmes once said, "While there is properly in law a duty not to harm, there is not ... a negative duty not to allow harm to happen."

In the next excerpt, nineteenth-century philosopher John Stuart Mill describes the connection between individual freedom of choice and the law of the liberal democratic state.

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## ON LIBERTY

JOHN STUART MILL

Over himself, over his own body and mind, the individual is sovereign. . . .

This, then, is the appropriate region of human liberty. It comprises, first, the inward domain of consciousness; demanding liberty of conscience, in the most comprehensive sense; liberty of thought and feeling; absolute freedom of opinion and sentiment on all subjects, practical or speculative, scientific, moral, or theological. . . . Secondly, the principle requires liberty of tastes and pursuits; of framing the plan of our life to suit our own character; of doing as we like, subject to such consequences as may follow; without impediment from our fellow-creatures, so long as what we do does not harm them, even though they should think our conduct foolish, perverse, or wrong. Thirdly, from this liberty of each individual, follows the liberty, within the same limits, of combination among individuals; freedom to unite, for any purpose not involving harm to others: the persons combining being supposed to be of full age, and not forced or deceived.

No society in which these liberties are not, on the whole, respected, is free, whatever may be its form of government; and none is completely free in which they do not exist absolute and unqualified. The only freedom which deserves the name, is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs, or impede their effort to obtain it. Each is the proper guardian of his own health, whether bodily, or mental and spiritual. Mankind are greater gainers by suffering each other to live as seems good to themselves, than by compelling each to live as seems good to the rest.

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Creating a legal duty to rescue would not only run into resistance on philosophical grounds. There would also be practical objections. How would we enforce such a rule? Where would we draw the line? Must a person attempt to rescue even if it would be terribly dangerous? Should a rescuer be compensated by the victim for any injuries suffered? Who, in a crowd, are the potential rescuers? The closest witnesses? Anyone at the scene? Anyone aware of the incident?

## Radical Change?

*Lawgivers make the citizens good by training them in habits of right ... this is the aim of all legislation, and if it fails to do this it is a failure; this distinguishes a good form of constitution from a bad one.*

— ARISTOTLE, NICHOMACHEAN ETHICS

While the Anglo-American tradition emphasizing individual freedom of choice is a major reason our legal system demands no duty to rescue, law professor Steven Heyman argues that recognition of a duty to rescue is in line with that very tradition. His article appeared in a communitarian journal. Communitarians are concerned with reviving the notion of shared responsibility and interconnectedness at a time when, they believe, too many people view social change solely in terms of defining and enforcing an ever-growing number of personal rights.

He begins his essay by mentioning two famous examples in which bystanders chose to ignore those who desperately needed help. The first incident happened one night in March 1964. Twenty-eight-year-old Kitty Genovese was returning home to her apartment complex in a quiet, respectable neighborhood in Queens, New York. Manager of a bar in another part of Queens, she was arriving late; it was 3:00 a.m. As she left her red Fiat and began walking to her apartment, she saw a man walking towards her. He chased her, caught up with her, and attacked her with a knife. She screamed, “Oh my God, he stabbed me! Please help me! Please help me!” People opened windows, someone called out, “Let that girl alone,” and several lights went on. But as more than a half hour passed, none of the witnesses did anything more. The killer had time to drive away, leaving Ms. Genovese collapsed on the sidewalk, and then to drive back to stab her again. Thirty-eight people later admitted they had heard Ms. Genovese’s screams, but no one even called the police until after she was dead.<sup>4</sup>

The second incident happened many years later. In 1983, in New Bedford, Massachusetts, a young woman went into a bar to buy a pack of cigarettes. She was gang-raped on the pool table while customers watched and even cheered.<sup>5</sup>

## THE DUTY TO RESCUE: A LIBERAL-COMMUNITARIAN APPROACH

STEVEN J. HEYMAN<sup>6</sup>

### Rescue and the Common-Law Tradition

Consider two notorious incidents: the 1964 slaying of Kitty Genovese and the 1983 New Bedford tavern rape. In both cases, neighbors or bystanders watched as a young woman was brutally and repeatedly assaulted, yet they made no effort to intervene or call for help. Under current doctrine, their inaction breached no legal duty, however reprehensible it may have been morally.

Suppose, however, that a police officer had been present at the time. Surely we would not say that the officer was free to stand by and do nothing while the attack took place. The state has a responsibility to protect its citizens against criminal violence. It performs this function largely through its police force. An officer who unjustifiably failed to prevent a violent crime would be guilty of a serious dereliction of duty, which might result in dismissal from the force or even criminal prosecution. Thus the officer would have a legal duty to act. But what if there is no officer on the scene? In that situation, the state can fulfill its responsibility to prevent violence only by relying on the assistance of those persons who *are* present.

Contrary to the conventional view, there is strong evidence that, for centuries, the common law of England and America did recognize an individual duty to act in precisely such cases. According to traditional legal doctrine, every person was entitled to protection by the government against violence and injury. In return for this protection,

<sup>4</sup> A. M. Rosenthal, *Thirty-Eight Witnesses: The Kitty Genovese Case* (Berkeley, CA: University of California Press, 1999).

<sup>5</sup> This incident became the basis of a film, *The Accused*, with Kelly McGinnis and Jody Foster.

<sup>6</sup> *The Responsive Community*, Vol. 7, No. 3, Summer 1997, pp. 44–49.

individuals had an obligation not merely to obey the law, but also, when necessary, to actively help enforce it.... Thus, individuals at the scene of a violent crime had a duty to intervene if they could do so without danger to themselves. If they could not, they were required to notify the authorities.

With the development of modern police forces in the 19th century, this tradition of active citizen participation in law enforcement gradually declined. In recent decades, however, it has become increasingly clear that effective crime prevention requires the efforts of the whole community—a recognition that is reflected, for example, in neighborhood crime watch and community policing programs....

### **Rescue and the Liberal Tradition**

A duty to prevent violence finds support not only in the Anglo-American common-law tradition but also in liberal political theory. According to Locke and other natural rights theorists, individuals enter into society to preserve their lives, liberties, and properties. Under the social contract, citizens obtain a right to protection by the community against criminal violence. In return, they promise not only to comply with the laws, but also to assist the authorities in enforcing those laws. In this way, Locke writes, the rights of individuals come to be defended by “the united strength of the whole Society.” In *On Liberty*, John Stuart Mill recognizes a similar duty on the part of individuals.... Mill agrees “that every one who receives the protection of society owes a return for the benefit,” including an obligation to bear one’s fair share of “the labours and sacrifices incurred for defending the society or its members from injury.”

In addition to endorsing a duty to prevent violence, liberal thought suggests a way to expand that duty into a general duty to rescue. According to liberal writers, the community has a responsibility to preserve the lives of its members, not only against violence but also against other forms of harm. For example, Locke, Blackstone, and Kant all maintain that the state has an obligation to relieve poverty and support those who are unable to provide for their own needs. In Locke’s words, both natural right and “common charity” teach “that those should be most taken care of by the law, who are least capable of taking care of themselves.” Of course, this is also a major theme in contemporary liberal political thought....

### **Rescue and Communitarian Theory**

Communitarian theory supports and deepens the argument for a duty to rescue. On this view, community is valuable not merely as a means to the protection of individual rights, but also as a positive human good. Human nature has an irreducible social dimension that can be fulfilled only through relationships with others. The community has a responsibility to promote the good of its members. But this can be fully achieved only within a society whose members recognize a reciprocal obligation to act for the welfare of the community and their fellow citizens. A core instance is the duty to rescue.

Of course, some might doubt whether contemporary society is characterized by the kind of community required for a duty to rescue. Community is not simply given, however; it must be created. Common action, and action on behalf of others, plays a crucial role in creating relationships between people. Thus the adoption of a duty to rescue might not merely reflect, but also promote, a greater sense of community in modern society.

### **The Contours of a Duty to Rescue**

Advocates of a duty to rescue usually propose that it be restricted to cases in which one can act with little or no inconvenience to oneself. But this does not go far enough. Because its purpose is to safeguard the most vital human interests, the duty should not be limited to easy rescues, but should require an individual to do anything reasonably necessary to prevent criminal violence or to preserve others from death or serious

bodily harm. Rescue should not require self-sacrifice, however. Thus the duty should not apply if it would involve a substantial risk of death or serious bodily injury to the rescuer or to other innocent people.

This responsibility falls on individuals only in emergency situations when no officer is present. Moreover, the duty would often be satisfied by calling the police, fire department, or rescue services....

In performing the duty to rescue, one acts on behalf of the community as a whole. For this reason, one should receive compensation from the community for any expense reasonably incurred or any injury suffered in the course of the rescue. Any other rule would mean that some people would be required to bear a cost that should properly be borne by the community at large, simply because they happened to be at a place where rescue was required....

Far from diminishing liberty, the recognition of a duty to rescue would enhance it by strengthening protection for the most basic right of all—freedom from criminal violence and other serious forms of harm. And by requiring action for the sake of others, a duty to rescue also has the potential to promote a greater sense of community, civic responsibility, and commitment to the common good.

## QUESTIONS

1. According to the writer, a change in our law—a new duty to rescue—might change the way people think, heightening their awareness of one another as members of a community, and leading them to be more responsive to one another. Do you think law can have such power? Can you think of any examples where a change in the law seemed to improve the moral climate of our society?
2. Do you think law should be used as a tool for shaping a shared moral climate? Why or why not?

### When Rescue Is Required

The law recognizes a number of exceptions to the “no duty to rescue” rule. Many states impose criminal penalties, for example, for failing to report child abuse or an accident in which someone is killed. Only a few states—Rhode Island, Vermont, Wisconsin, Hawaii, and Minnesota—impose a more general duty to rescue by statute. In theory, violators would be fined. In fact, however, the statutes are rarely, if ever, invoked.

One means of finding a legal duty to rescue is through contract law. Certain persons assume contractual responsibilities to help others or to prevent them from being harmed. A lifeguard, for instance, cannot ignore a drowning swimmer, nor can a firefighter let a building burn. While a person could be disciplined or fired for refusing to attempt rescue under such circumstances,<sup>7</sup> to commit to a dangerous job such as policing or firefighting is itself a statement of willingness to risk one’s life to save lives—to risk rescue as a part of an ordinary day’s work. In fact, of the 343 firefighters killed on September 11, 2001, 60 were not on duty that day, but responded to the alarm as if they were.

*continued*

<sup>7</sup> For reasons of public policy, however, civil lawsuits against police, fire, or other government workers are rarely permitted.



When people—trained or not—volunteer to rescue, they become legally bound to take reasonable care in finishing what they have started. In one case, an 80-year-old woman had a stroke while she was shopping at a department store. A salesclerk led her to the store infirmary and left her unattended for six hours. By the time help arrived, her condition was irreparably aggravated, and the store was held liable for failing to carry through on the rescue attempt.<sup>8</sup> Liability is imposed in this kind of case for making a bad situation worse: The person in trouble may be lulled into a false sense of security, believing they will be helped, and other would-be rescuers may not realize assistance is needed.

Another exception to the “no duty to rescue” rule applies when a person has endangered another, even indirectly, or has participated in creating a dangerous situation. When professionals in a mental institution release a violent psychotic without taking measures to make certain he will be properly medicated, they may be putting members of the public in danger. When organizers of a rock concert sell general admission tickets to a performance of a wildly popular group and do not provide lane control, they may be held responsible for the fatal result as fans are suffocated in the crush to gain entry.

Finally, a set of exceptions is triggered when there is a “special relationship” between the person who needs help and the person who must take responsible action. Special relationships may be based on their custodial, rather intimate nature, such as that between a parent and child or between a teacher and young pupils. Or such relationships may exist because of an economic connection, such as that between an employer and employees or between a provider of public transportation and its passengers. In either type, the relationship involves a degree of dependency. The law allows those who are dependent to expect reasonable protection from harm and requires the more powerful to provide it. A father must make some effort to save his drowning infant, and a city transportation system must take reasonable steps to protect its subway riders from criminal attacks.

## Ethical Decision Making: A Toolkit

We have been looking at the way U.S. law addresses the question of balancing two important values, that of freedom—the freedom of individuals like Mr. Bigan to choose not to help in an emergency—and that of responsibility—the responsibility we might have to respond to one another in certain circumstances.

We now alter the scenario: Suppose a business strategy, although legal, happens to have harmful effects on certain people. Again, there is an interplay between freedom and responsibility, but here the focus will be more on ethics than on law. We’ll begin with a business news story.

### The Ethics of Offshoring: Outsourcing IBM Jobs to India

In late 2003 the *Wall Street Journal* reported that IBM planned to move nearly 5,000 jobs overseas to save expenses, the latest twist in the “offshoring” phenomenon that had become pronounced in the U.S. high-tech industry. Employees at IBM facilities in Texas, North Carolina, New York, Colorado, and Connecticut would be affected; IBM had already hired hundreds of engineers in India to begin taking on their work. According to the *Journal*, IBM workers slated for replacement throughout 2004 would be expected to train their foreign replacements.

<sup>8</sup> *Zelenko v. Gimbel Bros. Inc.*, 287 N.Y.S. 134 (1935).

For years U.S. firms had been shifting manufacturing and other blue-collar jobs to Asia where labor costs are much lower, but IBM's plans made headlines because they were depicted as part of a disturbing new trend: Job losses would now affect well-educated, white-collar employees. Having begun with call centers and information technology positions, offshoring had mushroomed to include accountants, production control specialists, industrial engineers, medical transcriptionists, and others. By late 2003 the U.S. Bureau of Labor Statistics estimated that half a million high-tech professionals had lost their jobs since 2001, a figure that was expected to double by the end of 2004. Although many IT jobs had been eliminated due to the bursting of the dot-com bubble, U.S. corporate foreign outsourcing was predicted to be the main driver of future losses.

Late in 2003, Sam Palmisano, chairman of IBM's board of directors and its chief executive officer, justified the company's decision to move to India for skilled labor in a speech to the Council on Competitiveness in Washington, D.C. He stated that the nations of Asia not only provide low-cost labor, but also have heavily invested in their educational and communication infrastructure. It would only be fair to respond to what they offer:

*China, India, South Korea, and other rapidly developing nations are replicating the structural advantages that historically have made the U.S. the center of innovation. We can't—shouldn't—regret improvements in other nations' competitiveness. Their people deserve to participate fully in the benefits of innovations.*

Was Sam Palmisano's decision ethical?

There are many different ways to answer this question. Ethical analysis, unlike much quantitative analysis, can be a messy, complex business, without a clear and definitive outcome. However, we do have tools at our disposal to help us make these complicated assessments.

First, let's turn to an approach that will be familiar to you. It amounts to the bedrock principle of strategic management; it underlies the entire free market system. This value system is so embedded in both business theory and business reality that we might fail to recognize it as not only an economic perspective, but also as an ethical one.

## Free Market Ethics

A basic assumption of classic microeconomic theory is that the overriding goal of any business is to be profitable. As trustees (**fiduciaries**) of the shareholders, managers have a primary responsibility to try to improve the value of shareholder investment. In fact, under the law of corporations, managers are answerable to the owners of a company—its stockholders—if they fail to take reasonable care in running it.

Milton Friedman, a well-known free market economist and a proponent of this view, has written:

*In a free enterprise, private property system, a corporate executive is the employee of the owners of the business. He has a direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom.... In a free society, 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.<sup>9</sup>*

Friedman argues it is wrong for managers to use corporate resources to deal with problems in society at large. Decisions regarding what might be best for society should be made in the political arena, and implementation of policies agreed upon there should be funded by tax dollars. For managers to make those kinds of decisions themselves, and to use corporate monies to pay for them, is the equivalent of theft—steal of stockholders' resources.

<sup>9</sup> "The Social Responsibility of Business Is to Increase Its Profits," *New York Times*, September 13, 1970.

Let's apply Friedman's thinking and free market ethical theory to Sam Palmisano's decision to move several thousand IBM jobs to India. First we must ask: Will this choice be profitable for the company? The answer is yes. In India, chemists with doctoral degrees and employees in high-tech jobs earn one-fifth of the salaries of their American counterparts; a software programmer in Bangalore will earn about one-third of what someone with comparable skills in the United States would earn. Even with extra communication costs, IBM would save at least 50 percent by hiring overseas. There are other profit factors. Offshoring yields capacity increases, providing service more rapidly while taking advantage of time zone variations. Offshoring allows companies like IBM to concentrate on what they do best. Highly innovative work may still be done domestically, while maintenance chores, minor enhancements, and bug-fixing that make up most of what programmers do in a large software firm can be handled overseas.

Looking ahead, the flexibility offered by offshoring would seem to be the best way for IBM to remain competitive. In 2003, offshore outsourcing increased by 60 percent. Because other high-tech companies were participating in this trend<sup>10</sup>—it would seem to be in IBM's best interests to position itself ahead of the curve.<sup>11</sup>

Using Friedman's analysis we would also need to know whether the process of moving jobs to India was legal. At this writing, there are no legal impediments to outsourcing, other than a federal rule passed in January 2004 stating that any private contracting done for a federal agency "may not be performed by the contractor at a location outside the United States" unless the work had been done outside the country previously. According to an IBM spokesperson, its federal government contracts generally do not involve offshore work.<sup>12</sup>

In microeconomic terms then, the decision to move jobs to India should focus on shareholder interests and not be swayed by the interests of other stakeholders—except to the extent that these would impact profits. Sam Palmisano's choice should not be made out of concern for the families dependent on jobs at IBM, for example, or out of concern for possible degrading of educational systems dependent on local property taxes in those places—Dallas, Poughkeepsie, Boulder, and Raleigh—where the job losses will take place. Palmisano should not be troubled by the political storm that might be brewing as his company outsources to India. (Campaigning for president in 2004, John Kerry called executives who participated in offshoring "Benedict Arnolds," unpatriotic in the extreme.) He should not worry about controversy unless it reaches such a pitch that there is real public outrage. Only if offshoring becomes a focal point for consumer activism, and only if profits are likely to be significantly affected, would Friedman urge IBM to put the brakes on its plans.

The decision to move jobs to India could—in the long run—turn out better for all concerned. It allows IBM to react to market forces with minimal losses, to be flexible as it faces domestic and global competition, and may put the company in a better position to expand and create new jobs in the future. Since 2005, profits at IBM have risen steadily.<sup>13</sup> In other words,

<sup>10</sup> Cisco, Dell, General Electric, Accenture, EDS, Microsoft, and SAP are a few of these companies.

<sup>11</sup> As of July 2007, IBM employed 53,000 people in India. The company continues to tap the global labor pool, and to automate wherever possible. As Sam Palmisano puts it, "We couldn't keep building out labor. The long-term strategic answer was not to have a half a million people working for IBM." IBM and other multinationals are making use of a network of employees around the world, globalizing services, much as they have already globalized manufacturing.

<sup>12</sup> A politically hot topic in the election year of 2004, offshore outsourcing was the target of several proposed state laws banning or restricting such moves on the part of those contracting with government. At this writing, none of them had been enacted.

<sup>13</sup> As of July 2007, it appeared that Sam Palmisano's "huge reinvention" of the company was the right thing to do, at least for shareholders. As Steve Lohr of the *New York Times* put it: IBM has been reorganized from a classic multinational company with country-by-country operations, working in isolation, to a more seamless global enterprise with centers of expertise in industries and technical skills, scattered around the world, each a hub in a global network for delivering services. Its experience offers a textbook case of a company successfully navigating the twin challenges of globalization and rapid technological change. . . . So far, it seems to be working. "IBM Showing that Giants Can be Nimble," *New York Times*, July 18, 2007.

what works for IBM may have long-term benefits for many other stakeholders, but cost-benefit shareholder analysis of offshoring would not take such possibilities into account.

Notice that this analysis aligns with a belief in maximum freedom of choice for individuals—and minimal power of government to obstruct that freedom. This strand of thought, which we saw supporting the “no duty to rescue” rule, has been key in the development of both our market economy and our legal system. It would support both IBM’s freedom to invest where it can best make a profit and the freedom of IBM’s employees to leave their jobs and seek work elsewhere. The idea is that we can best progress as a society if we grant as much leeway as possible to private preference, allowing people (and private associations of people, like corporations) the right to do what they think is best with their property and their personal lives. This ethical perspective is deeply imprinted upon the economic and cultural lives of most people in the developed world.

## Utilitarianism: Assessing Consequences

Through much of our history, the most influential ethical reference point was religious; the rules to be followed were “written in the heavens” and were guidelines for achieving immortality of the soul. It was a radical break with tradition, then, for eighteenth-century philosopher and social thinker Jeremy Bentham to suggest an entirely new frame of reference. Ethical behavior, he argued, was not a matter of pleasing God, but of bringing about as much happiness as possible for the greatest number of people. According to Bentham, the definitive moral standard is that of “utility,” requiring us to consider the consequences of an act (or a social policy) for all those affected by it. One of Bentham’s followers, nineteenth-century philosopher John Stuart Mill (discussed earlier), would become the best-known proponent of this ethical approach, known as **utilitarianism**.

According to the principle of utilitarianism, the right way to behave in a given situation is to choose the alternative that is likely to produce the greatest overall good. Cost-benefit analysis, the sort of efficiency calculation that is common to business decision making—what IBM CEO Sam Palmisano probably used as he chose to outsource thousands of jobs to India—is based on notions of utility. As an ethical theory, however, utilitarianism asks us to compare the harms and benefits of an action not just for the decider, but for *all persons who will be affected by the decision*. In the IBM scenario, this would mean, at the least, not only weighing the effects of offshoring upon IBM shareholders, but also looking at the consequences to IBM employees whose jobs were lost (and their families) and at those in India who were hired to replace them (and their families). Since local communities in both the United States and India are affected, consequences to people in that wider circumference must also be assessed.

Hardest hit would have to be IT employees who are laid off. While job retraining programs exist for manufacturing workers when their jobs move overseas, there is no such safety net for workers in IT or in other white-collar fields. According to the December 8, 2003 issue of *Business Week*, only about one-third of those Americans displaced by offshoring found jobs at the same or higher pay. The utilitarian calculation asks us to consider not only the immediate and direct consequences, but also those that are indirect, and those that are foreseeable into the future. Suppose the offshoring job exodus continued—and most experts forecasted that it would, estimating that by 2005 some 600,000 IT jobs for American-based companies would be performed elsewhere. What would happen to a local community as many of its citizens lose well-paying jobs? As the tax base diminished, would its libraries, schools, police and fire forces experience cutbacks? There was concern too about another major ripple effect: Offshoring, and the threat of offshoring, could become leverage, putting downward pressure on the salaries and benefits of all U.S. workers.

Yet some analysts saw a silver lining. As the *Washington Post* reported in September 2003, offshoring could be a “healthy trend”:

*Some IT workers here may be forced to leave the “computer industry” and move into non-offshorable jobs, but this may not mean they give up doing computer work, because as our economy continues to shift away from manufacturing and toward services, we may see ... many non-portable*

*IT "support" jobs created.... The upshot: Even though hundreds of thousands of programming and other IT jobs are likely to leave the U.S. over the next few decades, the vast majority of U.S. IT workers will survive, and possibly even prosper in the end, although they may have new employers and work in new fields.*

Quoting an editorial in the Silicon Valley's *San Jose Mercury News*, the *Post* article highlighted how tricky it might be to track the consequences of offshoring for U.S. workers:

*It is impossible to make a direct link between a job lost here and a job gained elsewhere. The economics of labor are more complex. First, the savings incurred by U.S. companies when they hire low-paid workers overseas help generate profits used to hire workers, or make new investments, here. Second, Valley companies sell nearly two-thirds of their products overseas, so the rise in overseas markets helps boost their fortunes.*

The extent of the threat to U.S. service jobs remained in dispute. There was a high tide of anxiety throughout 2004, the year after IBM made its announcement; more than 1,000 references to outsourcing appeared in the media that year. Then concern appeared to subside. In 2006, the director of the McKinsey Global Institute was stating that, by 2008, outsourcing would have affected less than 2 percent of all U.S. service jobs.<sup>14</sup> Offshoring might end up boosting the American economy overall. According to McKinsey, "at least two-thirds of the economic benefit from sending jobs offshore will flow back to the U.S. economy in the form of lower prices, expanding overseas markets for U.S. products, and fatter profits that U.S. companies can plow back into even more innovative businesses."<sup>15</sup> By 2007, most economists viewed the impact of offshoring as minimal or even positive in the long run, with savings to companies and increased productivity resulting in better cheaper services, and from there to more competition, more innovation, and more growth.<sup>16</sup>

Then there are the benefits of offshoring, both short and long range, overseas. In India, revenue from U.S. outsourcing shot up 50 percent through 2003 to \$3.6 billion, and was predicted to do the same in 2004. Consider the positive effects as thousands of competent individuals begin to earn decent salaries in a country where half of the population lives on pennies a day. A critical mass of new wage earners materializes, each one in a position to produce significant benefits for themselves and their loved ones. As they rise into the middle class, they create markets for refrigerators, cars, computers, and so on—to the benefit of producers in India and elsewhere. And as this happens, there are cultural side effects. In her July 2004 *New Yorker* article, "The Best Job in Town," Katherine Boo wrote about Office Tiger, a firm where college-educated Indians perform various types of data entry for U.S. companies:

*[I]t was the possibility that one could rise up from a lowly position that had made Office Tiger one of the city's status employers, a firm whose workers were so pleased by their affiliation that they put*

<sup>14</sup> Daniel Gross, "Why 'Outsourcing' May Lose Its Power as a Scare Word," *New York Times*, August 13, 2006. Gross quotes Princeton economist Alan Binder, who disagrees with the McKinsey estimates, arguing that as technology improves and offshore workers gain experience, the capacity to deliver services electronically will rise. He believes far more than 2 percent of jobs will migrate overseas.

<sup>15</sup> Even within management ranks there is no consensus that offshoring makes sense long term, however. William J. Holstein, editor of *Chief Executive Magazine*, recently noted that direct labor costs represent a shrinking percentage of the overall costs of production for many businesses, making the savings from offshoring less significant. He also pointed to less tangible negative effects: "I don't think of many things as more intrinsic to the long-range thrust of a company, to the development of a company as a place of innovation and creativity ... than the ability to design your own products and build your own products. You have to lovingly make them and care about their quality. It's difficult to wrap numbers around that and prove it, but I think it's central." "Does Outsourcing Cost More Than It Saves," *New York Times*, June 6, 2004. Links to articles with similar import can be found at <http://www.yourjobisgoingtoindia.com>, where a posted article included survey results of 100 executives representing New York's largest companies who were not finding offshoring to be as cost efficient as they had expected it would be. Linda Prospero, "New York Survey Finds Outsourcing Not a Panacea," *Reuters*, July 19, 2004.

<sup>16</sup> "Offshoring has faded, like Y2K, Red Menace," *Philadelphia Inquirer*, February 18, 2007.

*it on their wedding invitations, just below their fathers' names. A foreign notion—that jobs should be distributed on the basis of merit—was amending the rules of society where employment had for millennia been allotted by caste, and great possibilities abounded.<sup>17</sup>*

The utilitarian weighing of pluses and minuses becomes complex, especially because it is not simply a matter of numerical quantifying. How to assess the harm—the emotional hurt and anxiety—that a person feels when they lose a well-paid job in a “jobless recovery”? How much weight to give the loss of a job in Dallas, Texas? Might that be a city with plenty of other options for IT professionals? Of the thousands of jobless in the United States, how can we know how each employee (and each family of each employee) will be affected? One person whose job has gone to Bangalore may be married to someone earning more than enough to comfortably support the family; another may be a single parent with no real backup. All of these immeasurables play havoc with neat measurement.

Although it is difficult to meaningfully assess comparative harms and benefits, our analysis does seem to suggest that IBM's decision was ethical, given all the actual and potential benefits of offshoring, and given that relatively few people would be harmed by it. This outcome points to one of the problems with utilitarian theory. Consider another situation: The federal government requires that new drugs be tested on humans after they have been tested on animals. Drug companies must advertise widely and offer to pay as much as \$250 a day to attract test subjects. But one company, Eli Lilly, does not have to advertise and pays only \$85 per day, because most of its subjects are homeless alcoholics recruited through word-of-mouth from soup kitchens, shelters, and prisons across the country.<sup>18</sup> What happens when we run this arrangement through the utilitarian analysis? Where is the harm? New drugs are brought to market, benefiting the public—Lilly developed Prozac, for example. Cost savings may not be passed on to consumers, but they enhance corporate profits, benefiting the employees and stockholders. Alcoholism in volunteers does not skew the company's data, since those with severe liver disease will fail the initial screening process and be excluded in the first place. Even the test subjects are comfortable: Those who have participated in Lilly's program describe themselves as happy with the “easy money” they can earn—as much as \$4,500 when the testing continues over months. Is this an ethical outcome? Arguably it is, on utilitarian grounds. We might wonder if the homeless alcoholics are capable of making decisions that are truly voluntary. We may wonder if it is fair to use a small number of relatively desperate people in this way, even if the results benefit many more people.

## Deontology: Rights and Duties

In contrast to the utilitarian concern with maximizing social welfare, **deontological**<sup>19</sup> ethics is marked by steadfastness to universal principles—for example, respect for life, fairness, telling the truth, keeping promises—no matter what the consequences. At the core of this approach to making ethical choices is the understanding that moral action should be guided by certain overriding rights and duties.

The most famous deontological thinker, eighteenth-century German philosopher Immanuel Kant, believed that human beings could reason their way to a set of absolute rules for right behavior. A person should never lie, according to Kant, even when lying seems to produce a good result. Suppose someone running away from a murderer tells you where he is going to hide, and then the murderer rushes up to ask you where the first person went. Wouldn't this be a good time to lie? Kant would say there is never a good time, even in this example.

<sup>17</sup> More on the plus side: Some Indian companies have found that offshoring is creating a positive synergy, enabling them to do more hiring of their own—even in the United States. By 2007, Indian high tech firms were recruiting Americans to work in India.

<sup>18</sup> Laurie P. Cohen, “Stuck for Money,” *Wall Street Journal*, November 14, 1996, pp. 1, 10.

<sup>19</sup> From the Greek *deon*, or duty.

Moral behavior, then, is a matter of holding, without exception, to certain principles. Kant believed that each person has the right to be treated with respect as the equal of every other, and that each person has the corresponding duty to treat everyone else with respect as an equal.

He arrived at this by means of his **categorical imperatives**. The first of these states that a people should be willing to have the reasons for their actions become universal principles. That is, people should be willing to live in a world where an action they chose to take would be repeated for the same reasons whenever the same situation arose, even if they wound up on the receiving end of such actions.

Think of IBM and offshoring. If we apply Kant's first categorical imperative, the decision maker should ask: Would I want to live in a world where multinational corporations cut labor costs by replacing skilled white-collar U.S. employees with equally competent employees in other countries? Perhaps Mr. Palmisano would be comfortable with a universe of such behavior until it was his job that was eliminated. So, in Kantian terms, his action might not be an ethical one.

In another formulation of the categorical imperative, Kant states that we should have respect for the intrinsic value of other people and not just use them as means to achieve our own purposes. By this Kant did not mean that people should *never* use other people at all. People "use" one another in mutually beneficial ways all the time. For example, in a typical contractual transaction, each party to the agreement gives something up to get what it wants. Each party "uses" the other to get what it wants; if you purchase gasoline, you "use" the oil company's product and it "uses" you to pay for it. Kant would have no objection here. Rather, he believed it was unethical for people to use others *only* as a means to accomplishing their own purposes, with no mutual benefit attached. So, if the oil company uses slave labor to build an oil pipeline in Southeast Asia, it would be violating this Kantian categorical. Here one party—the more powerful one—is able effectively to remove the free will of the other, to make it do what it wants the way a puppeteer would pull a marionette's strings. What is lost—of great ethical value in deontology—is the right to autonomy, the right to make fully informed decisions for oneself about how to live one's life. Consider IBM and offshoring. Was IBM manipulating its U.S. engineers? Think of the way the company expected them to spend several weeks training their own replacements. This does appear to involve some manipulation. Were the engineers really in any position to make decisions for themselves?

In late 2003 the *Wall Street Journal* obtained IBM documents which indicated that IBM was also trying to conceal information as it offered pointers to its managers on how to "sanitize" the offshoring process. "The words 'offshore' or 'on-shore' should never be used," the company warned. "Do not be transparent regarding the purpose/intent" of offshore outsourcing. Assuming the *WSJ* report is accurate, if IBM was attempting to cover up what was really happening, we could say it was violating Kant's categorical imperative.

So far the deontological approach appears to be leaning against the decision to go ahead with the offshoring. There can be real murkiness within this moral framework, though, when it comes to interpreting those universal rights and duties that Kant considered "absolute"—beyond compromise. In the offshoring scenario, for example, how should we interpret the duty to be "fair"? Sam Palmisano, we might say, is caught in a latticework of different versions of fairness. On the one hand, moving white-collar jobs away from well-educated American employees is unfair to them and to their families. But not to go through with the offshoring plan is arguably unfair to IBM's shareholders, who deserve the best possible return on investment, and to the well-qualified employees in India and their families. Recall how Palmisano himself used the concept of fairness when explaining offshoring:

*China, India, South Korea, and other rapidly developing nations are replicating the structural advantages that historically have made the U.S. the center of innovation. We can't—shouldn't—regret improvements in other nations' competitiveness. Their people deserve to participate fully in the benefits of innovations.*

Another difficulty with deontology is the confusion created when different universal rights and duties crop up in the same ethical problem, and seem to conflict with one another. How does

one decide which absolute value should prevail? These situations can get ugly. Consider the intensity of conflicting beliefs on the question of abortion. Both the right-to-life and the pro-choice factions are convinced that their points of view derive from natural rights; both embrace referents that each of them consider beyond debate, beyond compromise. How do we resolve competing claims of this type? The “war on terror” presents us with other examples of clashing rights and duties, such as lengthy detentions under the USA PATRIOT Act of suspects not charged with any crime, proposals to allow the Pentagon to randomly monitor personal e-mail, and problems with prisoner abuse in Afghanistan and Iraq. Conflicting views here pit the right to life and safety against the right to privacy, the duty to be fair, and the categorical imperative to respect others—including those of Middle Eastern origin or beliefs—as equals.

## Virtue Ethics: Habits of Goodness

For some critics, both the utilitarian and deontological frameworks are inadequate in a fundamental sense; while both set forth logical bases for deciding what might be called moral minima—the floor beneath which no one should drop in terms of ethical choices—they are silent on the concept of moral excellence. They also focus on the moral acceptability of *actions*. Virtue ethics, on the other hand, directs our attention to what human beings are capable of *being*, on how they can cultivate the habits of good character that will naturally lead them to their fullest potential.

This strand of thinking derives from Aristotle, who argued that people develop their moral abilities, called **virtues**, through training, by being repeatedly exposed to demonstrations of decent behavior within families and communities. We learn to become courageous, generous, just, honest, cooperative, and cheerful gradually, as we become habituated to living in social settings where these qualities are exhibited and valued. Ethics, then, is not a matter of teasing out the correct choice given a series of knotty dilemmas; it is instead a lifelong conditioning process. In harmonious relationship with their communities, people thrive, reaching the fullest unfolding of their potential, learning the habits that allow them to excel at everything they are capable of doing.

Virtue ethics does raise its own set of questions, however. What does it mean to define moral character in term of one’s community? What community? As the new millennium unfolds, too many Americans are living in family environments in which relatedness endures in spite of severe economic and psychological stresses. Half the population of the world lives in poverty. If children grow up in hardship, where the natural environment is harshly degraded and the social fabric is weakened, does the transmittal of virtuous habit become a luxury? If families cannot effectively teach virtue to their young, what are the alternatives? Schools? Religious communities? And when these are in such diverse forms—sometimes in sharp opposition—how do we judge which moral community is best? We call the men who flew into the World Trade Center terrorists, but at some schools in the deserts of the Middle East, boys memorize the Koran and learn the heroic significance of being a suicide bomber. Which system can claim moral hegemony?

And what do we mean by community in the business context? Where is the community touchstone in the IBM scenario? To answer this question about a large company like IBM, we must examine what is called “corporate culture.” Here one scholar describes what that is meant by the culture of an organization:

*The pattern of basic assumptions that a given group has invented, discovered, or developed in learning to cope with its problems of external adaptation and internal integration, and that have worked well enough to be considered valid, and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems.*<sup>20</sup>

More colloquially, a company might describe its culture as “the way we do things around here.” In studies by Harvard corporate management guru John Kotter, as of 1987–1991, IBM was ranked at

<sup>20</sup> Edgar H. Schein’s definition. Professor Schein is a management expert at MIT.



number 8 (out of the more than 2,300 firms studied) in terms of the strength of its corporate culture. We can see how it got that way by looking at its ascendancy under Thomas Watson, Sr., called “the greatest capitalist in history” by *Fortune Magazine*. It was Watson who named the company International Business Machines in 1924. Originally a manufacturer of tabulating machines, IBM would move into electric punch-card accounting and then into early computers. Throughout its growth in the 1920s and 1930s, Watson posted the motto “T-H-I-N-K” in all offices and required all his salesmen to wear blue suits and white shirts. An intense focus on sales and on a “buttoned-down” image would stay with the company throughout the twentieth century. Extremely charismatic, vain, and proud of his company, Watson built a corporate culture designed to instill loyalty and enthusiasm. IBM had company sports teams, family events, and was one of the first firms to offer workers paid vacations, life insurance, and survivor benefits. During the Depression, even as sales weakened, IBM managed to avoid mass layoffs. By mid-century the company had an unparalleled reputation as a fair employer. IBM continued to pay salaries to employees serving in WWII, while the company used weapons manufacturing profits to help widows and orphans of IBM employees killed in the conflict.<sup>21</sup> The firm covered moving expenses for transferees, guaranteed minimum resale prices on their homes, and paid for retraining. Most impressively, during this time IBM guaranteed lifetime employment for all employees. For years Watson told his people: “The IBM is not merely an organization of men; it is an institution that will go on forever.”

A powerhouse of the computer mainframe market, the company would continue to grow through the 1950s, 1960s, and 1970s. “Big Blue” was ranked the most admired company in the United States year after year. By 1984 it was the most valuable company in the world, famous for consistent stock and dividend growth. It stood for the best of American big business—for its stockholders, its consumers, and its workforce.

Then—a crisis. As technology advanced, the computer market changed. Personal computers came to the fore, innovative upstarts such as Apple entered the field, and by the 1990s, IBM had suffered serious losses. As its stock lost half of its value, tens of thousands of workers were laid off. The very strength of IBM’s culture was blamed, in part, for this catastrophe. As one commentator put it:

*The company, it seemed, had become the epitome of an overgrown, anonymous, monopolistic, bureaucratic monster—outmatched in marketing and technology by swifter, nimbler competitors; too big to change, it appeared destined to collapse under its own ungainly weight.*<sup>22</sup>

Although it recovered profitability by the late 1990s, IBM would never recover its former image as a benevolent giant, with a strong, paternalistic and compassionate corporate environment.

Returning to our question: If virtue ethics is a matter of moral characteristics ingrained within a community, and if CEO Sam Palmisano attends to the culture of his corporate community, he would be guided by this ethical code, touted today by IBM.

## The IBM Principles

1. The marketplace is the driving force behind everything we do.
2. At our core, we are a technology company with an overriding commitment to quality.

<sup>21</sup> There were less salutary aspects to IBM’s activities during this period. Thomas Watson accepted a medal from the Nazi regime in 1937, an event featured in Edwin Black’s recent book, *IBM and the Holocaust*. Although IBM was not alone in its willingness to do business with Hitler, Black tells how crucial its role was. IBM’s German subsidiary, acting “with the knowledge of its New York headquarters,” supplied the Nazis with a punch card system that organized, tabulated, and analyzed population data, making possible mass deportations and executions. From Black’s introduction: [D]azzled by its own swirling universe of technical possibilities, IBM was self-gripped by a special amoral corporate mantra: If it can be done, it should be done. To the blind technocrat, the means were more important than the ends. The destruction of the Jewish people became even less important because the invigorating nature of IBM’s technical achievement was only heightened by the fantastical profits to be made at a time when bread lines stretched across the world.

<sup>22</sup> Steven Kotok, *St. James Encyclopedia of Popular Culture*, 2002 Gale Group. See [http://articles.findarticles.com/p/articles/mi\\_glepc/is\\_tov/ai\\_241910061](http://articles.findarticles.com/p/articles/mi_glepc/is_tov/ai_241910061)

3. Our primary measures of success are customer satisfaction and shareholder value.
4. We operate as an entrepreneurial organization with a minimum of bureaucracy and a never-ending focus on productivity.
5. We never lose sight of our strategic vision.
6. We think and act with a sense of urgency.
7. Outstanding, dedicated people make it all happen, particularly when they work together as a team.
8. We are sensitive to the needs of all employees and to the communities in which we operate.

As you review these guidelines, and Sam Palmisano's speech to the Council on Competitiveness, can you sense whether the culture of IBM supports offshoring?

What forces inside a company determine the type of culture that develops inside it? What forces outside a company might influence that process? Are there *business* virtues?<sup>23</sup> What might they be?

## Ethic of Care

*The elusive mystery of women's development lies in its recognition of the continuing importance of attachment in the human life-cycle ... while masculine development intones the celebration of separation, autonomy, individuation and natural rights.*

— CAROL GILLIGAN

*I hope I would have the guts to betray my country before I would betray my friend.*

— E.M. FORSTER, "WHAT I BELIEVE," 1938

The ethical theories we have looked at so far assume that a decision about the right thing to do is ultimately a private decision, made by an individual in isolation. Whether using their intellectual powers or responding to trained habit, people act as autonomous beings, as free agents in this process. A different approach to ethics assumes that people are deeply connected to one another in webs of relationships, and that ethical decisions cannot be made outside the context of those relationships. This alternative view holds that ethics is essentially a matter of nurturing and reinforcing the ties we have with one another. This has become known as the "ethic of care," as it is based on caring for others.

The notion of an ethic of care was developed by feminist theorists such as Carol Gilligan, a psychologist who studied moral development. Her research led her to believe that men and women approach moral issues from different perspectives. While most men have an individualistic focus on abstract rights and justice, women tend to focus on caring, on supporting human interconnectedness—an approach that Gilligan saw as undervalued, and which she characterized as "a different voice." Over time this understanding has shifted: Rather than a split between male versus female ethics, it is thought that there are two different approaches to moral problem solving that can be accessed by either men or women.

In the following reading Leslie Bender, professor of law at Syracuse University, suggests a feminist reframing of negligence law and the "no duty to rescue" rule. She begins by referencing Gilligan's work.

<sup>23</sup> Robert C. Solomon thinks so. He has written extensively about Aristotle and business. Included in his list of business virtues are friendliness, charisma, fairness, heroism, style, toughness, and wittiness. See his book, *A Better Way To Think About Business* (New York: Oxford University Press, 1999).

## A PRIMER OF FEMINIST THEORY AND TORT

LESLIE BENDER<sup>24</sup>

### A Feminist Ethic of Caring and Interconnectedness

Gilligan recognized that there are two thematic approaches to problem solving that generally correlate with gender, although she makes no claims about the origin of the difference.... When she asked what characterizes the different methods for resolving and analyzing moral dilemmas, Gilligan found that the "right" answers (according to the traditionally formulated stages of moral development) involve abstract, objective, rule-based decisions supported by notions of individual autonomy, individual rights, the separation of self from others, equality, and fairness. Often the answers provided by women focus on the particular contexts of the problems, relationships, caring (compassion and need), equity, and responsibility. For this different voice "responsibility" means "response to" rather than "obligation for." The first voice understands relationships in terms of hierarchies or "ladders," whereas the "feminine" voice communicates about relationships as "webs of interconnectedness...."

While an ethic of justice proceeds from the premise of equality—that everyone should be treated the same—an ethic of care rests on the premise of nonviolence—that no one should be hurt.

### Negligence Law: A Feminist Ethic of Care and Concern as a Basis for the Standard of Care

Our traditional negligence analysis asks whether the defendant met the requisite standard of care to avoid liability.

In tort law we generally use the phrase "standard of care" to mean "level of caution." How careful should the person have been? What precautions do we expect people to take to avoid accidents? We look to the carefulness a reasonable person would exercise to avoid impairing another's rights or interest. If a defendant did not act carefully, reasonably, or prudently by guarding against foreseeable harm, she would be liable. The idea of care and prudence in this context is translated into reasonableness, which is frequently measured instrumentally in terms of utility or economic efficiency.

When the standard of care is equated with economic efficiency or levels of caution, decisions that assign dollar values to harms to human life and health and then balance those dollars against profit dollars and other evidences of benefit become commonplace.... The risk of their pain and loss becomes a potential debit to be weighed against the benefits or profits to others. The result has little to do with care or even with caution, if caution is understood as concern for safety.

What would happen if we understood the "reasonableness" of the standard of care to mean "responsibility" and the "standard of care" to mean the "standard of caring" or "consideration of another's safety and interests?" What if, instead of measuring carefulness or caution, we measured concern and responsibility for the well-being of others and their protection from harm? Negligence law could begin with Gilligan's articulation of the feminine voice's ethic of care—a premise that no one should be hurt...

### "No Duty" Cases

One of the most difficult areas in which questions of duty and the standard of care arise is the "no duty to rescue" case. The problem is traditionally illustrated by the drowning-stranger hypothetical and the infamous case of *Yania v. Bigan*.

<sup>24</sup> 38 J. Leg. Educ. 3 (1988), pp. 63–68.

How would this drowning-stranger hypothetical look from a new legal perspective informed by a feminist ethic based upon notions of caring, responsibility, interconnectedness, and cooperation?

If we put abstract reasoning and autonomy aside momentarily, we can see what else matters. In defining duty, what matters is that someone, a human being, a part of us, is drowning and will die without some affirmative action. That seems more urgent, more imperative, more important than any possible infringement of individual autonomy by the imposition of an affirmative duty.

If we think about the stranger as a human being for a moment, we may realize that much more is involved than balancing one person's interest in having his life saved and another's interest in not having affirmative duties imposed upon him in the absence of a special relationship....

The drowning stranger is not the only person affected by the lack of care. He is not detached from everyone else. He no doubt has people who care about him—parents, spouse, children, friends, colleagues; groups he participates in—religious, social, athletic, artistic, political, educational, work-related; he may even have people who depend upon him for emotional or financial support. He is interconnected with others. If the stranger drowns, many will be harmed. It is not an isolated event with one person's interests balanced against another's. When our legal system trains us to understand the drowning-stranger story as a limited event between two people, both of whom have interests at least equally worth protecting, and when the social ramifications we credit most are the impositions on personal liberty of action, we take a human situation and translate it into a cold, dehumanized algebraic equation. We forget that we are talking about human death or grave physical harms and their reverberating consequences when we equate the consequences with such things as one person's momentary freedom not to act....

Bender goes on to write:

The duty to act with care for another's safety, which under appropriate circumstances would include an affirmative duty to act to protect or prevent harm to another, would be shaped by the particular context.

This is one of the hallmarks of the ethic of care, a willingness to be concerned with the particulars of a situation, and from there an interest in discovering compromise—creative ways to find a solution that might work for all the stakeholders.

How might the IBM offshoring decision look through the lens of the ethic of care? The strongest relational connection in the scenario must be between IBM and its employees. Some of them may have survived the deep job cuts of the 1990s, but even if not, they were probably well aware of the effort the company had recently made to turn itself around and become profitable again. What happens, though, when market pressures interfere with established relationships? How can we reconcile these apparently opposite forces, the urge to do the right thing for the people you know best, and the imperatives of business? The ethic of care suggests that the specific context of offshoring at IBM receive attention. Who are these people about to lose their positions? How can IBM ease their transition? From what we know of the facts—that many employees will be told to train their replacements for weeks, and that most cannot expect to be rehired anytime soon—these are a harsh set of particulars.

The ethic of care might lead Sam Palmisano to investigate *how* the offshoring process will be managed at IBM. If the process itself cannot be reversed, then the way it is to be implemented might be changed. What can IBM do to soften the blow? Are there any resources to retrain and/or rehire workers, to assist them in job searches? Open communication can be very important, both for laid-off employees and for local communities. The ethic of care suggests that creative efforts be made, not just for the sake of “damage control,” but because there is value in relationships that have been nourished over time.

Ironically, putting relationships first can end up positively affecting the bottom line. When his large textile mill burned to the ground just before Christmas 1995, owner Aaron Feuerstein perceived the tragedy as one for a network of stakeholders, his family, his employees, and the surrounding community. As he responded by including all of those affected in his plans for rebuilding, the network responded in turn. Donations came in from local businesses; customers such as Patagonia and Lands' End pledged support and promised to wait for their Polartec; citizens from neighboring New Hampshire donated Christmas trees and toys for idled workers. Once the rebuilt factory was in operation, productivity rose 25 percent.

Problems arise with the ethic of care, though, as with the other theories. Sometimes there are several relationships at stake, and it becomes difficult to rank and care for them. The ethic of care can be troubling in another way. Suppose you have the responsibility of recommending someone from your work team for promotion. One of the team members is your friend. She's a single parent and could really use the extra income. But she isn't the most deserving person in your group. If you are fair, you'll recommend the best person for the job—but the ethic of care might push you to recommend your friend, as care deteriorates into favoritism.

## Why Ethical Theory?

Having explored several approaches to ethics, we have seen potential flaws in each. We may feel unsettled by the journey, uncertain how useful it has been. Yet this unresolved aftertaste may be exactly appropriate. There are no easy answers at the intersection of law, ethics, and business. The best we can hope for may be a reflective approach, combining one or more frameworks to reach several possible solutions, and then comparing the solutions to see if they “agree.”

Ideally, familiarity with these theories will support you in at least two ways as you face business dilemmas in the future. First, the models for analysis can spark creative thinking, as you brainstorm ways of handling the dilemmas. Second, they offer you a means of explaining your decisions to others. Explanations can be useful. Suppose you are working for the pesticide manufacturer that cannot sell certain of its products in the United States because they are hazardous by U.S. standards, yet the company plans to sell them overseas. Knowing the theoretical basis for ethical decision making could help you understand your own position, and help you articulate it to your superiors, your co-workers, and those who report to you in the organization. There is a familiar “language” in the business world for most decision making: cost-benefit analysis. Ethical theory offers you another language, making you “bilingual” in complex situations.

## Corporate Governance

### Corporate Roles, Rights, and Responsibilities

#### Shareholders

Shareholders are, collectively, the owners of a corporation. As their holdings rise in value, they profit; when their shares lose value, shareholders lose. They may be private shareholders—individual investors, both large and small—or they may be institutional shareholders, such as pension funds, mutual funds, insurance companies. The

*continued*

legal liability of shareholders is limited by law to the amount of investment they make in the company. Their rights include:

- Receipt of true and accurate financial reports
- Dividends whenever dividends declared
- Attendance at shareholder meetings
- Vote (by proxy or in person) on
  - Membership of board of directors
  - Significant mergers and acquisitions
  - Changes in charter or by-laws
  - Proposals by management or shareholders

Shareholders can also hold managers and directors accountable by bringing shareholder derivative suits (see below).

### Board of Directors

Board members are elected by shareholders from a slate provided by management. They can be “inside directors” with ongoing or previous contractual relationships with the company, or “outside” or “independent directors” with no financial relationship with the company other than as a member of its board. Directors are held by law to a **duty of loyalty**. They cannot interfere with corporate opportunities, compete with the corporation, take secret profits or engage in other forms of self-dealing at the company’s expense. They are also required to abide by a **duty of care**—to act in good faith and as reasonably prudent persons in their role as directors. These two duties are known as **fiduciary duties**, to be carried out by those who are entrusted with responsibility for other peoples’ investments.

The board may create committees and delegate certain powers to them; since the Sarbanes-Oxley Act of 2002, all public companies must have audit committees made up of independent directors, which hire independent public accountants to supervise the audit of company financial records.

In a broad oversight function, the board sets company policy and goals. In addition, it:

- Presents financial data to shareholders
- Hires and fires management
- Slates membership of the board and of its committees
- Is authorized to file lawsuits on behalf of corporation to recover damages

### Officers and Management

The chief executive officer (CEO or President) of a company and other officers are appointed by the board of directors, and must report to the board about the ongoing operations of the corporation. Like the directors, management is held to both a duty of loyalty and a duty of care, and must:

- Run the company on a day-to-day basis
- Implement decisions made by the board of directors
- Prepare reports for the board of directors and shareholders

Although the structure outlined above appears to confer a degree of representative democracy to the corporate form, with investors having the ability to vote on proposals and to sue for

misconduct of managers and board members, the shareholders of a corporation have limited power to influence or control the decisions of corporate officers and directors. In Chapter 7 you will read about the hurdles shareholders face when they attempt to make proposals and bring them to a vote; their right to sue will meet resistance based on the way in which state corporate law is structured to protect the ability of officers and directors to run a company as they see fit.

A **shareholders derivative lawsuit** can be initiated by individual shareholders on behalf of the corporation as a whole against persons or entities that have harmed the company—most often one or more of its own directors or officers for breach of fiduciary duty. (In other words, shareholders attempt to bring a suit that they believe the board of directors should have brought.) First, however, they must give the board a chance to act by making a “demand” that the board pursue the suit. To a large degree the board has the power to refuse to do so. A board’s decision to reject the demand is seldom overturned by a court—the **business judgment rule** gives wide latitude to the board to make such a call. Under certain circumstances, however, shareholders are excused from first making this demand. They can argue that doing so would be futile, because board members themselves are very much “part of the problem” that the shareholders derivative suit seeks to redress. But shareholders must allege specific facts that prove so-called **demand futility**. In most states, that means demonstrating why the board members who decided not to launch the suit were not “disinterested, informed and rational.” (A “disinterested” board member would be someone without any competing personal stake in the situation.)

The next case is an example of a shareholders derivative suit that survived a motion to dismiss. Note the interplay among shareholders, management and board, both in terms of what allegedly happened, and in how the law structures their relationships.

Career Education Corporation (CEC) provides private, for-profit post-secondary education on dozens of campuses throughout the United States, Canada, France, United Kingdom, and United Arab Emirate, and an online university. According to shareholder Scott McSparran, the board of directors artificially inflated CEC’s stock price by enrolling students without complete financial aid, enrolling students who did not actually attend classes, and claiming inflated job-placement rates for CEC graduates. Much of the information that should have alerted directors to this fraud—newspaper articles, court papers, and stock analyst reports—was available to the public.

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## MCSPARRAN v. LARSON

United States District Court, Illinois, 2006

2006 WL 250698

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**ANDERSEN, J.** ☀

... According to the plaintiffs, defendants’ scheme enabled them to dispose of 2.8 million shares of CEC stock for proceeds of over \$136 million.

The Complaint posits that the defendants knew exactly what was happening at CEC and lied about the extent of the problems CEC faced even after the accounting irregularities came to light, all so that they could continue to sell stock at high prices....

Also detailed in the Complaint are the ties between CEC’s CEO and Chairman of the Board, and each and every other member of CEC’s Board of Directors. While CEC’s CEO and Chairman of the Board unquestionably had some degree of control over the compensation of officers of CEC, the Complaint does not allege other business relationships that would allow him to control the compensation of outside directors. Instead, the

Complaint refers to general social and business ties and mentions fees paid to the directors for their services....

The Supreme Court of Delaware created a two-part test for demand futility in *Aronson v. Lewis*. Under this test, we ask whether “a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.” Plaintiffs assert two main grounds for demand futility: (i) the Board of Directors is dominated and controlled by CEC’s CEO and Chairman of the Board; and (ii) a majority of the Board of Directors are interested in the outcome of this litigation because they face a substantial likelihood of liability for claims predicated on the fact their decisions were not protected by the business judgment rule. As such, the two-part test laid out in *Aronson* is distilled in the present case into questions of independence and interest.

Delaware courts have noted that “[a]t bottom, the question of independence turns on whether a director is, *for any substantial reason*, incapable of making a decision with only the best interests of the corporation in mind. That is, ... cases ultimately focus on impartiality and objectivity.” However, “neither mere personal friendships alone, nor mere outside business relationships alone, are sufficient to raise a reasonable doubt regarding a director’s independence.”

Nor does the fact that directors receive directorial fees destroy their independence. (“[T]he fact that each [director] is paid an annual retainer of \$30,000 plus a fee of \$1000 for each meeting attended and annual grants of stock options does not make them beholden to [the company’s CEO].”)

There is no substantial reason to question the independence of a majority of CEC’s Board of Directors. Plaintiff has not put forth any allegations outside directors have their salary set by any board member, or are otherwise financially dependent upon other directors. If mere social acquaintances and prior business relationships with other board members coupled with the receipt of directorial fees destroyed a board member’s independence, few boards would have any independent members....

... A reasonable doubt regarding a director’s interest is raised when a corporate decision “will have a materially detrimental impact on a director, but not on the corporation or the stockholders.” ... As such, if plaintiffs’ Complaint pleads facts that indicate a majority of CEC’s Board of Directors face a “substantial likelihood” of personal liability, a demand upon the Board of Directors is futile.

Generally, board members are protected from individual liability by the business judgment rule, which provides a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts.”... [As the Delaware Supreme Court determined in 1996, however,] individual liability for directors can result from two possible contexts: (i) ... a board decision that results in a loss because that decision was ill advised, negligent, or intentionally adverse to the best interests of the company and (ii)... “from an unconsidered failure of the board to act in circumstances in which due attention would, arguably, have prevented the loss.”

... [A] board’s extreme indifference or failure to act may create individual liability for board members. “[A] director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by noncompliance with applicable legal standards.” Moreover, it is beyond dispute that a director who profits from confidential corporate information and takes actions adverse to the corporation’s best interest is personally liable to the corporation. [As Delaware courts held in 1949,] “a person in a



confidential or fiduciary position, in breach of his duty, uses that knowledge to make a profit from himself, he is accountable for such profit.”...

Plaintiffs’ Complaint contains two alternative allegations. Defendants were allegedly either active participants in a scheme to report false accounting of revenues and enrollment figures so that they could sell their holdings of CEC stock at inflated prices, or they failed to act in the face of evidence that should have prompted remedial measures. Either of these two scenarios could result in personal liability for the defendants. In support of these allegations, the Complaint details company policy that should have brought CEC’s false accounting to the attention of the defendants, quotes from news articles, court filings, and analyst reports that discussed allegations of false accounting, and names of two defendants who supposedly received comparisons of accurate information versus the inaccurate information that was provided to the public and the federal government. Additionally, the Complaint alleges that all defendants except for one sold sizable stock holdings while they knew, or should have known, of significant, non-public, problems with CEC’s reported financial and enrollment figures. In fact, the plaintiffs contend that the reason CEC was engaged in the reporting of false figures was primarily to allow defendants to profit from selling their holdings of CEC stock. The Complaint also explains that the reporting of false figures to the federal government was extremely adverse to the interests of CEC due to the dire consequences a revocation of HEA loan eligibility would visit upon the company....

At this stage in the litigation plaintiffs have met their burden of pleading with particularly their reasons for demand futility. The plaintiffs have told us the “who, what, when, where, and how” of a story that raises a reasonable doubt about the defendants’ personal liability. Since the defendants may have personal liability, they are interested parties to any demand upon the Board of Directors to institute litigation. As such, plaintiffs are excused from making a demand upon the Board of Directors based on the doctrine of demand futility....

[Held: Defendants’ motion to dismiss is denied.]

## QUESTIONS

1. What is a shareholder derivative suit? On what grounds was such a suit brought against CEC?
2. What is the business judgment rule? In what ways were defendants alleged to have violated that rule?
3. The judge explains that the fact that members of the board have personal relationships with management, or receive considerable fees for serving does not destroy their status as “independent.” For about two weeks work a year, independent directors at Enron averaged \$87,000 from cash and stock options.<sup>25</sup> What effect might treating directors this well have on corporate governance? What ethical issues arise here?
4. Defendants argued that there were no damages to CEC, despite allegedly high legal fees and diminished business reputations. How would you articulate the shareholders’ claims that the behavior of its officers and directors amounted to harm to the corporation?

<sup>25</sup> Robert Bryce, *Pipe Dreams: Greed, Ego, and the Death of Enron* (New York: Public Affairs, 2002).

## Corporate Social Responsibility as Creation of Shared Value

The notion that corporations have a responsibility to their stakeholders—not only their stockholders—is not new. Waves of scandal—defense contracting in the 1970s, insider trading in the 1980s, and most recently and spectacularly, the financial fraud that bankrupted companies like Enron and WorldCom at the turn of the twenty-first century—have been accompanied by public relations problems for corporations, a certain amount of public soul-searching on their part, and calls, sometimes heeded, for a ratcheting up of government regulation. The drama is a predictable one, with business leaders cast first as villains, then as penitents, demonstrating each time fresh concern for those stakeholders who are not shareholders—employees, regulators, local community members, the American investing public, and so on. What appears to have remained constant through all of these cycles is that most businesses will strive to be ethical in order to stay out of crisis management mode—until and unless the profit imperative simply becomes too strong. Even an organizational culture that supports ethical decision making can be put at risk when the pressures of market competition overwhelm it.

This final article raises the hopeful possibility that companies might build ethics into their value chain, becoming responsive to stakeholder networks in a way that is sustainable. Michael E. Porter, professor at Harvard Business School, and Mark R. Kramer, senior fellow at Harvard's Kennedy School of Government, co-founded FSG Social Impact Advisors, an international nonprofit consulting firm. In this article they urge businesses to take a proactive or “strategic” approach to Corporate Social Responsibility (CSR), in which companies can zero in on what they do best to benefit both themselves and the larger society. Strategic CSR, they write, goes beyond philanthropy, and beyond mitigating any harmful impacts a firm might have on its surroundings, to take advantage of an important reality: the mutual dependence of business and society.

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### STRATEGY & SOCIETY: THE LINK BETWEEN COMPETITIVE ADVANTAGE AND CORPORATE SOCIAL RESPONSIBILITY

MICHAEL PORTER, MARK R. KRAMER<sup>26</sup>

#### Integrating Business and Society

Successful corporations need a healthy society. Education, health care, and equal opportunity are essential to a productive workforce. Safe products and working conditions not only attract customers but lower the internal costs of accidents. Efficient utilization of land, water, energy, and other natural resources makes business more productive. Good government, the rule of law, and property rights are essential for efficiency and innovation. Strong regulatory standards protect both consumers and competitive companies from exploitation. Ultimately, a healthy society creates expanding demand for business, as more human needs are met and aspirations grow. Any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and ultimately temporary.

At the same time, a healthy society needs successful companies. No social program can rival the business sector when it comes to creating the jobs, wealth, and innovation

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<sup>26</sup> *Harvard Business Review*, December 2006, Vol. 84, Issue 12.

that improve standards of living and social conditions over time. If governments, NGOs, and other participants in civil society weaken the ability of business to operate productively, they may win battles but will lose the war, as corporate and regional competitiveness fade, wages stagnate, jobs disappear, and the wealth that pays taxes and supports nonprofit contributions evaporates.

Leaders in both business and civil society have focused too much on the friction between them and not enough on the points of intersection. The mutual dependence of corporations and society implies that both business decisions and social policies must follow the principle of shared value. That is, choices must benefit both sides ...

[Porter and Kramer identify “inside-out linkages,” or points at which businesses can impact society—from waste disposal to hiring practices. Inside-out linkages can exist all along a company’s “value chain,” the series of operations it performs to produce goods or services. The authors also note “outside-in linkages,” or ways in which the external environment impinges on business operations—from the quality of the labor pool, to the nature of consumer demand, to the way government creates and enforces rules and offers incentives. Outside-in linkages, according to Porter and Kramer, provide the “competitive context” for any business.]

### **Choosing Which Social Issues to Address**

No business can solve all of society’s problems or bear the cost of doing so. Instead, each company must select issues that intersect with its particular business. Other social agendas are best left to those companies in other industries, NGOs, or government institutions that are better positioned to address them. The essential test that should guide CSR is not whether a cause is worthy but whether it presents an opportunity to create shared value—that is, a meaningful benefit for society that is also valuable to the business.

Our framework suggests that the social issues affecting a company fall into three categories that distinguish between the many worthy causes and the narrower set of social issues that are both important and strategic for the business.

**Generic social issues** may be important to society but are neither significantly affected by the company’s operations nor influence the company’s long-term competitiveness. **Value chain social impacts** are those that are significantly affected by the company’s activities in the ordinary course of business. **Social dimensions of competitive context** are factors in the external environment that significantly affect the underlying drivers of competitiveness in those places where the company operates.

Every company will need to sort social issues into these three categories for each of its business units and primary locations, and then rank them in terms of potential impact. Into which category a given social issue falls will vary from business unit to business unit, industry to industry, and place to place.

Supporting a dance company may be a generic social issue for a utility like Southern California Edison but an important part of the competitive context for a corporation like American Express, which depends on the high-end entertainment, hospitality, and tourism cluster. Carbon emissions may be a generic social issue for a financial services firm like Bank of America, a negative value chain impact for a transportation-based company like UPS, or both a value chain impact and a competitive context issue for a car manufacturer like Toyota. The AIDS pandemic in Africa may be a generic social issue for a U.S. retailer like Home Depot, a value chain impact for a pharmaceutical company like GlaxoSmithKline, and a competitive context issue for a mining company like Anglo American that depends on local labor in Africa for its operations. ...

### **Creating a Corporate Social Agenda**

[Porter and Kramer argue that companies can and should engage in “responsive CSR,” acting as good corporate citizens with philanthropic activity and taking care to address

any harmful impacts they might have caused. Such CSR is fittingly “responsive to stakeholders” they write, but “it cannot stop there.”]

### **Strategic CSR**

For any company, strategy must go beyond best practices. It is about choosing a unique position—doing things differently from competitors in a way that lowers costs or better serves a particular set of customer needs....

Strategic CSR moves beyond good corporate citizenship and mitigating harmful value chain impacts to mount a small number of initiatives whose social and business benefits are large and distinctive. Strategic CSR involves both inside-out and outside-in dimensions working in tandem. It is here that the opportunities for shared value truly lie.

Many opportunities to pioneer innovations to benefit both society and a company's own competitiveness can arise in the product offering and the value chain. Toyota's response to concerns over automobile emissions is an example. Toyota's Prius, the hybrid electric/gasoline vehicle, is the first in a series of innovative car models that have produced competitive advantage and environmental benefits. Hybrid engines emit as little as 10 percent of the harmful pollutants conventional vehicles produce while consuming only half as much gas. Voted 2004 Car of the Year by Motor Trend magazine, Prius has given Toyota a lead so substantial that Ford and other car companies are licensing the technology. Toyota has created a unique position with customers and is well on its way to establishing its technology as the world standard.

Urbi, a Mexican construction company, has prospered by building housing for disadvantaged buyers using novel financing vehicles such as flexible mortgage payments made through payroll deductions. Crédit Agricole, France's largest bank, has differentiated itself by offering specialized financial products related to the environment, such as financing packages for energy-saving home improvements and for audits to certify farms as organic.

Strategic CSR also unlocks shared value by investing in social aspects of context that strengthen company competitiveness. A symbiotic relationship develops: The success of the company and the success of the community become mutually reinforcing. Typically, the more closely tied a social issue is to the company's business, the greater the opportunity to leverage the firm's resources and capabilities, and benefit society.

Microsoft's Working Connections partnership with the American Association of Community Colleges (AACC) is a good example of a shared-value opportunity arising from investments in context. The shortage of information technology workers is a significant constraint on Microsoft's growth; currently, there are more than 450,000 unfilled IT positions in the United States alone. Community colleges, with an enrollment of 11.6 million students, representing 45 percent of all U.S. undergraduates, could be a major solution. Microsoft recognizes, however, that community colleges face special challenges: IT curricula are not standardized, technology used in classrooms is often outdated, and there are no systematic professional development programs to keep faculty up to date.

Microsoft's \$50 million five-year initiative was aimed at all three problems. In addition to contributing money and products, Microsoft sent employee volunteers to colleges to assess needs, contribute to curriculum development, and create faculty development institutes. Note that in this case, volunteers and assigned staff were able to use their core professional skills to address a social need, a far cry from typical volunteer programs. Microsoft has achieved results that have benefited many communities while having a direct—and potentially significant—impact on the company.

### **Integrating Inside-out and Outside-in Practices**

... Activities in the value chain can be performed in ways that reinforce improvements in the social dimensions of context. At the same time, investments in competitive con-

text have the potential to reduce constraints on a company's value chain activities. Marriott, for example, provides 180 hours of paid classroom and on-the-job training to chronically unemployed job candidates. The company has combined this with support for local community service organizations, which identify, screen, and refer the candidates to Marriott. The net result is both a major benefit to communities and a reduction in Marriott's cost of recruiting entry-level employees. Ninety percent of those in the training program take jobs with Marriott. One year later, more than 65 percent are still in their jobs, a substantially higher retention rate than the norm.

### ***Creating a Social Dimension to the Value Proposition***

At the heart of any strategy is a unique value proposition: a set of needs a company can meet for its chosen customers that others cannot. The most strategic CSR occurs when a company adds a social dimension to its value proposition, making social impact integral to the overall strategy.

Consider Whole Foods Market, whose value proposition is to sell organic, natural, and healthy food products to customers who are passionate about food and the environment. Social issues are fundamental to what makes Whole Foods unique in food retailing and to its ability to command premium prices. The company's sourcing emphasizes purchases from local farmers through each store's procurement process. Buyers screen out foods containing any of nearly 100 common ingredients that the company considers unhealthy or environmentally damaging. The same standards apply to products made internally. Whole Foods' baked goods, for example, use only unbleached and unbromated flour.

Whole Foods' commitment to natural and environmentally friendly operating practices extends well beyond sourcing. Stores are constructed using a minimum of virgin raw materials. Recently, the company purchased renewable wind energy credits equal to 100 percent of its electricity use in all of its stores and facilities, the only Fortune 500 company to offset its electricity consumption entirely. Spoiled produce and biodegradable waste are trucked to regional centers for composting. Whole Foods' vehicles are being converted to run on biofuels. Even the cleaning products used in its stores are environmentally friendly. And through its philanthropy, the company has created the Animal Compassion Foundation to develop more natural and humane ways of raising farm animals. In short, nearly every aspect of the company's value chain reinforces the social dimensions of its value proposition, distinguishing Whole Foods from its competitors.

Not every company can build its entire value proposition around social issues as Whole Foods does, but adding a social dimension to the value proposition offers a new frontier in competitive positioning....

### ***The Moral Purpose of Business***

...Corporations are not responsible for all the world's problems, nor do they have the resources to solve them all. Each company can identify the particular set of societal problems that it is best equipped to help resolve and from which it can gain the greatest competitive benefit. Addressing social issues by creating shared value will lead to self-sustaining solutions that do not depend on private or government subsidies. When a well-run business applies its vast resources, expertise, and management talent to problems that it understands and in which it has a stake, it can have a greater impact on social good than any other institution or philanthropic organization.

## **QUESTIONS**

1. How do Porter and Kramer support the claim that business and society are interdependent?
2. According to the writers, how should a business begin to position itself in terms of strategic CSR?

3. Porter and Kramer write: "For any company, strategy must go beyond best practices. It is about choosing a unique position—doing things differently from competitors in a way that lowers costs or better serves a particular set of customer needs." What does this mean with regard to strategy for CSR?
4. Reconsider IBM's decision to offshore jobs to India in light of Porter and Kramer's arguments. Has IBM acted in a socially responsible way? How might IBM alter its strategic plan for social responsibility?
5. When immigration reform re-appeared on the nation's legislative agenda in 2007, Bill Gates and other leaders in the high tech field entered the debate, advocating changes in the law to make it easier for highly skilled software engineers to gain legal entry to the United States. How would Porter and Kramer characterize their lobbying for changes in the law?
6. Whole Foods Company is touted in this article as a prime example of integrated strategic CSR. John Mackey, CEO of Whole Foods, was in the news in July 2007 for very different reasons: He was accused of an ethical breach as a blogger, using the name Rahodeb.

**Internet Assignment:** Find out what Mackey was doing. Is the firm's CSR reputation intact?

## CHAPTER PROBLEMS

1. Analyze this scenario from the standpoint of law, and of ethics: For years, Dr. Eddingfield, a licensed physician, had been the Hurley family doctor. When Hurley became dangerously ill, he sent a messenger to Dr. Eddingfield, who told him of Hurley's violent sickness, explained that no other doctor was available, and offered to pay Eddingfield's fee for services. At the time, none of his other patients needed attention, so Dr. Eddingfield was free to help the sick man, but he chose not to do so. Mr. Hurley died.
2. **Internet Assignment:**
  - a. Although in the United States there is no general "duty to rescue," other countries do have such requirements. In France, Germany, and Russia, for example, bystanders may not legally ignore a fellow citizen who needs help in an emergency. What can you find about laws that require rescue in other parts of the world?
  - b. Several states in the United States, including Wisconsin, Vermont, and Minnesota, also have such legislation. Many states require certain persons to report specific kinds of crimes, most often child abuse. Find and compare two state statutes.
  - c. While rescue is not required in the United States, it is encouraged by the existence in every state of "Good Samaritan" laws, protecting people who assist in an emergency from liability in most circumstances. Locate the Good Samaritan law in your home state. Describe it in your own words. Does it protect those who do not have medical training?
3. In late 2004, after some ten years of taking tax breaks and union concessions, Maytag closed its refrigerator manufacturing plant in Galesburg, Illinois (population 33,000) and relocated it to Mexico. The company had received more than \$10 million from the town and the state. Galesburg District Attorney Paul Mangieri wanted to sue the firm to reclaim tax money that the town would have spent on its schools: "We gave Maytag these incentives and they accepted them. We did it on faith and trust." Yet other locals believed such a strategy would backfire, driving away other potential business interests. "Maytag's leaving town

has devastated our community,” car dealer Jeff Klinck pointed out, “But I don’t think any good comes from revenge. We want to move forward, not back.”

**Internet Assignment:** A final decision as to whether to sue Maytag was made in November 2004. What happened? Find out if any other communities in the United States went to court to catch up with corporations which had benefited from tax abatements but ended up closing down operations for more cost-efficient locations. See: *Township of Ypsilanti v. General Motors*, 1993 WL 132385 (Michigan Cir. Ct.) and *Ypsilanti v. GM*, 506 N.W.2d 556 (Michigan Court of Appeals, 1993).

4. In mid-2004, a carpenter from Durham, North Carolina, found out that his potentially fatal heart condition required surgery that would cost \$200,000. As one of the 45 million uninsured American citizens, he could not afford it. So he outsourced the job to India, flying to Delhi for a heart valve replacement that would cost only \$10,000, including airfare and a side trip to the Taj Mahal! Approximately 150,000 so called “medical tourists” traveled to India for similar reasons in 2004, a growing number from the United States. They are taking advantage of lower costs and quality services—everything from airport pickups to private hospital rooms to treatments that include yoga and other traditional forms of healing. Overall, India’s health care system is poor, but there is an increasing number of private medical facilities there that provide services as good as or better than those in the developed world. For example, while the death rate for heart bypass at Escorts Heart Institute and Research Centre in Delhi was just 0.8 percent, the 1999 death rate for the same procedure at the New York hospital where former president Bill Clinton had bypass surgery was 2.35 percent.<sup>27</sup>

**Internet Assignment:** What can you find out about the trend to outsource high-end services like these? Is it on the up tick? Is it expanding to include other services which require advanced professional training?

5. As companies increasingly do business around the world, they often must decide how to behave in developing countries where the legal system may be more lax than that of their home base. Some believe in the principle, “When in Rome, do as the Romans do,” justifying activities abroad that are illegal and unacceptable at home. Others argue that transnational companies must use their influence to nudge other businesses and nations towards higher standards, even attempting to make a difference in the way foreign governments handle human rights. In the 1980s many companies stopped doing business in South Africa, in an effort to pressure that government to end apartheid. In 1992 Levi Strauss withdrew operations from Burma, claiming, “It is not possible to do business [there] without directly supporting the military government and its pervasive violations of human rights.” In 1994 Reebok and Liz Claiborne pulled out of Burma; in 1995 Eddie Bauer and Amoco also withdrew, citing growing opposition in the United States to company involvement there. Wal-Mart, IKEA, Crate and Barrel, Jones New York, and (under pressure from activists) Ames Department Stores have promised to stop sourcing products from Myanmar (formerly Burma). In 1998, after many strikes and negative press reports, Nike announced plans to improve conditions in Indonesia. It offered education and business loans to workers’ families, promised to improve air quality in its plants, bringing them in line with U.S. OSHA standards, agreed to open its plants to inspections, and raised wages by 40 percent. Rejected at a 1998 shareholders’ meeting was a proposal that Nike spend about 2 percent of its yearly advertising budget to double the wages of its workers in Indonesia, which would have provided them with what critics claim is a living wage.

<sup>27</sup> John Lancaster, “Surgeries, Side Trips for Medical Tourists,” *Washington Post Foreign Service*, October 21, 2004.

Where should companies draw the line in their activities abroad? If they decide to go in the direction of challenging the moral climate, is that a form of “cultural imperialism”? How wide should they spread their net of rescue in these settings? Is it enough to raise their own employees’ wages, or should they also be concerned with the behavior of their suppliers? Should they try to improve infrastructure (education, environment)? Should they try to influence government policies? What about boycotting products from an “outlaw” state?

6. Plato believed that the rulers of the ideal society should be paid no more than four times what the lowliest member of that society was paid. In the United States today, executives commonly earn many times more than ordinary employees do. In 1980, CEO compensation was estimated to be 42 times that of average employees; by 2005, it was 411 times. In 2006, the average CEO of a Standard and Poors 500 Company earned \$14.78 million.

And corporate leaders are often recompensed heftily even after leading their companies into disaster. In 2006, Henry McKinnell of Pfizer and Robert Nardelli of Home Depot departed from their respective companies with exit packages valued at more than \$200 million. Under McKinnell’s tenure as CEO, Pfizer stock dropped nearly 40 percent, while McKinnell earned \$60 million in salary and other compensation. Nardelli received more than \$240 million in compensation over the six years he headed Home Depot, while company stock fell 8 percent.

Business reporter Cassidy traces the use of stock options as a form of executive compensation back to the “stockholder value credo,” the notion that CEOs should act as agents for shareholders, and that a smart way to make them keep shareholders’ best interests in focus would be to tie their financial rewards to their firm’s stock performance. Stock options, granting the right to buy stock in the company at a certain price at a certain future date, became increasingly popular between 1980, when they were given to fewer than one-third of the CEOs of publicly traded companies, and 1997, when 92 of the top 200 CEOs received options with an average value of \$31 million.<sup>28</sup> Suddenly these executives had very big incentives to drive stock prices up—at least temporarily, so they could realize enormous profits. The cascade of corporate scandals that included Enron was, experts now agree, at least in part caused by greedy senior executives who wanted to get the numbers up by any means necessary.

Analyze stock options and executive compensation with the ethical toolkit. How would Milton Friedman want to recompense corporate executives? How would a utilitarian? A deontological thinker? What would a virtue ethicist have to say about executive compensation? What would be the response of the ethic of care?

7. In 2004, M.J. Furman, owner of 1,600 shares of Wal-Mart stock, demanded that Wal-Mart’s board of directors sue certain members of the board and senior officers for breaching their fiduciary duty, recklessly mismanaging the company by authorizing and encouraging labor practices that systematically violated federal civil rights, employment, and labor laws. As a result, she claimed, Wal-Mart suffered lawsuits, market losses, loss of goodwill, and a deteriorating public image, causing its stock to underperform compared to competitors. When the board declined to bring suit—holding a final decision until the outcome of a pending discrimination suit (the largest in U.S. history)—Furman filed a shareholder derivative suit.

Internet Assignment: The case was decided in California in 2007. Find out what happened.

8. Commerce Bank was founded in New Jersey with a single location in 1971. Its founder, chairman and CEO, Vernon W. Hill II was a real estate developer, whose wife owned an interior decorating business. By 2007, it had 450 branches from New York City to

<sup>28</sup> www.aflcio.org/corporatewatch/paywatch/pay/index.cfm. John Cassidy, “The Greed Cycle,” *The New Yorker*, 64, September 23, 2002.



Washington D.C., open 7 days a week. With branches springing up like Burger Kings, Commerce Bank became the fastest growing bank in America. Mr. Hill was in all things entrepreneurial. He persuaded his board of directors to pay millions in rent for buildings owned by his family and over \$50 million to Mrs. Hill for her decorating services. In June 2007, in the face of numerous federal investigations, and at the insistence of his board of directors, Mr. Hill resigned all of his posts at Commerce Bank. His severance package has been estimated at \$17 million, however, and his Commerce Bankcorp shares, when he stepped down, were worth \$225 million. What corporate responsibilities were violated in this scenario? Who are the stakeholders? What can any of them do?

9. As practices surrounding the timing of options grants for public companies came under increased scrutiny in early 2006, Merrill Lynch analyzed the timing of stock option grants from 1997 to 2002 for the semiconductor and semiconductor equipment companies that comprise the Philadelphia Semiconductor Index. It revealed that backdated options—a common practice before Sarbanes-Oxley was implemented in 2002—often yielded higher returns, a result that spawned numbers of shareholder derivative suits. By 2007, the Securities and Exchange Commission (SEC) was investigating more than 160 companies involved in stock options backdating.

Internet Assignment: Read any one of those suits and find out if the shareholders won. If not, why not?

10. In a part of the reading not included in this chapter, Porter and Kramer offer this example of strategic CSR so well integrated with business operations it is not possible to distinguish day-to-day operations from social impact:

*Nestlé...works directly with small farmers in developing countries to source the basic commodities, such as milk, coffee, and cocoa, on which much of its global business depends. The company's investment in local infrastructure and its transfer of world-class knowledge and technology over decades has produced enormous social benefits through improved health care, better education, and economic development, while giving Nestlé direct and reliable access to the commodities it needs to maintain a profitable global business.*

Internet Assignment: Find another company—not mentioned in the article above—that has accomplished this degree of CSR integration. What are its inside-out and outside-in linkages?

## CHAPTER PROJECT

### The Social Responsibility Report<sup>29</sup>

The objective of this project is to expand your understanding of social responsibility for corporations. This is a topic that continues to generate considerable controversy—from free market theorists who believe that corporations violate their duty to shareholders when they engage in

<sup>29</sup> This project was developed by Professor Ronnie Cohen of Christopher-Newport University and is reprinted with her permission.

activities that are not directly related to increasing shareholder wealth, to reformers who believe that the enormity of corporate power comes with a corresponding responsibility to use that power in ways that benefit society as a whole, in addition to serving the interests of shareholders. Is corporate social responsibility a desirable and/or an attainable goal?

Two important and very readable books on the subject of corporate social responsibility are Paul Hawken's, *The Ecology of Commerce*, and Ray Anderson's, *Midcourse Correction*. The first book sets out a vision of sustainable commerce, giving many examples—some practical, some theoretical; in the second the CEO of the world's largest carpet manufacturer describes his company's effort to build sustainable practices into every aspect of the value chain. If there is another book on the subject that interests you, your instructor may want to consider it as a possible additional choice.

The assignment requires you to read one of the two books to gain an understanding of what a socially responsible corporation might do that is different from how the majority of corporations currently operate. You are also required to look at a publicly held company's performance on specific social responsibility criteria. Finally, you need to reach a conclusion about how the current legal environment could accommodate a social responsibility requirement for publicly held corporations and give your opinion about whether you believe this is a goal worth seeking.

Specific components of the assignment are:

**Section One:** Read one of the two books. Explain what social responsibility means to the author. How does he believe it relates to the current model of corporate accountability as structured through the legal system? Use the material in this chapter and additional readings at the end of this assignment to give you some background for this analysis. This section should be two to three pages long.

**Section Two:** Once you have read your chosen book, go to <http://www.vhcoaudit.com/SRAarticles/responsibilityaudits.htm>. This is the Web site for Vasin, Heyn & Co, Accountants, a company that performs social responsibility audits. Choose any two of the audit programs listed (community development, diversity, employee relations, environmental, international relationships, marketplace practices, fiscal responsibility, or accountability). Select a publicly traded company and obtain a copy of their most recent annual report. Using the report and other publicly available information, evaluate the company's performance in light of the standards for those two audit programs. Depending on the complexity of your company's activities, this section should be from three to five pages long. Be specific with examples of how the company does or does not meet the criteria. Don't just rely on company-generated information. Look at other sources that are likely to be more objective in their assessments. Try to verify all company claims by doing an Internet search. At a minimum, your examples should be based on at least two outside sources in addition to whatever company generated information you use. If you choose a local company, you may be able to interview key corporate officials for additional sources. Following the samples provided, give your opinion—qualified or unqualified—regarding the audit.

**Section Three:** Considering the perspective of the author of the book you read, and the practical observations about the company you audited, what changes would have to be made in corporation law in the areas of governance, fiduciary duty, organizational structure, and liability of officers and directors, in order to legally enforce a social responsibility requirement on publicly held corporations? Some ideas about corporate governance are included in the suggested readings on the next page. This section should be one to two pages long.

**Section Four:** Finally, give your opinion about whether you think imposing such a requirement is warranted, productive, and/or desirable. This section should be between one to two pages long.

**Additional Readings**

Andrew Savitz and Karl Weber. *The Triple Bottom Line: How Today's Best-Run Companies Are Achieving Economic, Social, and Environmental Success—and How You Can Too* (Jossey-Bass, 2006).

**From the Corporate Governance Web Site**

Browse these sites for other relevant info:

<http://www.corpgov.net/library/definitions.html>

<http://www.corpgov.net/forums/commentary/entinel1.html>

<http://www.corpgov.net/forums/commentary/Four%20Ideas.html>