3 Adopting an Ethics Code and Corporate Social Responsibility

Why, What, and How?

CHAPTER LEARNING OBJECTIVES

On completion of this chapter, students should be able to

- list and discuss the elements they would include in corporate codes of ethics and social responsibility and indicate whether they would implement different codes in different nations,
- suggest how they would relate with various stakeholder groups in responding to their interests and concerns,
- describe how they would structure corporate social responsibilities (CSR) within a multinational enterprise (MNE),
- explain the changing nature and responsibilities of the board of directors as they relate to ethics and CSR.

The issues concerning corruption and fraud discussed in Chapter 2 are leading to new and clearer government guidelines for corporate decisions. Throughout the world, laws are being changed to compel the firm to adhere to higher standards of transparency and honesty. Both firms and business schools are adopting formal codes in regard to ethics and CSR in hopes of improving management decisions. Corporate employees, as well as students, are being urged to pursue values beyond the maximization of their individual income and short-term profits. How best to implement these values underlies a recent shift to new expanded responsibilities for

boards of directors. However, throughout the world these new paradigms for strategies and management are being created to varying degrees and in different ways.

Countless authors have commented on Milton Friedman's (1970/2001) article "The Social Responsibility of Business is to Increase its Profits," in which Friedman argues that business activities should be limited to those that increase profits. Many regard Friedman's famous dictum as a rationale for ignoring ethical perspectives, social forces, corporate philanthropy, and obligations to stakeholders. In recent years, however, authors have analyzed the linkages between specific CSR policies and programs on the one hand and shareholder value on the other hand, emphasizing that a CSR strategy can be an important mechanism for increasing profits and shareholder value. A firm can use CSR to differentiate its reputation and brand from those of its competitors. Employees may contribute more effectively in their work if they have pride in their firm's CSR. Furthermore, various stakeholder groups have significantly increased their ability to disrupt corporate activities—through boycotts, for example—so the maximization of shareholder value requires a new involvement in CSR activities in order to minimize negative impacts of activist groups. Opportunities to create a new competitive advantage based on CSR, together with this ongoing threat of negative public responses greatly expands the activities that are consistent with Friedman's dictum.

Some authors disagree strongly with Friedman's (1970/2001) interpretation of the principal/agent argument, which states that "in his capacity as a corporate executive, the manager is the agent of the individuals who own the firm . . . and his primary responsibility is to them" (p. 51). Many authors emphasize that management today must acknowledge the firm's obligations as a member of the society in which it operates. From this perspective, management may feel that it has a responsibility to use corporate resources in some ways that might not increase shareholder value. An important element of this debate concerns the time horizon of management. If management considers only the short-term maximization of shareholder value, then it may feel justified in limiting CSR activities. However, if management is concerned with long-term shareholder value maximization, then management may see a much larger array of CSR activities as being appropriate.

As indicated in Chapter 2, significant differences exist among countries in regard to what is considered ethical or appropriate business behavior. MNEs must confront the conflict between adapting to cultural relativism in each country and adhering to global ethical positions. Many believe that MNEs should adhere to more stringent standards than may be required by some of the countries in which they do business and that each MNE must create global moral foundations. Fundamental human rights give rise to fundamental MNE duties and obligations. These obligations may include actions to advance the long-term welfare of employees and customers and

obedience to minimum standards of justice. Further, most managers do have some personal sense of public responsibility, and their preferences and choices can underlie a firm's "corporate culture" in regard to ethics and CSR. In regard to responsiveness, the firm must be involved in managing issues whenever it confronts them and must respond to these issues in the context of an ongoing analysis of the environment in which the firm operates. Stakeholders cannot be ignored, and the firm should develop procedures for relating with them and responding to them. Finally, each firm should focus on the outcomes of its CSR activities, including analyses and measurement of the social impacts of the programs and policies that have been put in place.

The New Emphasis on Ethics

A recent advertisement by the Chartered Financial Analyst Institute (CFA) consists of the word "ethics" prominently displayed, followed by the assurance that the CFA designation brings with it a thorough awareness of ethical responsibilities.

> When someone has achieved the CFA designation—make no mistake he or she is well aware of ethical responsibilities. He upholds the Code of Ethics and Standards of Professional Conduct. She knows why GIPS [global investment performance standards] were created and to whom they apply. He has acknowledged his obligation to act in an ethical manner and to encourage others to do the same, with integrity, competence, diligence and respect. (CFA Institute Advertisement, 2009, p. 12)

Cacioppe, Forster, and Fox (2008) published their results from "A Survey of Managers' Perceptions of Corporate Ethics and Social Responsibility and Actions that may Affect Companies' Success." The authors emphasize the positive impacts of a corporate culture that rests on clear guidelines for ethical decision making.

> As research is beginning to document, companies that bring ethical discipline to bear on their activities and tap into the moral capabilities of their people start to reap a variety of economic benefits from doing so. . . . Given a choice, most people prefer to work for and do business with companies that are honest, fair, reliable and considerate. (p. 681)

The media in many countries have adopted a new investigative role in uncovering decisions that reflect questionable ethics. Corporations and their employees are not the only focus for such news stories. In Britain, reports of bloated and inappropriate expense claims by members of

Parliament raised a public outcry, and throughout the world, British strictures against corruption and fraud were mocked as hypocrisy. In Brazil, three senate presidents were suspended or resigned because of scandals over the period 2001 to 2009, and a fourth was similarly criticized in 2009. Meanwhile, media themselves have been accused of unethical behavior. A *Financial Times* article in 2009 reported that employees of one of Rupert Murdoch's British newspapers had been accused of hacking into the mobile phones of celebrities. "If true, this would represent an unpleasant invasion of privacy that could prove very costly to the present company ("Tapped for the Top," 2009).

Academic journals now place greater emphasis on research concerning ethics, and some journals such as *Corporate Responsibility Management* are devoted to this subject. There are now research centers that specialize in ethics. Simon Webley (2006), research director for the Institute of Business Ethics, has advocated a clear code of ethics to inform and guide all employees, together with the following procedures:

- Make a distinct (senior) person responsible for implementing the ethics part of the function.
- Have a clear reporting route to the CEO/board.
- Make clear the role of internal audit.
- Make sure there is an effective and continuous ethics training program.
- Always base the case for compliance on corporate values. (Webley, 2006)

Using CSR to Create a Competitive Advantage

Porter and Kramer (2002) argue that corporate philanthropy can be designed so as to improve the firm's competitive advantage, which will also improve the firm's profitability over time. From this perspective, the firm should align its long-term business interests in each nation with each nation's social and economic goals. A purpose in the design of charitable activities should be to leverage the firm's capabilities and relationships in order to create social benefits that exceed those that could otherwise be achieved. Porter and Kramer refer to this as "context-focused philanthropy." This perspective can be successful, for example, in financially supporting the education of the local workforce. In addition, efforts to preserve the environment through pollution reduction can also strengthen the firm's productivity and create goods for which consumers have special preferences and for which they will pay higher prices. Here the firm's profitability goals need not conflict with CSR objectives. "It is only where corporate expenditures produce simultaneous social and economic gains that corporate philanthropy and shareholder interests

converge" (p. 33). Consequently, management should analyze the elements of its competitive context in order to identify overlaps between these social and economic values.

Porter and Kramer (2006) also emphasize the importance of creating a strong competitive cluster of related CSR activities in which many firms and institutions may collaborate. Education and water and sewage treatment are obvious areas in which firms can collaborate in efforts to strengthen research institutions, the legal system, and physical infrastructure—each of which can improve the international competitiveness of all local firms. Philanthropy can also increase the size and nature of the local market, leading consumers to demand product and service improvements that can be the basis for international competitiveness. A variety of collaborations among firms can create a more productive cluster. Both Transparency International and the International Corporate Governance Network have developed successful collaborations. Strengthening the network of suppliers, exchanging information, and lowering transaction costs can all stimulate the development of clusters that can help each member firm. A central element in this analysis is that a firm can gain a competitive edge for itself even when collaborating with competitors. In this process, the firm's philanthropy can enhance the performance of grant recipients and on a more general scale can advance the social capital in a region. With strategic philanthropy as a foundation for its CSR, MNEs should increasingly take an activist stance on social issues such as hunger, community development, literacy, school reform, AIDS, and environmentalism. CSR should involve different activities for each firm and for each country in which it does business. Furthermore, the expectations of the public and governments for a firm's citizenship role may change over time. This cross-national and intertemporal perspective leads to the conclusion that management must be involved in CSR decisions on an ongoing basis.

> Each company can identify the particular set of social problems that it is best equipped to help resolve and from which it can gain the greatest competitive benefit. 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 than any other institution or philanthropic organization. (Porter & Kramer, 2006, p. 14)

In the 1980s, only a few firms reported anything publicly in regard to their CSR activities. Today, several organizations, such as Ethical Investment Research Services (EIRS), conduct research in regard to CSR activities, with EIRS providing performance indicators in regard to about 3,000 firms worldwide. To a major degree, EIRS receives its funding from institutional investors, especially pension funds, which make their investment decisions in the context of each firm's CSR. Hence, the firm's access to capital may now be impacted by its CSR activities. CSR has now evolved

into a mainstream business responsibility that integrates a firm's CSR activities into its core business strategy. EIRS predicts that investors will increasingly be concerned with social performance indicators since there is a growing belief that CSR does impact long-term financial performance. EIRS also goes beyond specific performance indicators to place an emphasis on corporate governance as a driving force in each firm's CSR activities. They point to the need for independent directors and the importance of governance codes that increase corporate transparency and director responsibilities.

Hillman and Keim (2001) examine the ways in which stakeholder management and participation in social issues can ultimately result in improvements in long-term shareholder value. They suggest that stakeholder management and social issue participation are very different activities and may have opposing impacts on a firm's financial performance. Stakeholder management can have positive impacts while general social issue support may not. Effective stakeholder-management relations may include ongoing structural dialogues with customers, employees, suppliers, community residents, and environmental groups. These relations can constitute intangible, socially complex resources that may enhance a firm's ability to outperform competitors in terms of long-term value creation (Hillman & Keim, 2001). Many other authors have also attempted to analyze the relationship between corporate social performance (CSP) and corporate financial performance (CFP). An objective has been to determine whether or not a CSR strategy can in general enhance shareholder value. Orlitzky, Schmidt, and Rynes (2003) have undertaken a meta-analysis of 52 studies containing a total sample size of nearly 34,000 observations. While many of these studies have suggested a negative relationship, indicating that CSR may be a net expense to the firm, the authors demonstrate flaws in statistical techniques that can explain these results. In general, Orlitzky et al. conclude that a positive relationship does exist between CSP and CFP across a wide variety of industries and studies.

> Portraying managers' choices with respect to CSP and CFP as an either/or trade-off is not justified in light of 30 years of empirical data. This meta-analysis has shown that (1) across studies, CSP is positively correlated with CFP, (2) the relationship tends to be bidirectional and simultaneous, and (3) reputation appears to be an important mediator of the relationship. (p. 427)

Managing the Activists

Each firm today confronts a wide variety of stakeholders whose objectives may often conflict. Pressures now emerge continually from employees, suppliers, customers, various community groups, nongovernmental

organizations (NGOs), and institutional shareholders. Somehow, management must develop CSR strategies that can cope effectively with their conflicting goals and objectives. CSR today means going beyond obedience to the law and creating strategies that can differentiate the firm from its competitors. For this to be successful, the firm must have a public relations strategy designed to build its reputation. Cost-benefit analysis can be used for potential CSR activities in the same way that the firm would analyze other investment decisions. The ability of activists to damage the firm—and the avoidance of this damage—becomes a major component of the cost-benefit analysis.

Groups of activists can compel a firm to transfer some of its resources to satisfy the interests of each activist group. Here, activist groups may solicit support from the general public in regard to their wishes concerning the CSR activities of the firm. Each firm today must develop a thorough understanding of the objectives of these various stakeholder groups, as well as their ability to impact its activities—through boycotts, for example. While managers may be motivated by altruistic preferences, this compulsory redistribution of firm resources must now be considered carefully. Furthermore, each firm must strive to mitigate the impacts of incomplete information provided by activists to potential customers and must actively bolster its reputation and market image in regard to CSR. Activists may have strategies that not only impact the firm directly but also impact the political process with the objective of changing laws and regulations that affect the firm.

In recent years, media have developed an increased interest in the interactions of firms with society and in the ethical performance of firms. To some degree, this may be the result of ethical scandals in firms such as Enron, Tyco, and Parmalat. This increased media attention has become a global phenomenon, as various media organizations have themselves become global. The Internet has also enabled a new level of global communication and unified global action on the part of concerned individuals and NGOs. As a result, CSR decisions throughout the world have become linked in terms of public perceptions. This globalization of media and interest groups has made the CSR activities, or lack thereof, in faraway countries of immediate concern to consumers in the economically advanced nations. Consequently, the decisions that are made in subsidiaries or suppliers in China may impact the firm's success in the United States or Western Europe. International conflict resolution concerning CSR has become a new responsibility of management. For example, corporations such as Nike and Gap have suddenly faced global campaigns and threats of boycotts due to their treatment, or their suppliers' treatment, of employees abroad. By 2009, Wal-Mart had initiated a widespread campaign in China to ensure continual adherence by its suppliers to its global environmental standards.

Teegan, Doh, and Vachani (2004) have emphasized the global reach of NGOs and their impact on the concepts of value creation and governance.

They suggest that increasingly citizens have lost trust in the institutions that they have relied on in the past. Consequently, citizens are turning to NGOs to further their interests. They note that some NGOs focus on advocacy in regard to certain CSR objectives and have become expert in lobbying, conducting research, holding conferences, disseminating information, defining agendas, developing and promoting codes of conduct, and organizing boycotts. Throughout the world today, NGOs are giving voice to citizens who otherwise would lack the ability to impact firm decisions. Some NGOs have developed operational activities where they feel that both private and public markets have failed. Such NGOs have developed skills and expertise in providing certain goods and services to the public. Teegan et al. note the huge increase in the number of NGOs within Organisation for Economic Co-operation and Development (OECD) countries. The result of these developments is that management cannot ignore NGOs without the risk of suffering financially. "In conclusion, we recognize the emerging role of NGOs in advancing broad social issues of major concern around the world and providing critical goods and services" (p. 477).

To some degree, a "governance gap" is caused by the failure of governments at the country or regional level to participate effectively in economic and social development. The need for global public policies is particularly challenging since there is no global government and international institutions lack adequate authority and enforcement capabilities. Furthermore, pressures to create free trade can conflict with government intervention aimed at social issues. Consequently, this subject of global CSR will not be dealt with easily in the near term. As part of this social change process, the firm's employees develop their own vision of the firm and may become activists themselves. These perceptions influence employee commitment to the firm. A particularly important managerial implication is that each firm can play a leadership role in relating universal ethical principles to local cultural norms as part of the social change process.

Creating Unique CSR Strategies for Each Nation

Hillman and Hitt (1999) examine the linkages between the firm's involvement in CSR activities and the firm's political strategy. A political strategy may rest on alternative approaches. First, the firm can deal with specific issues as they arise. Second, beyond a transactional approach, a firm can develop long-term relationships that enable it to deal more effectively in an ongoing manner with an array of potentially significant issues. Third, the firm must also decide whether to participate in this process by itself alone or whether it can be more effective in collaboration with other firms

and stakeholder groups. Based on these alternative approaches, each firm must delineate its unique political strategy.

Hillman and Hitt focus on three components of the firm's political strategy. First, the firm provides information to political decision makers in the expectation that this information will influence government decisions in the interests of the firm. Second, the firm provides political decision makers with financial contributions necessary in election campaigns. Third, the firm develops support in the general electorate for the policies and programs that it believes can enhance its profitability. Optimal CSR activities and political strategies depend on relationships between social forces, corporate strategies, and government decisions. For the MNE, the many differences among countries may require that the firm develop multiple political strategies that differ among nations.

Ernst & Young interviewed senior executives at 147 of the largest MNEs in order to determine the impacts of the CSR concept and to understand likely trends in firm activities in response to CSR pressures. While most of these companies did not have a CSR strategy in 2002, those interviewed emphasized the need for their firms to adopt a much greater role for CSR. Ernst & Young concluded that

> CSR has emerged as a significant business issue with the majority of survey respondents. . . . Even though CSR rates highly on the boardroom agenda, few survey respondents feel that they have an adequate understanding of the relevance of CSR to their company, nor do they believe that the business case for the CSR strategy has been systematically developed. (Grant, Buttle, McKenzie, & Veale, 2000, p. 3)

In this Ernst & Young survey, 63% of the MNEs considered stakeholder dialogue to be necessary in developing a CSR strategy, while an additional 33% thought that it would be useful. Nevertheless, only 8% of the firms felt that they had effectively engaged with stakeholders in creating a strategy. Only 19% believed that their CSR agenda was understood throughout the firm. Nearly half of the companies published reports regularly on various aspects of CSR, and three quarters believed such reporting to be critical. However, the survey found that much remained to be done in terms of developing reporting strategies. CSR was generally the responsibility of personnel in corporate affairs and public relations rather than being an element of corporate strategy at the senior management level. The survey suggested that the following factors were believed to be critical in improving the reporting process:

- More effective dialogue with stakeholders
- Greater awareness of the relevance of CSR to the organization
- Better understanding of critical risks

- Improved metrics/measurement
- Data collection on the basis of measurable metrics

Survey respondents pointed to a series of important nonfinancial issues that they thought could be impacted by a CSR strategy: brand value, company reputation, risk mitigation, staff retention and attraction, market position, customer attraction, and customer loyalty. Respondents also pointed to a series of stakeholder groups that saw themselves as having an important role to play in determining these nonfinancial issues, including employees, customers, suppliers, the local community, NGOs, and government, quite apart from shareholders. Throughout the interviews, respondents expressed their conviction that an appropriate CSR strategy could lead to an increase in shareholder value. As the Ernst & Young survey indicates, CSR has been increasing greatly in importance for the MNE.

A central issue is whether the MNE should apply the laws and norms of its home country to the issues it confronts in other nations. MNEs may be motivated to locate facilities in certain nations because of lower costs related to less stringent requirements in regard to environment and labor standards. A further complication is that some analysts feel that firms in less developed nations should use resources to address issues that in developed nations would typically be dealt with by governments. Many authors point to the challenges for a firm in applying CSR concepts to nations where law may not be as extensive in regard to these issues, where social expectations of corporate behavior may be quite different from those in the economically advanced nations, and where cultures may place a different emphasis or priority on various CSR issues. In many countries, corporate ownership is held by powerful elites who play an instrumental role in the determination of government laws and regulations. Consequently, CSR activities face more complex challenges where the MNE has to translate its business citizenship into the culture, economics, and government practices in these countries.

Competition continually exerts pressure on the MNE to minimize costs in ways that may violate its home-country vision of CSR. Certain business sectors, such as textiles, footwear, and the assembly of electronics, may face this risk to a greater degree than others. Different countries have different cultural priorities and so have different stakeholder groups. Consequently, cultural differences must be considered carefully by management as they develop a global CSR strategy. In some cases, MNEs may choose not to do business in a given country because of the gap between their corporate ethics and that country's norms. Nevertheless, globalization is causing an automatic transfer of CSR activities and practices from the advanced nations to less developed nations over time. An important component of this spread of CSR has to do with values of senior management within the MNE. From this perspective, senior management of an MNE has a new

responsibility: understanding how to articulate a common global vision within different cultures. This reality emphasizes the importance of international governmental agreements that attempt to create global CSR standards in regard to labor and environmental issues, as well as in regard to general human rights and codes of conduct.

The Division of Responsibilities for CSR Within the MNE

A basic challenging question concerns the appropriate division of responsibilities between the head office and the subsidiaries of MNEs as management struggles to create optimal CSR strategies and respond to issues, some of which may be global and some local. Subsidiaries may have limited functions and may lack the staff to be able to monitor and respond successfully to local CSR issues. This need for local responsiveness may require changes in the governance structure of the MNE. Social causes that are seen as important in one particular geographical area will not be seen as important everywhere, and community projects that the public want to promote will also differ. Consequently, the mechanics of nonmarket strategies have to be geared to the particular host country or city, and a CSR strategy that includes political involvement and stakeholder relationships may have to be tailored to local conditions.

Decentralization of responsibility could lead subsidiaries to pursue lower standards than those of the parent firm in the home country. Hence, an MNE needs global strategies and standards in regard to some issues and practices while permitting the decentralization of responsibility for others. An additional complication is that managers may have nonbusiness-related motives for engaging in CSR since some managers are internally driven to adhere to their personal ethical code. This perspective supports the importance of ongoing evaluation in regard to the optimal location of CSR decision-making responsibility.

Neef (2003) uses the risk of mistakes as a CSR focus in his book *Managing Corporate Reputation and Risk*. With widespread de-layering and downsizing, more employees within a firm have responsibility for decision making. Neef emphasizes that today a series of challenges could lead to financial penalties, consumer boycotts, lawsuits, greater regulation, damage to reputation, a decrease in profits, and a loss of share value. The Internet and international news services have completely changed the environment of business, exposing firms everywhere to public scrutiny and criticism. Furthermore, individual members of senior management and the board of directors are increasingly being held accountable legally for the actions of the firm. From this perspective, business

integrity is necessary quite apart from ethical motivations. At the same time, incentive-based remuneration provides continual pressure for management to minimize the costs of corporate actions that could prevent these kinds of mistakes.

Neef (2003) recommends a combination of managing corporate integrity and ethical behavior; managing knowledge and information that is necessary for appropriate decisions, which he refers to as knowledge and risk management (KRM); and creation of reporting techniques that clarify risks prior to accidents happening. MNEs should transform the pursuit of ethics and the knowledge management that is required to enforce ethical behavior into a core competency. Increasingly, new international standards are requiring that firms develop frameworks for monitoring and auditing the firm's social performance. The opportunity to use new information technology systems can enable MNEs to communicate their CSR strategies easily and effectively with employees, customers, suppliers, and other stakeholders throughout the world.

For Neef (2003), the firm's board of directors should be playing a far more active role in this subject area. In the past, board members did not make themselves aware of risks that the firm faced in regard to these issues. They failed to control senior management who were placing too great an emphasis on short-term profitability or who were even involved in personal unethical behavior. International investments have made this subject increasingly important. MNEs are now operating in countries and cultures where senior management may not be aware of what is happening within subsidiaries, joint ventures, suppliers, or strategic alliances. A particularly difficult area concerns labor standards overseas. Many U.S. firms have suddenly faced public outcries and damage to reputation as a result of employment conditions within their own subsidiaries or within supplier organizations. "Here, innovative policies by companies that pay for housing, education, and health care can not only ensure a humane response, but can also help to ensure stability and continuity of a workforce" (p. 59). Senior management and board members must have "an integrated KRM process that helps them to know whether they are being ethically compliant or not" (p. 63). While many MNEs have a series of departments within their organization that consider some of these issues, most firms have not yet integrated or coordinated these multiple areas to develop a consistent global corporate culture.

Today, an appropriate governance structure includes procedures for involving many groups of stakeholders, referred to as multiple stakeholder collaborative processes. As part of this new approach to governance, most firms have to create new kinds of networks with a wide variety of organizations. This perspective has revolutionized traditional views of corporate governance. As part of this process, most governments have adopted new responsibilities for supervising firm decisions

that can impact society, so corporate governance now involves new and intensified interactions with a wide range of government agencies.

The Development of Trust

The above perspectives emphasize the need for mutual trust among personnel within the MNE if CSR is to be successful. This mutual trust has to be based on a set of beliefs shared globally with an implicit code of conduct for some issues and an explicit code of conduct for others. This trust has to be based on shared values related to these shared beliefs. Leaders at both the head office and subsidiary level have to set the right example both in terms of specific decisions and also in terms of the objectives that they encourage. In this process, it is necessary to create benchmarks so that success can be measured and failures can be the target of remedial action. With a positive global CSR, the various stakeholders, including NGOs, may develop loyalty and support for the firm that can add significantly to shareholder value.

The above perspectives are also important in risk minimization and in dealing effectively with crises. For the firm, the assessment and management of CSR risks and the appropriate management of human error have become essential. MNEs continually confront risks, and many of these pose difficult challenges in regard to measurement of the risk, judgments about risk taking, and appropriate crisis management. The firm requires an ongoing risk-scanning process that provides analyses in regard to risks and also early alerts of oncoming crises. The firm should develop reporting procedures for creating transparency in regard to how the firm is dealing with these various issues.

This subject of the relationship between culture and trust with its implications for management decisions and strategies is explored more fully in Chapter 4. Here, it is important to note the problems that asymmetry in trust between the MNE and its stakeholders can cause for the creation and implementation of a global CSR strategy. When one sees CSR as an investment strategy, then one can appreciate the challenge of developing an optimal pattern of investment in trust building and monitoring within CSR activities. The structural and social dimensions of trust may differ across cultures. Trust may be more difficult to instill in subsidiaries or partners in certain countries. Legal, political, and social systems monitor and sanction social behavior, and these differ significantly among countries. Institutional differences cause differences in behavior relating to trust. A central concern has to do with expectations on the part of stakeholders in different countries.

Many MNEs have put considerable effort into developing a wide variety of firm-specific CSR codes of conduct. In CSR codes, corporate values

or practices are formalized in order to guide the decisions of firm employees operating in different countries. A code is "an aspirational strategy" that encourages employees to behave in certain ways. The need to preserve and convey a reputable public image may require codes that can be readily understood by employees in different countries. The creation of codes can be the result of a series of motivations ranging from the need for internal control systems, the differentiation of the firm in the marketplace, the reduction of insurance premiums, and the prevention of activist criticisms and boycotts.

International CSR Agreements

The OECD (2008) has created *Guidelines for Multinational Enterprises* with the objective of encouraging CSR initiatives. In this international code, the 39 signatory countries have expressed their shared commitment. The OECD guidelines provide recommendations in the major areas of CSR, and the government signatories have pledged to promote the guidelines within their nations. The guidelines include recommendations in regard to managements' decisions and activities that bear on human rights, labor relations, the environment, consumer protection, and corruption. In addition, the OECD has promulgated its "Declaration and Decisions on International Investment and Multinational Enterprises." This declaration relates to government treatment of foreign investors and indicates the OECD's objective of encouraging a more widespread balance of rights and commitments between businesses and governments.

The New Responsibilities of Boards of Directors

Janet Arnold (2008) has written an article titled "It's Not Your Father's Board Seat: The Evolution of Corporate Governance in an Era of Scandal." Arnold describes how the evolution of the concept of "fiduciary duty" has extended the legal responsibilities of board members. She presents eight "critical lessons":

1. Be independent.
2. Be loyal to the organization.
3. Be informed. Really informed.
4. It's all about process. Have one.
5. Have a supportable basis for your decisions and document, document, document.

6. Devote sufficient time and analysis to your decisions.
7. Don't be passive. Ask questions.
8. Trust, but verify.

Increasingly, boards of directors in many nations must act as adjudicators, standing guard between management's day-to-day operations and the long-term interests of shareholders. This means that board members must incorporate a new attention to ethics into their adjudication process. A particular concern relates to the appropriate timeline for the maximization of shareholder value. While management's interests are geared to the short term, many shareholders are focused on the long term. Recent corporate disasters have emphasized the importance of this trade-off, as management in certain corporations has sacrificed the corporate entity itself in order to maintain short-term profitability and share values. Individual shareholders and institutional investors are now playing a far more active role in pressuring boards to consider long-term value. Until recently, individual investors had little means of monitoring a company's performance other than the occasional report in the media or the annual financial reports that public companies were legally bound to provide.

Today, many nations are experiencing the rise of investor education and investor mobilization. Through the Internet, individual investors are now able to access a vast array of information, not only on the financial results of most public companies but also on upcoming annual meetings, on the issues being addressed, and on how institutional investors are planning to vote. Investors are now voting online at annual meetings of companies that allow such practice. The Internet has empowered small investors—who can now make their voices heard—to communicate with other investors, present their points of view, and influence decisions. Contacting other shareholders is inexpensive and rapid. New Web sites are created regularly for investors to exchange information and strategies about publicly traded companies. A number of sites now offer information that can help individual investors decide whether to renew a director's term of service, hire new auditors, or change management's compensation. Individual investors are now forcing public companies to change the way they deal with their shareholders. Companies must now consider even small investors in their communication strategy, as well as in their governance policies.

The Internet has spurred a movement to make corporations more transparent. The rise of this new, better informed class of investors is forcing companies to comply with what is publicly perceived as ethical governance behavior. The increase in class action lawsuits initiated by unsatisfied shareholders is another way to make management and boards more accountable. Companies have been sued for releasing financial statements that were false or misleading or even for questionable management decisions that affect share prices, such as those related to mergers, acquisitions, and takeovers.

Unlike individual investors, institutional investors often take such large positions in companies that they cannot just sell the stock when they are concerned with the way management operates, since this could drive the stock price down considerably, hence affecting their returns. Consequently, their most effective way of affecting the performance of their investment is to take an active role in influencing the management of the company. A key mechanism for such influence consists of more open and transparent governance structures and policies.

Today, American, Canadian, and European institutional investors are pressuring large domestic and foreign companies (and, increasingly, midsize and small companies) into electing directors who are independent from management and who have a diverse portfolio of experiences and competencies to fulfill the board's new responsibilities. Their actions have played a role in the gradual disappearance of the "old boys' network" approach of selecting directors and helped replace them with independent, value-adding, competent members that constitute a stronger and broader portfolio of skills. As enterprises become more international, boards of directors will also be modified to include qualified individuals who represent both the new, large shareholder blocks and all parts of the MNE's operations. More diverse representation will bring more objectivity to the board table, as well as international experience and a network of contacts that can enrich the board's contribution to company decisions.

The rise of the Internet, the growth of institutional investors and the intensified pressures of international competitiveness are doing a great deal to change the form and function of boards. The impacts of these three influences are far-reaching, affecting the composition of boards, their responsibilities, the way they function, and the compensation and time commitment of directors. In this new corporate governance paradigm, questions remain about how to ensure the right "balancing of power" between mammoth institutional investors, Internet-enabled individual investors, company management, the public, and each stakeholder's agenda, be it the maximization of shareholder value or responses to social or environmental concerns. It is in this "balancing of power"—particularly in the context of an ethical analysis of short-term versus long-term shareholder-value maximization—that boards are playing a new, powerful role in corporate governance.

Apart from the firm's own ethical code and internal organization, a firm's supplier relationships can create difficult CSR challenges. Decisions within supplier organizations can lead the firm indirectly to inappropriate management practices. In the 1980s and 1990s, the Mexico-U.S. border region became severely degraded because a series of realities outside the manufacturing firms limited the MNE's scope of responsible environmental behavior. This case illustrates the complexity of managing change within Mexico's laws and enforcement agencies, within Mexico's cultural norms and values, and within all of the organizations that supply goods or services to the MNE.

In Practice 3.1 Environmental Degradation: The Result of Corruption and Fraud and Deficiencies in Ethics and CSR

One example of the difficult nature of multination negotiation over environmental problems is the situation that has been observed along the Mexico-U.S. border. As a result of incentives created through multilateral trade agreements, it is economically advantageous for American companies to assemble products in the border region of Mexico. The result of the increased manufacturing activity in Mexico has been the production of significant volumes of hazardous waste. This waste was supposed to be returned to the United States for safe disposal, however, this has not been what has evolved over time.

Hazardous waste has not been adequately stored and has leaked into the groundwater, affecting both Mexicans and Americans. The reasons for this are numerous. First, although Mexico does have stringent environmental regulation, the implementation and monitoring of the adherence to these regulations is, at best, lax. Fines for noncompliance are often significantly less than the costs of adhering to the regulations. The economic benefit these American factories provide the people of Mexico makes it undesirable for the Mexican government to come down hard on Americans who have violated the regulations. To lose investment in these regions would risk putting a great number of Mexican workers into poverty. Second, the legal system in Mexico does not hold the offending parties responsible for their actions. Individual lawsuits brought against companies for environmental damage are rare, and class-action lawsuits are virtually nonexistent. Mexican companies contract with trucking services to dispose of hazardous waste but are not held liable if those contractors dump the hazardous material inappropriately. Given the costs involved with appropriate disposal, it is only reasonable for these contractors to disregard regulations and use illegal dumping locations.

The problem of American-owned Mexican factories polluting the environment would, at first glance, appear to be solely within Mexican control. However, the United States is also impacted in a number of ways. First, its companies are responsible for much of the pollution problem. So long as it is cheaper to produce in Mexico because it is less costly than adhering to U.S. environmental standards, the U.S. companies will continue to contribute to the problem. Second, and most pressing, is that the health of U.S. residents has been placed in jeopardy as a result of the Mexican pollution seeping into the groundwater that eventually flows into U.S. soil. The incidence of birth defects in Texas has increased drastically in the past few decades, and this increase has been attributed to the pollution produced in the Mexican border regions.

The Chilpancinco settlement in Tijuana sits in the shadow of Otay Mesa, on top of which sprawl dozens of the city's *maquiladora* factories, on the California-Mexico border. Many of them are owned by U.S. corporations, including a now closed battery recycling plant. A white chemical crust rims the clods of dirt in the field outside the plant, and pools of strange, yellow water dot the barren landscape.

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Lead and heavy metal deposits have been measured in the soil on the mesa at concentrations 40,000 times over safe levels. In this unincorporated settlement, or *colonia*, 6 babies were reported born without brains in 1993, and 13 in 1994, just one of several clusters of this rare birth defect, called anencephaly, on the border.

Contrary to what was often portrayed in the public press, solutions to the pollution problem in the border region were neither obvious nor easy to implement. Many economists argued that it was misplaced for a developing country like Mexico to implement U.S. and Canadian-level environment standards. In fact, the chief economist for the World Bank, Lawrence Summers, had written an internal memo (subsequently leaked to the press) stating that "the economic logic behind dumping a load of toxic waste in the lowest wage country is impeccable." According to this view, environmental consciousness, along with greater enforcement of environmental laws, should—and surely would—follow Mexico's long march out of poverty toward economic prosperity. To environmental groups, such arguments were misconceived and ignored both the very real costs of the pollution hazards for those living in the region, as well as the long-term costs of a badly degraded natural environment.

Based on U.S. legislation, Mexican environmental laws and regulations were relatively strict. Where Mexico and the United States diverged in terms of environmental legislation was mostly in areas that were only secondarily related to the environment, such as so-called "right to know laws" and provisions for civil liability. For example, companies in Mexico were not required to make public the nature of their manufacturing activities to interest groups or the general public. Even when individuals or groups were able to collect evidence of damages caused to them by a polluting company, the Mexican legal system did not provide an adequate opportunity to seek restitution. Multimillion-dollar class-action settlements were nonexistent in Mexico.

Most of the criticism surrounding Mexico's environmental record was aimed at the country's ability to enforce the legislation already in place. Fears of lax enforcement were, in fact, central to the so-called "pollution haven hypothesis"—the notion that free trade would precipitate a race to the bottom in environmental standards as countries competed for foreign investment.

The controversy over the environmental impact of NAFTA (North American Free Trade Agreement) led the Clinton administration to negotiate a parallel side agreement pertaining to the environment. The agreement established several bodies designed to deal with environmental issues and to investigate "persistent patterns of failure to effectively enforce (a country's) environmental law."

Despite claims that NAFTA was the "greatest trade agreement in history," its environmental provisions had been criticized on several accounts. First, environmentalists complained that the dispute resolution process was secretive, exclusive, and lacked provisions for enforcement. No apparent means existed for public comment

on environmental matters presented before NAFTA panels. A second complaint was with the burden of proof provisions, which required the challenging party to establish that the sanitary (health) or phytosanitary (plant health) measure in question is inconsistent with or in violation of NAFTA. In addition, no specific trade sanctions were provided as a means to combat noncompliance with the provisions of either NAFTA or the side agreement on the environment. Moreover, the sanctions specified under NAFTA were considered to be unenforceable and too complex to be of much use.

SOURCE: Frost, Campbell, and Eaton (1997).

Critical Thinking Questions

1. What are the ethical and CSR obligations of an MNE investing in the U.S.-Mexico border region? Do these obligations extend to supervision of companies that transport their hazardous wastes?
2. How can a head office monitor the environmental impacts of its subsidiary and supply chain in Tijuana? How can a head office enforce its environmental standards?
3. Are new international agreements and international enforcement mechanisms necessary in order to deal effectively with such social issues?

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