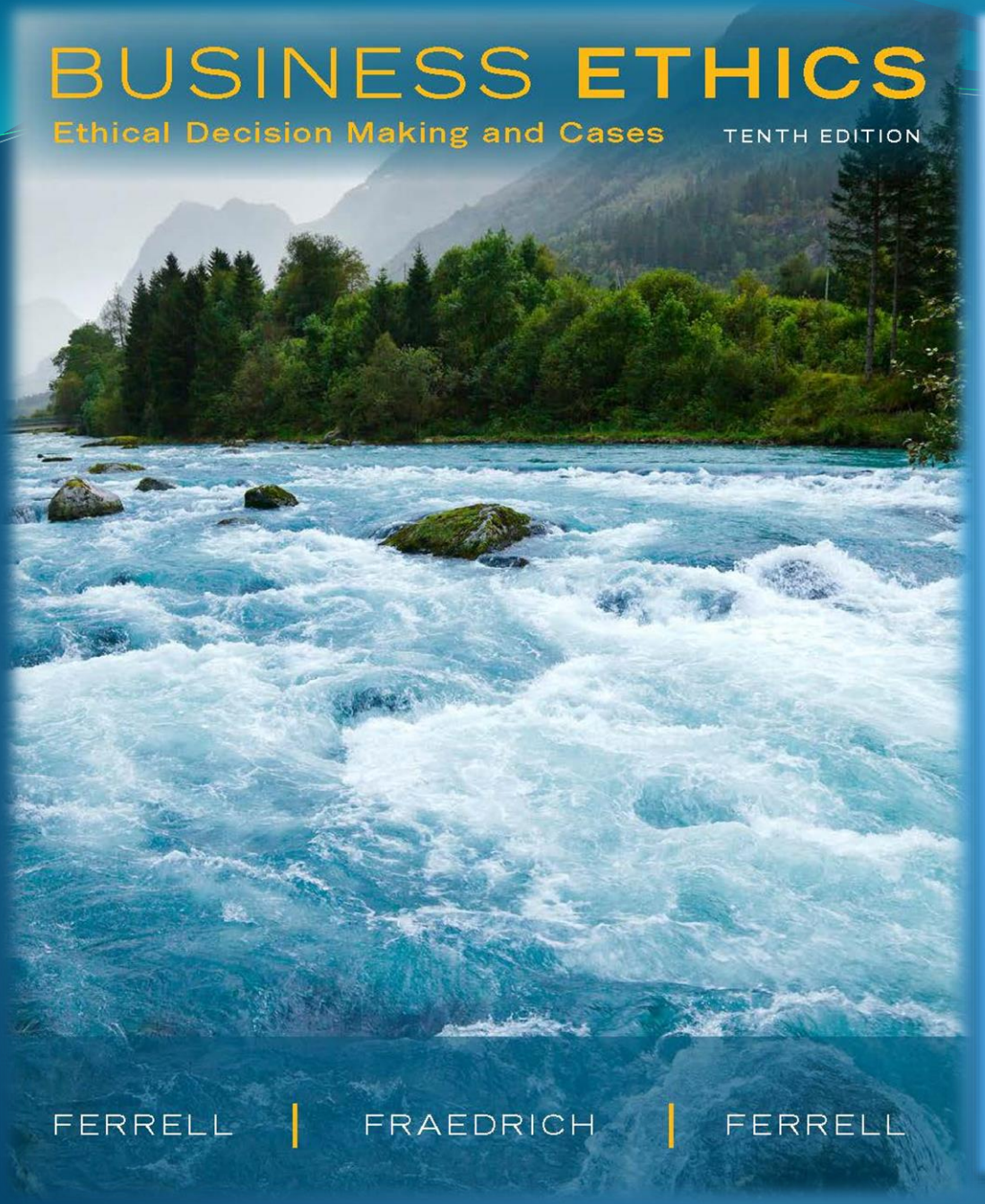


Part One
An Overview of Business Ethics

Chapter 2
Stakeholder Relationships, Social Responsibility and Corporate Governance

Relationships and Business

Building effective relationships is one of the most important areas of business today

- *Business ethics is a team sport and few decisions are made by only one individual*

- **Stakeholder framework**
  - *Helps identify internal and external stakeholders*
  - *Helps monitor and respond to needs, values, and expectations of stakeholder groups*
- **Corporate governance**
  - *The formal system of accountability and control of ethical and socially responsible behavior*

Stakeholders Define Ethical Issues in Business

- **Stakeholders:** Those who have a stake or claim in some aspect of a company's products, operations, markets, industry, and outcomes
- *Customers* *Investors*
- *Employees* *Suppliers*
- *Government agencies* *Communities*
- **The relationship between companies and their stakeholders is a two-way street**

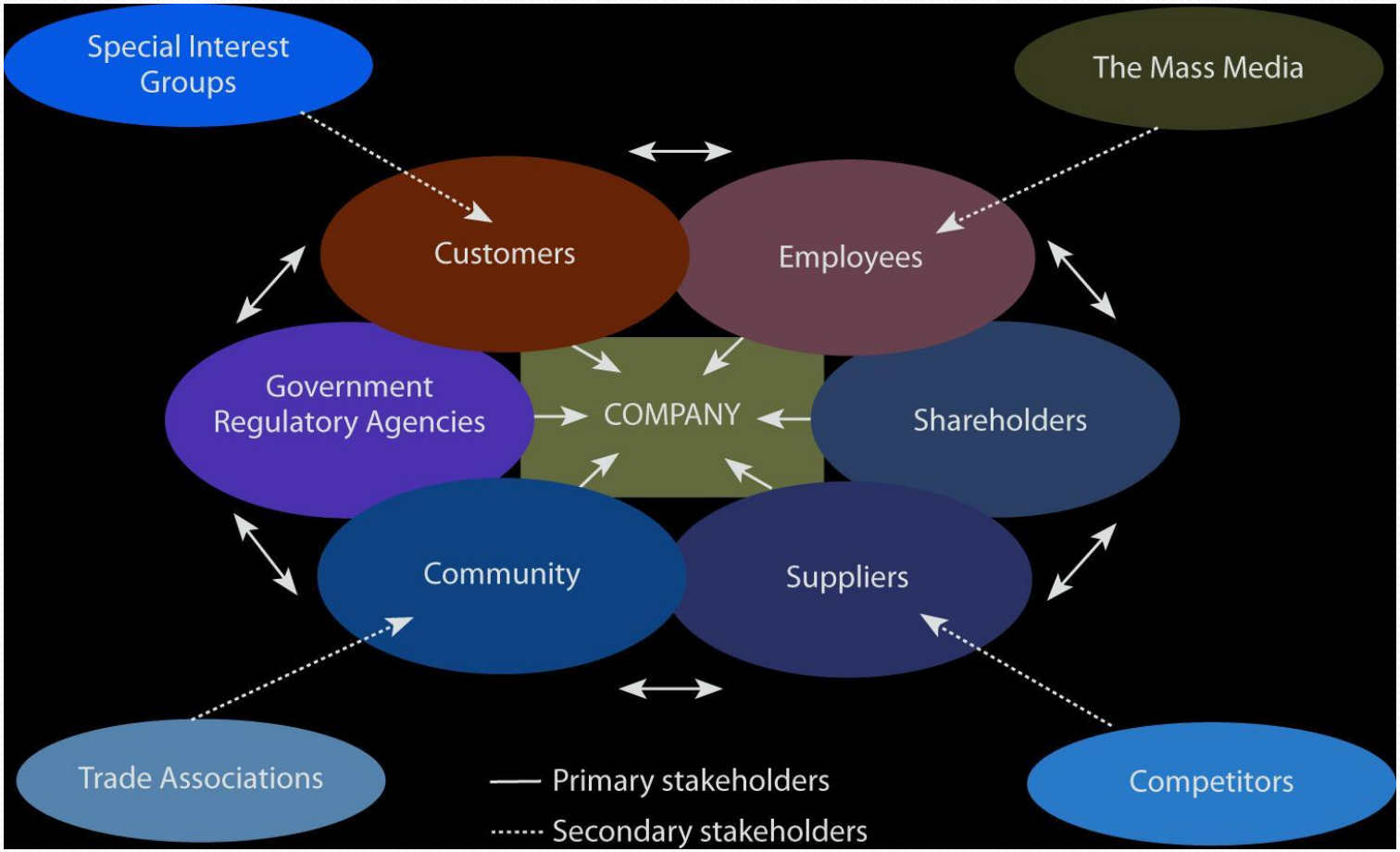
Stakeholder Theory

- Three approaches to stakeholder theory
  - Normative
    - *Principles and values help identify ethical guidelines that dictate how to treat stakeholders*
  - Descriptive
    - *Focuses on actual behavior, addressing decisions and strategies in stakeholder relationships*
  - Instrumental
    - *Examines stakeholder relationships and describes outcomes for particular behaviors*

Identifying Stakeholders

- **Primary stakeholders**: those whose continued association is absolutely necessary for a firm's survival
  - *Employees, customers, investors, governments, and communities*
- **Secondary stakeholders**: do not typically engage in transactions with the firm and are not essential to a firm's survival
  - *Media, trade associations, and special interest groups*

The Stakeholder Interaction Model



Source: Adapted from Isabelle Maignan, O. C. Ferrell, and Linda Ferrell, "A Stakeholder Model for Implementing Social Responsibility in Marketing." *European Journal of Marketing 39 (2005): 956–977. Used with permission.*

A Stakeholder Orientation

- The degree to which a firm understands and addresses stakeholder demands
- Involves activities that facilitate and maintain value with stakeholders
  - *Generation of data about stakeholder groups*
  - *Distribution of that information*
  - *Responsiveness of the organization as a whole*

Social Responsibility

- An organization's obligation to maximize its positive impact on stakeholders and minimize its negative impact
- **Four levels of social responsibility**
  - *Economic*
  - *Legal*
  - *Ethical*
  - *Philanthropic*

The Steps of Social Responsibility

Source: Adapted from Archie B. Carroll, "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders," *Business Horizons (July–August 1991): 42, Fig. 3.*

Corporate Citizenship

- The extent to which businesses strategically meet their economic, legal, ethical, and philanthropic responsibilities
- **Four interrelated dimensions**
  - *Strong sustained economic performance*
  - *Rigorous compliance*
  - *Ethical actions beyond what is legally required*
  - *Voluntary contributions to advance reputation and stakeholder commitment*

The World's Most Ethical Companies

L'ORÉAL	Petco
Xerox	Kellogg Company
OfficeMax	Starbucks
Cummins, Inc.	Target
Ford Motor Company	Salesforce.com, Inc.
General Electric	T-Mobile USA
PepsiCo	Hasbro
Whole Foods Market	Microsoft Corporation
Aflac	ARAMARK

Source: Ethisphere Institute, "2013 World's Most Ethical Companies," *Ethisphere*, http://m1.ethisphere.com/wme2013/index.html (accessed March 7, 2013).

Reputation

- **Reputation** is one of an organization's greatest intangible assets with tangible value
  - Difficult to quantify but very important
  - A single negative incident can influence an organization's image and reputation instantly and for years afterwards

Social Responsibility Issues

- Social
  - *Deals with concerns that affect the welfare of our entire society, associated with the common good*
- Consumer Protection
  - *The company has the responsibility of taking precautions to prevent consumer harm*
- Sustainability
  - *Businesses can no longer afford to ignore the natural environment as a stakeholder*
- Corporate Governance
  - *Research shows corporate governance has a strong positive relationship with social responsibility*

Social Responsibility and Stakeholder Orientation

- Caring about stakeholders can lead to increased profits
  - The purpose of a stakeholder orientation is to maximize positive outcomes that meet stakeholder's needs
  - Stakeholders support companies they perceive to be socially responsible, enhancing profitability

Best Corporate Citizens

1.	**Bristol-Myers Squibb**
2.	International Business Machines Corp.
3.	Intel Corp.
4.	Microsoft Corporation
5.	Johnson Controls Inc.
6.	Accenture plc
7.	Spectra Energy Corp.
8.	Campbell Soup Co.
9.	Nike, Inc.
10.	Freeport-McMoran Copper & Gold Inc.

Source: *CR's 100 Best Corporate Citizens 2012 , http://www.thecro.com/files/100Best2012_List_3.8.pdf* (accessed February 14, 2013).

Corporate Governance

- Formal systems of accountability, oversight, and control
  - **Accountability**
    - *How closely workplace decisions align with a firm's strategic direction*
  - **Oversight**
    - *A system of checks and balances to minimize opportunities for misconduct*
  - **Control**
    - *The process of auditing and improving organizational decisions and actions*

Corporate Governance Topics

Executive Compensation
Enterprise-Wide Risk Management
Short- and Long-Term Strategies
Board Composition and Structure
Shareholder Relations
CEO Selection, Termination, and Succession Plans
Role of the CEO in Board Decisions
Auditing, Control, and Integrity of Financial Reporting
Compliance with Government Regulation and Reform
Organizational Ethics Programs

Source: "Corporate Alert: Top 10 Topics for Directors in 2011," December 6, 2010, http://www.corpgov.deloitte.com/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/USEng/Documents/Board%20Governance/Top%2010%20Topics%20for%20Directors%20in%202011_Akin_120610.pdf (accessed February 15, 2011).

Changes in Corporate Governance

40 % of boards split the CEO and Chair functions
Boards are getting smaller, with an average of 11 members (5 : 1 ratio independent: non-independent)
74 % of boards have mandatory retirement rules for directors
Almost all boards conduct annual board performance evaluations
71 % limit the time that board members can serve on outside boards
21 % of new directors are women, although 10 % of boards have no women directors
Over 50 % of CEOs in the S&P 500 do not serve on outside boards
Important characteristics in directors: strong financial background, industry background, and international experience
Average board member retainer: $ 20,00 in 1986 ($ 40,000 in today's dollars) and $ 80,000 in 2010
Average total director compensation has risen to $ 215,000 in 2010

Source: Julie Hembrock Daum, "How Corporate Governance Changed from 1986–2010," *Business Week* , *http://www.businessweek.com/managing*/content/nov2010/ca2010118_316346.htm (accessed April 2, 2013).

Views of Corporate Governance

- **Shareholder model**
  - *Founded in classic economic precepts*
  - *Maximizing wealth for investors and owners*
- **Stakeholder model**
  - *A broader view of the purpose of business*
  - *Includes satisfying concerns of primary stakeholders including employees, suppliers, regulators, communities and special interest groups*

Role of Board of Directors

- Holds final responsibility for its firm's success, failure, and ethicality of actions
  - The global financial crisis motivated many to demand greater accountability from boards
  - In reality, boards rarely manage but instead monitor executive decisions
  - Executive compensation is a growing ethical concern

Demands for Accountability and Transparency

- Stakeholders demand that boards are accountable and transparent
  - Directors offer expertise, competence, and diverse perspectives to strategic decisions
  - Qualified, knowledgeable, diverse, unbiased boards can prevent misconduct
- **Interlocking directorate** is the concept of board members being linked to more than one company

Executive Compensation

- Many boards spend more time discussing compensation than ensuring integrity of financial reporting systems
  - How closely linked is executive compensation to company performance?
  - Does performance-linked compensation encourage executives to focus on short-term performance at the expense of long-term growth?

Implementing a Stakeholder Perspective

1. Assessing the corporate culture
2. Identifying stakeholder groups
3. Identifying stakeholder issues
4. Assessing organizational commitment to social responsibility
5. Identifying resources and determining urgency
6. Gaining stakeholder feedback