Corporate Social Performance: Ethics and Corporate Culture

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I. INTRODUCTION

Frauds in corporate behavior have become so commonplace that some news outlets have been posting scandal sheets documenting the status of the extensive fraud in business.1 Cases found in popular business ethics texts have changed emphasis from product safety, safeguarding the environment, and marketing irregularities to issues of corporate governance, financial reporting, improper influence of public officials, and accounting fraud.2 Examples of major ethical scandals have been observed in such major businesses as Arthur Andersen

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Accounting, Enron, Global Crossing, Sunbeam, Waste Management, WorldCom, and Qwest. The examples shown in Table 1 suggest the common theme of fraudulently overstating income in order to increase stock prices and executive compensation, and to obtain equity funding for strategic initiatives.

This article offers a model for analyzing business social performance, a framework for considering the mechanisms of business control that are available to society, and some suggestions concerning how to improve the ethics of corporate conduct. Ethical corporate behavior would cause managers to avoid exploitation in pursuing corporate strategy and to avoid excesses when seeking to influence public policy through social issues management and public affairs activities. Ethics enables managers to go beyond profits when considering corporate performance.

The key concepts of business social performance include competitiveness, responsibility, legality[,] and legitimacy. These concepts parallel the four questions outlined [below]. Economic performance requires competitiveness; ethical performance requires responsibility in seeking to do what is right; legality requires compliance with the laws and regulations that apply to the business situation; and legitimacy requires sensitivity to the political context of the situation so that the political and social support necessary for a favorable business environment can be maintained.10

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3. Id. at 281-89.


**TABLE 1: SELECTED CORPORATE FRAUD CASES**

<table>
<thead>
<tr>
<th>Company</th>
<th>Period</th>
<th>Nature of Scandal</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arthur Andersen Accounting</td>
<td>1999-2005</td>
<td>Served as auditor and consultant to businesses and allowed questionable accounting and fraudulent financial statements. Bankruptcy of client firms and Andersen.</td>
<td>Used strategy of rewarding executives to increase revenue rather than quality audits. This led to increased priority of consulting services and undermined the quality of independent audits.</td>
</tr>
<tr>
<td>Enron</td>
<td>2000-2003</td>
<td>Used mark to market accounting inflated earnings. Special business entities concealed fraud leading to bankruptcy.</td>
<td>Financial statement fraud inflated earnings, raised stock prices, and profited executives who had stock options in compensation package. Andersen Accounting was the CPA.</td>
</tr>
<tr>
<td>Global Crossing</td>
<td>1997-2003</td>
<td>Accounting fraud inflated reported earnings leading to bankruptcy.</td>
<td>Fraudulent accounting statements increased stock prices, which enriched compensation of executives and bankrupted the company.</td>
</tr>
<tr>
<td>Sunbeam</td>
<td>1996-2001</td>
<td>Accounting fraud inflated reported earnings which led to bankruptcy.</td>
<td>Conglomerate acquisition and turnaround initially yielded high income. Fraud used to maintain appearance of high earnings.</td>
</tr>
<tr>
<td>Waste Management</td>
<td>1999-2002</td>
<td>Failed merger and overstatement of earnings by $1.4 billion which led to investor loss of over $20.5 billion and 11,000 employee lay-offs.</td>
<td>Andersen Accounting received special consulting projects for “cooperation” with financial statements.</td>
</tr>
<tr>
<td>WorldCom</td>
<td>2000-2002</td>
<td>Accounting practice to capitalize expenses and inflate income by some $12 billion.</td>
<td>Inflated earnings statements from accounting fraud inflated stock price to allow stock swap funding of conglomerate acquisitions.</td>
</tr>
</tbody>
</table>

11. *See supra* notes 3-9 (providing information about the various scandals incorporated into the table).

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II. CORPORATE SOCIAL PERFORMANCE

The four dimensions of corporate social performance (CSP) are concerned with four key questions:

1. Economic Performance: Is it profitable?
2. Ethical Performance: Is it responsible?
3. Legal Performance: Is it legal?
4. Political Performance: Will it maintain our legitimacy?\(^\text{12}\)

High performance involves developing and achieving goals along all four dimensions of CSP.\(^\text{13}\) Most of the scandals listed in Table 1 note major businesses with poor economic performance covered up by unethical behavior so that the financial investors would be unaware of the performance problem. For example, WorldCom was able to inflate its stock price through capitalizing its expenses in violation of accounting principles to finance the acquisition of other companies via stock swaps.\(^\text{14}\) The company was operating at a loss or with very small profits while reporting high profit levels.\(^\text{15}\) Stock prices normally reflect levels of actual and expected profitability. WorldCom was able to use the artificially high stock price to trade its shares and to buy MCI and other companies.\(^\text{16}\) In the end, the scheme was discovered, WorldCom ended in bankruptcy, and its executives were prosecuted for fraud.\(^\text{17}\) The legitimacy of corporate business dropped so low due to the Enron and WorldCom controversies that a major legal reform, the Sarbanes-Oxley Act, was enacted in corporate governance.\(^\text{18}\)

Enron began with a sound business model of creating stability in energy markets using its resources and capabilities. When Jeffrey Skilling joined Enron as CEO, he expanded the business model to include trading in over 1,500 commodity markets where the business model was not workable.\(^\text{19}\) Enron management used fraudulent accounting practices overlooked by Arthur Andersen; used social issues management to successfully obtain exceptions to

\(^{12}\) See Peery, supra note 10, at 8.

\(^{13}\) See id. at 9.


\(^{15}\) Id. at 2.

\(^{16}\) See generally Benston et al., supra note 14.

\(^{17}\) See id.


regulations from three key government oversight agencies; and overstated its earnings to maintain high stock prices. The cash flow from stock sales at inflated prices funded acquisitions and millions of dollars in management bonuses. Enron enjoyed a high level of legitimacy and was regularly selected in *Fortune* magazine as one of the most respected U.S. companies.\(^{20}\) In the end, Enron’s executives were found guilty of crimes, the company went bankrupt, and its legitimacy evaporated. Unfortunately, in the cases of WorldCom and Enron, investors lost millions of dollars and thousands of employees lost their jobs and retirement.\(^{21}\)

Archie Carroll developed a hierarchy of social responsibility founded on sound economic performance, and supported compliance with the law and regulations, ethical corporate conduct, and philanthropy as resources permitted.\(^{22}\) The foundation for responsible performance is sound economic performance within the activities allowed by laws and regulations. Executives often have substantial leeway in decisions and can use their moral imagination to improve the ethics or justice in any given situation.\(^{23}\) “Answering the four basic questions . . . of social performance is somewhat complex and requires considerable skill”\(^{24}\) in establishing priorities, weighing tradeoffs, and ultimately deciding what is best for stakeholders. There may be conflict among the four competing dimensions: “alternatives developed by managers [may] score high on some dimensions but unacceptably low in others. The high-performing manager[s] need[] to grapple with all four dimensions and strive to find imaginative approaches” that are high in social performance and “fulfill[] the mission of the organization.”\(^{25}\)

**A. Economic Performance and Competitiveness**

Competitiveness requires economic performance based upon a superior, distinctive competence relative to other firms within an industry.\(^{26}\) Business-level “[c]ompetitive strategy . . . can be based on low costs and low prices, differentiation of products, or focus[ed] on a well-defined customer [niche].

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25. Id.

Competitive pricing is usually based on some cost advantage” in the value chain based upon superior efficiency of the business.  

Theoretically, if a business does not have a competitive value chain and sells its output below its costs, the losses will prohibit the continued use of low prices. However, if accounting fraud is involved, as in the cases of WorldCom or Enron, cost structures are temporarily unknown to investors, who continue to provide funding of operations until the financial community knows the truth of a poor business model.

Differentiation strategies are based upon “a unique feature or characteristic that makes a business’s product or service more desirable to the customer and [provides] a basis for sustainable competitive advantage. Thus, competition is also based on differentiation that customers use as a criterion other than price to select a good or service over alternatives.”

Arthur Andersen was a well-known accounting partnership that differentiated itself through high-quality audits, consulting services, and a reputation for integrity. It changed its strategic objective to a fast-growth, high market-share operation and decentralized its operations. An accounting firm’s ability to increase market share depends on its ability to retain large clients. Without oversight and high pressure for growth, regional managers allowed questionable practices of client firms to go unchallenged, and Arthur Andersen lost its key basis of differentiation. These questionable practices led to an indictment by the Securities and Exchange Commission (SEC), and though Andersen Accounting was not found guilty of the obstruction of justice on appeal, the loss of differentiation and legitimacy led to the ultimate failure of its business.

A focus strategy requires that a business specialize in satisfying the needs of customers in a more narrowly defined group, market segment, or target market. “This targeted market may be users of a specialized product line within a specific geographic region [so] that” a firm may serve better than its competitors on the basis of lower costs or differentiation.

Some have questioned whether the broader construct of corporate social performance is consistent with high levels of financial performance. Between 1972 and 2002, there were 127 published studies of the empirical relationship between high CSR corporations and financial performance. Most studies found

27. Peery, supra note 10, at 10.
29. Peery, supra note 10, at 10.
31. FERRELL ET AL., supra note 2, at 281-89.
32. See Peery, supra note 10, at 10.
33. Id.
a positive relationship.

Institutional investors own some sixty percent of publicly traded stock in the United States, and these investors seem to value high CSR behavior. There is a positive relationship between the CSR level of publicly traded companies and the number of institutional investors holding corporate stock in such companies. In another study of the value of corporations in the chemical industry, researchers found that a ten percent drop in emissions of toxic waste increased the market capitalization valuation of a single company by $34 million. CSR, as measured by the percent of women on boards of directors, has also been found to increase with the percent of institutional investors in publicly traded companies.

B. Ethical Performance and Responsibility

“The second major dimension of business social performance is responsibility, which is concerned with the ethical performance of the enterprise. It relates to the questions What is right? and What is good?”

“Ethical analysis is concerned with the process of making judgments about the moral correctness of a decision. There are many different approaches to ethics, including utilitarianism, rights and duties, . . . justice,” ethical egoism, and the ethics of caring. Ethical egoism is based upon individual self-interest and is different from psychological egoism that can be characterized by a person who is boastful, arrogant, and self-absorbed. The ethical egoist exercises prudence, due diligence, and self-interest to maximize career outcomes.

Utilitarianism “focuses on the value of consequences or outcomes of a decision [or policy]. According to this approach, a decision is ethical if the results yield the greatest happiness to society.”

“In business decisions, utilitarianism takes the form of cost-benefit analysis” to see if the costs of a decision outweigh the benefits. Corporate utilitarianism focuses on profit maximization for the corporation and does not necessarily apply calculations to wider society. A major criticism of such corporate utilitarianism is that “the end...
is used to justify the means” and the means to goal accomplishment might involve violating the rights of some stakeholders. “If something is not economically worthwhile [to the corporation], then a manager is likely to consider it as unethical on the basis of [corporate utilitarian analysis].”\textsuperscript{45}

Another approach to ethical analysis is “concerned with whether an action is inherently right or wrong regardless of its results.”\textsuperscript{46} For example, it might be wrong for an entrepreneur to inflate profit expectations to obtain venture capital to launch a new but risky innovative technology. More clearly unethical would be to misstate financial statements to achieve false profits to inflate stock price and market capitalization for the purpose of obtaining funds for strategic initiatives and to disburse stock options in an executive compensation package. More justifiable might be to exaggerate feedback to a job candidate so she would have increased confidence during an interview.\textsuperscript{47} A friend considering only consequences might tell a person going into a job interview that he or she looks “great” even if that did not seem to be true. A person might justify a lie in this case because of the positive effect a word of encouragement might have on the applicant. Others [would] argue that it is never ethical to be untruthful.\textsuperscript{48}

A legal right is an entitlement, such as a property right, the right of self-expression, or the right to be accurately informed by a financial statement sanctioned and defined by laws and regulations. A moral right sanctioned by a philosophy may also be a claimed right in the public policy process. Different types of rights have different ethical and legal statuses. For example, a right to a minimum wage may be grounded in a philosophy of justice but does not become a legal right until it is sanctioned by law after it is debated in the public policy process. According to the rights or justice approach to ethical reasoning, “it is inherently unethical [or illegal] to violate the rights of another.”\textsuperscript{49} However, “many [moral and claimed] rights are debatable” when they are not legally sanctioned.\textsuperscript{50} “[S]ometimes one right contradicts other rights.”\textsuperscript{51} For example, an employee might oppose drug testing based upon the concept of privacy rights, while an employer might support drug testing based upon the right to a safe work environment.

“Typically rights are counterbalanced by duties. A duty is a legal or moral responsibility to honor the rights of another person.”\textsuperscript{52}

\begin{itemize}
    \item 45. \textit{Id.}
    \item 46. \textit{Id.}
    \item 47. \textit{Id.}
    \item 48. \textit{Id.}
    \item 49. \textit{Id.}
    \item 50. \textit{Id.}
    \item 51. \textit{Id.}
    \item 52. \textit{Id.} (emphasis omitted).
\end{itemize}
has a right to know of workplace danger that is counterbalanced by the employer’s duty to provide information about such dangers. The duties to be truthful, to keep confidences, and to avoid harming persons parallel the rights to be informed, to privacy, and to have a safe work environment. These rights have been established as public policy and are enforced by government regulatory agencies. As is the case with rights, “sometimes one duty contradicts another” leading to an ethical dilemma that must be resolved during the management process.

C. Stakeholder Theory

A stakeholder is defined as “any group or individual who can affect or is affected by the achievement of the organization’s objectives.” Some have argued that consideration of corporate stakeholders is an ethical theory of social responsibility. General categories of stakeholders include stockholders, employees, customers, the government, and the community. “Economic justice is concerned with the fairness with which benefits and burdens . . . are distributed within a society or among organizational stakeholders.” For example, high executive compensation has been questioned on these grounds. Employees as stakeholders are concerned not only with what rewards they receive but with procedural justice, that is, the due process by which such judgments are made. Stakeholders have been classified based upon the amount of power they could potentially wield, the legitimacy of their claim, and the urgency of their claim. Managers should also consider the consequences of decisions for various stakeholder groups outside the organization. Theorists have argued that the theory of stakeholders is focused on business decisions and should not be used as a model for society.

Stakeholders have been classified based upon the amount of power they could potentially wield, the legitimacy of their claim, and the urgency of their

53. Id. (“It can be argued that one has a moral duty to tell the truth, to keep confidences, and to avoid harming others.”).
54. Id.
55. R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 46 (1984); see also PEERY, supra note 10, at 12.
56. See, e.g., ROBERT PHILLIPS, STAKEHOLDER THEORY AND ORGANIZATIONAL ETHICS (2003); Bruce Langtry, Stakeholders and the Moral Responsibilities of Business, 4 BUS. ETHICS Q. 431, 441 (1994); Robert A. Phillips, Stakeholder Theory and A Principle of Fairness, 7 BUS. ETHICS Q. 51, 63-65 (1997); see also PEERY, supra note 10, at 12.
57. PEERY, supra note 10, at 12.
need in the situation.\(^{61}\) Table 2 uses these dimensions to develop a classification scheme for stakeholders.\(^{62}\) Stakeholders high in salience, that is, high in executive priority in a decision process, would score high in power, legitimacy, or urgency. Such stakeholders could be classified as definitive, dominant, or dependent based upon these three dimensions. A stakeholder with low legitimacy and urgency but high power might be considered dangerous by executives because they could use their power to disrupt corporate plans. Lower priority stakeholders would have lower legitimacy, lower power, or less urgent claims.

Do corporate CEOs consider these types of stakeholders when making decisions?\(^{63}\) Agle, Mitchell, and Sonnenfeld analyzed questionnaires from eighty CEOs of large corporations with revenues ranging from $90 million to $61 billion with an average of $6.2 billion and a median value of $3 billion.\(^{64}\) The study investigated the “relationships among the stakeholder attributes of power, legitimacy, urgency, and [the] salience,” that is, the priority that a CEO gives to a stakeholder.\(^{65}\) The priority afforded concerns of shareholders in each category (e.g., shareholders, employees, customers, the government, and the community) were all found to be positively and significantly related to the power, legitimacy, and urgency found within each stakeholder type.\(^{66}\)

<table>
<thead>
<tr>
<th>Stakeholder Type</th>
<th>Access to Power and Resources</th>
<th>Legitimacy of Claim</th>
<th>Urgency of Need or Perceived Need</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitive</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Dominant</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Dependent</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Dangerous</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Dormant</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Discretionary</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Demanding</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Non-Stakeholder</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>


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64. Id. at 513.
65. Id. at 507.
66. Id. at 520.
D. Legal Performance and Compliance with Laws and Regulations

Legality is defined as compliance with the laws and regulations of society. Businesses must comply with the laws passed at the local, state, and federal levels [in the global jurisdictions where they do business]. Managers must also obey international treaties and comply with the laws of the countries in which they do business. . . . [S]ocial performance requires obeying the laws of the land.67

The legitimacy of a stakeholder claim might be influenced by its legal standing in a particular case.

Legal performance also requires that organizations be aware of regulations developed by such federal agencies as the Environmental Protection Agency (EPA), the Food and Drug Administration (FDA), the Equal Employment Opportunity Commission (EEOC), the Consumer Products Safety Commission (CPSC), [the SEC,] the Occupational Safety and Health Administration (OSHA), the Internal Revenue Service (IRS), and many other[ ] [agencies at the federal and state levels]. Much of the legal environment of business is concerned with the administrative law of various regulatory agencies that seek to control certain aspects of business behavior.68

E. Political Performance and Legitimacy

Legitimacy is relevant social and political support for business as an institution and for a particular industry or business [practice]. Legitimacy is fundamentally a political, rather than a legal, concept. Through the political process, support is mobilized for a particular value or [public] policy. Business has the authority to operate within the confines of the law and regulatory system. If the public feels that business is acting irresponsibly, the political and social support for business in general or for a particular practice declines. This can set in motion a political process yielding a public policy or law that constrains business behavior.69

The Sarbanes-Oxley Act was a public policy response to declining legitimacy of business. The legislation constrains and requires certain governance

67. PEERY, supra note 10, at 12 (emphasis omitted).
68. Id.
69. Id. at 12-13 (emphasis omitted).
Social Issue Management (SIM) is the process corporations use to identify important social issues, evaluate their potential impact on business, develop objectives, and formulate and implement a strategic response to influence levels of corporate legitimacy in the public policy process. The entertainment industry has used SIM to respond to the controversies of violent content, issues related to content inappropriate for children, and adult material in entertainment. Enron successfully used SIM to obtain regulatory relief from agencies with oversight responsibility over energy, commodities trading, and securities while it engaged in unethical and illegal behavior. Though Enron had a code of ethics, it used legal standards and available regulatory loopholes in its actual decision-making.

SIM begins with monitoring environmental trends to identify developing issues of strategic importance to the corporation. An internal assessment follows to see if the capability profile of the business is sufficient to deal with expected issue demands. Capabilities include strategic resources, contacts and networks, stakeholder constituencies, social goodwill consistent with legitimacy, and information. A number of choices can be developed and then screened for consistency with the four CSP dimensions to determine the best and highest CSP strategic response.

Often SIM is used to develop a political strategy to influence public policy in a manner favorable to corporate interests. A political strategy developed through SIM might include:

1. Lobbying,
2. Grassroots strategies and using constituents,
3. Coalition building,
4. Testimony before legislative committees,
5. Electoral strategies,
6. Communication and public advocacy,

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75. Id. at 87-90.
7. Advising panels, boards, and legislative committees, and
8. Organization and administration for political strategy implementation.

Once a strategic response is developed and implemented, managers need to follow through with the implementation process and monitor the results of the SIM program. The SIM process is dynamic, and the environment, capabilities, nature of the problem, strategic intent, and results of corporate programs change over time. Organizational learning must be used to make needed changes in strategy and adjustments in the implementation of SIM programs. One criticism of SIM is the possible control of the public policy process by the corporation, to the extent that it undermines a free society.77

III. CONTROL OF CORPORATE CONDUCT IN A MARKET-ORIENTED SOCIETY

How does society insure that corporate conduct is consistent with the values of society? Mechanisms for social control can be found in each of the major spheres of threefold society: economic, political-legal, and cultural.

1. The economic sphere emphasizes market competition and corporate strategy;
2. The political-legal sphere emphasizes the public policy process, regulation, law, and litigation and corporate SIM process; and
3. The cultural sphere emphasizes the industrial practices and standards and the ethics of corporate conduct, stakeholder relations, and corporate cultures.

Corporations experience external pressures to bring their conduct into conformity with market forces, public policy, and industry standards and practice. As suggested in Table 3, corporate conduct involves a degree of managerial discretion. The corporation seeks to overcome market forces through competitive strategy and to overcome political and legal forces through its social issues management, moderated by CSP through corporate culture and ethical practice for dealing with external stakeholders’ demands. A key insight suggested in Table 3 is that social responsibility and ethical corporate conduct could be a mechanism for self-control that substitutes for external control by the market and public policy. Ethics might restrain the temptation of strategists to exploit market imperfections that might cause controversies leading to unfavorable laws and regulations. SIM programs designed to maintain public support while also demonstrating responsible, lawful, and ethical corporate behavior.

conduct could be used to make the case for corporate self-control. This is the key promise of CSP.
Laws and regulations of business are normally seen as remedies for corporate abuses and irresponsible or unethical behavior. Ethical corporate conduct has the potential of making laws less necessary. Unfortunately in the case of Enron, executives used SIM and public affairs to champion deregulation and waivers to energy and security regulations to commit abuses. Enron did not have an ethical corporate culture that reinforced society’s trust; rather, it defrauded investors and employees out of billions of dollars while pretending to be an outstanding example of high ethical standards.

### Table 3: Social Controls and Corporate Conduct

<table>
<thead>
<tr>
<th>Economic Sphere</th>
<th>External Control Mechanisms</th>
<th>Corporate Conduct</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Forces of Market Competition</strong></td>
<td><strong>Strategic Management</strong></td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Supply and Demand Conditions</td>
<td>$ \cdot $ Using Corporate Strategy to Seek Competitive Advantage</td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Competitive Market Conditions (number of buyers and sellers, information, and entry barriers)</td>
<td>$ \cdot $ Taking Advantage of Market Imperfections</td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Nature of Competitive Rivalry</td>
<td>$ \cdot $ Applying a Business Model</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Political-Legal Sphere</th>
<th>( \text{Public Policy Process Leading to Laws and Regulations} )</th>
<th>( \text{Social Issues Management} )</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ \cdot $ Agency Enforcement</td>
<td>$ \cdot $ Public Affairs</td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Courts and Litigation</td>
<td>$ \cdot $ Managing Regulatory Agency Relationships</td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Out of Court Settlements</td>
<td>$ \cdot $ Lobbying</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cultural Sphere</th>
<th>( \text{Industry Standards and Practice} )</th>
<th>( \text{Social Responsibility} )</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ \cdot $ Industry Associations and Coalitions</td>
<td>$ \cdot $ Stakeholder Relations</td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Industry Codes of Conduct</td>
<td>$ \cdot $ Corporate Culture</td>
</tr>
<tr>
<td></td>
<td>$ \cdot $ Threats of Interest Group Action like Consumer Boycotts</td>
<td>$ \cdot $ Codes of Conduct</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$ \cdot $ CSR Programs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$ \cdot $ Ethical Behavior</td>
</tr>
</tbody>
</table>

### IV. Market Competition

If markets are competitive, corporations have less discretion; managers and owners must produce only what the market demands at the prices set by the forces of supply and demand. Low levels of market concentration, informed buyers and sellers, and low entry barriers to the marketplace are all conducive to high market competition. Under these circumstances, there would be less need for public policy or ethics because market forces would be sufficient to assure that business does what stakeholders expect or demand. Demands are expressed through choices controlled by market forces.

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The economic theory of industrial organization suggests that competitive markets perform better than noncompetitive ones. Industrial organization theory maintains that competitive markets lead to a higher degree of competitive rivalry among businesses, which leads to more technological innovation, lower price levels and lower profit margins, a greater variety of goods or services for consumers, and higher levels of economic growth. In contrast, markets with insufficient competition are more likely to have anticompetitive behavior, like price fixing, market sharing, and collusion. Such behavior would lead to higher prices, less variety for consumers, reduced levels of technological innovation, and lower economic growth. Reduced industrial rivalry may make markets more attractive to corporations because higher profit margins are available in such markets.

Since markets are not perfectly competitive, corporate managers often have some discretion and can utilize a measure of self-control as they seek competitive advantage. Executive use of strategic management defines the conduct of corporations in the marketplace. Responsible strategic managers are always striving to serve the needs of customers and to outperform their competition. Economists are likely to see the higher profits of business as evidence of market failure and the exploitation of circumstances by the corporation leading to abnormally high returns rather than high social performance. This view leads to lower legitimacy and a public policy that supports anti-trust law.

V. CORPORATE CULTURE AND STAKEHOLDER RELATIONS

A corporate culture can be described as:

1. The employees’ assumptions about the nature of reality;
2. A set of normative, moral, and functional guidelines or criteria for making decisions, called values; and
3. The corporate practices that follow from its assumptions and values.

The assumptions, values, and practices that make up a corporate culture are likely to influence the corporation’s general orientation to the environment, stakeholder relations, and its corporate social performance (CSP).

82. MICHAEL E. PORTER, COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS 3-33 (1980).
83. Jones et al., supra note 62, at 142.
A. Institutional Orientation

Cultural values of executives strongly influence how they respond to nonmarket issues. Institutional orientation is the pattern of response by a corporation to its environment and has been characterized as avoidance, reactive, responsive, or proactive. Institutional orientation is embedded in the corporate culture and is closely associated with the values and particularly the political ideology of top management. Awareness of institutional orientation is important because much of the management approach to nonmarket issues is based upon the assumptions about what the role of business should be in society. The institutional orientation of avoidance is characterized by the view that “the business of business is business” and managers should not be involved in nonmarket matters. The mantra of this corporate culture would be: “Avoid social issues. Exploit market advantages. Use legal delays. Obey the law when it is unavoidable.”

 Corporations with a reactive institutional orientation also ignore social issues unless forced by litigation or by some usually unexpected development in the law or regulations to recognize such issues. Executives in reactive corporations may use litigation strategy to stonewall, delay, or block the demands from external stakeholder groups. These executives would invest in litigation when it is required and attempt to maximize corporate profits while focusing primarily on stockholders and not recognizing the legitimacy of other stakeholder demands.

 Corporations characterized by responsive institutional orientation are managed by proponents of CSR and seek to be a “good corporate citizen” by developing social programs like day care for employees and supporting local cultural activities. Executives are mindful of stakeholder groups beyond stockholders. They use SIM to cooperate with the development of public policy that resolves public problems in a way that least hinders the achievement of corporate objectives.

 Lastly, corporations with a proactive institutional orientation monitor the environment and forecast changes in social expectations, lifestyles, and public policy. The executives of these corporations deploy SIM resources so that the voice of business can be heard in the public policy debates. Executives also try to shape public policy so that it is workable and serves the legitimate interests of business and its stakeholders alike.

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B. Stakeholder Culture

Jones et al. have developed a typology of five stakeholder cultures labeled as agency culture, corporate egoist, instrumentalist, moralist, and altruist. These cultures parallel the institutional orientations outlined above. The cultures begin with the agency culture where managers tend to be individualistic, self-oriented, ethical egoists at one extreme and cultures that are “other-regarding” in their relations to stakeholders at the other extreme. Their typology might offer much insight into our understanding of the ethics of corporate conduct, the inclination for executives to invest in corporate social performance initiatives, and the manner in which stakeholder issues are resolved. A framework based upon the Jones et al. typology is demonstrated in Table 4.

C. Corporate Social Performance and Stakeholder Culture

The conceptual framework for stakeholder cultures offers a number of hypotheses for the ethical conduct of corporations. For example, approaches to CSP will vary depending upon the stakeholder culture of the corporation. First, corporations with corporate egoistic or agency cultures will have a tendency to strive for profit maximization and emphasize reward systems that link profits to stock options in executive compensation packages. Second, firms with instrumentalist stewardship cultures will seek the overall welfare of the corporation and its stockholders. Relations to other groups of stakeholders will depend upon their role in achieving or retarding financial corporate objectives. Executives here will strive for high economic performance of the corporation, perhaps medium legal compliance to maintain good relationships with regulators and threatening stakeholders, and medium ethical performance.

87. Jones et al., supra note 62, at 145.
88. Id. at 142-50.
TABLE 4: STAKEHOLDER CULTURES AND ETHICS OF CORPORATE CONDUCT

<table>
<thead>
<tr>
<th></th>
<th>Corporate Egoistic Agency Culture</th>
<th>Instrumentalist Stewardship Culture</th>
<th>Principled Stakeholder Culture</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institutional Orientation</strong></td>
<td>Reactionary</td>
<td>Proactive</td>
<td>Responsible</td>
</tr>
<tr>
<td><strong>Primary Goal</strong></td>
<td>Maximize profits and executive compensation</td>
<td>Maximize profits and shareholder wealth</td>
<td>Balance benefits to all normative stakeholders</td>
</tr>
<tr>
<td><strong>CSP Priority</strong></td>
<td>Economic: High; Legal: Medium – Resist Low; Political (SIM): Low</td>
<td>Economic: High; Legal: Medium – Comply High; Political (SIM): High – Influence public policy</td>
<td>Economic: High – Medium; Legal: Medium – Cooperate Medium – Cooperate in shaping public policy; Political (SIM): High</td>
</tr>
<tr>
<td><strong>Ethical</strong></td>
<td>Low</td>
<td>Medium</td>
<td>Medium – Cooperate in shaping public policy</td>
</tr>
<tr>
<td><strong>Primary Ethical Framework</strong></td>
<td>Ethical Egoism</td>
<td>Corporate Utilitarianism</td>
<td>Ethics of Caring</td>
</tr>
<tr>
<td><strong>Use of Code of Ethics</strong></td>
<td>To avoid legal liability</td>
<td>To constrain unacceptable behavior</td>
<td>To guide and encourage desired behavior</td>
</tr>
<tr>
<td><strong>Dominant Cultural Values</strong></td>
<td>Alertness, Carefulness, Prudence, Cool-headedness, Cleverness, Aggressiveness</td>
<td>Loyalty, Reliability, Diligence, Dependability, Cooperativeness, Sensibility</td>
<td>Truthfulness, Sincerity, Trustworthiness, Benevolence, Selflessness, Forgiveness, Altruism</td>
</tr>
<tr>
<td><strong>Stakeholder Priority</strong></td>
<td>Care for stockholders and executive interests only</td>
<td>Care for stockholders and other stakeholders instrumentally (when it helps to accomplish goals)</td>
<td>Care for all normative stakeholders who have legitimate claims</td>
</tr>
</tbody>
</table>

However, organizations with instrumentalist stewardship cultures would be likely to have effective SIM programs for enlightened self-interest of the corporation. Third, the corporations with principled stakeholder cultures would balance profit objectives against other stakeholder interests and claims perceived as being normatively legitimate. CSR programs would be commonplace and ethical corporate behavior would be encouraged.

**D. Ethics of Corporate Conduct and Stakeholder Culture**

The ethics of corporate conduct considered here include the primary ethical frameworks used by top management, including how the code of conduct would
be crafted and used, primary goals of the corporation, and commonly held values within the culture. A corporation with an egoistic agency culture would emphasize profit maximization for the purpose of maximizing executive wealth with some rhetoric directed toward shareholder wealth. Executives in this culture would be more likely to operate using the ethical framework of an ethical egoist, and they would be more likely to write ethical codes of conduct more carefully in order to avoid legal liability and to shield executives from the legislative intent of laws like the Sarbanes-Oxley Act. Values held dear in such cultures would include alertness, carefulness, prudence, cool-headedness, cleverness, and aggressiveness. Successful managers would be hard-hitting, driven, and sometimes boastful if they lapse into psychological egoism.

The ethics of corporate conduct for the instrumental stewardship culture would vary dramatically from the egoistic agency culture. Instead of resisting change in the form of new legal and regulatory requirements, companies with this culture would “try to get ahead” of the issues using SIM environmental monitoring and forecasting. As executives seek financial performance, they would cooperate in the formulations of legal remedies that would yield social benefits and also favor the corporation, or at least minimize the harm to the corporation.

The executives in instrumentalist stewardship cultures would be more receptive to an expanded framework of corporate social performance but “with guile.” Their behavior would follow the admonition by Milton Friedman to maximize profits “within the rules of the game.” Stockholders would continue to be the dominant stakeholder group, and other interest groups would be strategically and instrumentally considered when their interest could potentially impede the accomplishment of corporate objectives. Corporate codes of ethics would be taken more seriously and used as a normative control device to encourage acceptable behavior from employees and executives alike who would be in pursuit of corporate interests. Values commonly held by managers would include loyalty, reliability, diligence, dependability, cooperativeness, sensibleness, or practicality. However, there would still be room for accepting such values as hard-driving, prudent, and carefully calculated decisions. The key point here is the move from the ethics of self-serving ethical egoists to corporate citizenship, where stockholders and a broader community are considered legitimate stakeholders.

The principled stakeholder culture would be characterized by higher levels of moral development. According to the psychology of moral development,

89. See, e.g., Note, supra note 4, at 2138 (discussing the possibility of rewriting a corporate code of ethics to avoid requiring public disclosure under the Act).


91. See generally CAROL GILLIGAN, IN A DIFFERENT VOICE: PSYCHOLOGICAL THEORY AND WOMEN’S DEVELOPMENT (1982); 2 LAWRENCE KOHLBERG, ESSAYS ON MORAL DEVELOPMENT: THE PSYCHOLOGY OF

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individuals pass through a known series of moral stages as they mature throughout life. Generally such models of development begin with individuals early in life who avoid punishment and act egotistically. As teenagers, individuals try to be “good boy, nice girl,” following peer norms. In adulthood, if the moral development progresses normally, the individual becomes concerned with obedience to laws and policies. At higher stages of moral reasoning, the individual seeks due process approaches to the law, relationships with integrity, and rules consistent with higher moral principles that are internalized as a part of a personal philosophy of ethics. This pattern can be seen generally in the characterizations of stakeholder cultures that range from the individualist agency egoist culture where self-interest dominates, to the instrumental stewardship stakeholder culture that primarily uses corporate utilitarianism, and, lastly, the principled culture, which includes its ethics of caring and broader acceptance of stakeholder groups. The ethics of caring is based on the work by Carol Gilligan, whose study of women suggests that women start at a period of egoism where the emphasis is on survival and transition to a level that is focused on others. Women first follow peer-norms, next self-sacrifice for a group or organization, and finally move to an ethics of caring characterized by relationships with integrity and higher moral principles such as peace and nonviolence.

Profit maximization would be better characterized as profit optimization in the principled stakeholder culture because a wider array of stakeholder claims is perceived as legitimate. A broader framework of the CSP would be more widely accepted in such stakeholder cultures. Codes of ethics would be taken seriously for purposes of inspiring behavior and developing character rather than merely avoiding legal liability or controlling excessive or exploitive behavior. Stakeholder claims would be considered based on the normative legitimacy of their claims or demands. Power would remain important for salience but would be moderated by the question of legitimacy. The values celebrated in the moralist stakeholder culture would be truthfulness, sincerity as authentic relationships are emphasized, trustworthiness, benevolence, selflessness as self-oriented needs are transcended, forgiveness, and altruism. These values are suggestive, and perhaps too idealistic, when the harsh realities of competitive markets are concerned.

92. MORAL DEVELOPMENT (1984); MORAL DEVELOPMENT IN THE PROFESSIONS: PSYCHOLOGY AND APPLIED ETHICS (James R. Rest & Darcia Narváez eds., 1994) [hereinafter MORAL DEVELOPMENT].
93. Id. at 3.
94. Id. at 5.
95. Id.
96. Id.
97. GILLIGAN, supra note 91.
98. Id.
VI. CONCLUSIONS

As presented in Table 4, the typology of stakeholder cultures could be considered as archetypical with certain dimensions on continuums. For example, there is a discontinuity between the ethics of ethical egoism to corporate utilitarianism to the ethics of caring. Similarly discontinuous are the levels of moral development that begin with self interest, abruptly change to peer norms, and ultimately change again to moral decisions based on higher principles. These changes are evident in the different types of corporate cultures. Shifts in institutional orientations are also likely to be discontinuous as a corporation moves from a reactive to a responsive mode. Different stakeholder cultures will vary in the perceived legitimacy of different types of stakeholder demands based upon stakeholder culture as compared to the presence of stakeholder power, urgency, and legitimacy as suggested in Table 2. Once more research is available, many of the dimensions of stakeholder cultural values may form a continuum rather than types. The dominant values suggested for those in various stakeholder cultures may oversimplify value profiles.

The relationships between the ethics of corporate conduct and the stakeholder culture shown in Table 4 are meant to be suggestive and to stimulate thought. Much research is needed to verify what might be considered as a set of hypotheses here. It is the hope of this writer that a reflection on the proposed set of relationships will provide insights into the implications of legal remedies, regulatory remedies, and corporate ethics programs. If these relationships are supported, the tendency will be to attempt to encourage ethical self-control through CSP friendly stakeholder cultures as a substitute for legal and regulatory social control strategies.

Corporate social performance would be improved if performance objectives, like profit maximization and financial performance, were tempered by an increased appreciation for ethical conduct and existing law. Also, the design of compensation packages and corporate control systems need to consider the unintended consequences that are found in the corporations listed in Table 1. Executives at Enron, WorldCom, Sunbeam, and Global Crossing all used accounting fraud to manipulate profit reporting in financial reports to artificially inflate stock prices. Most of these cases involved pressuring auditors to allow questionable accounting in order to inflate reported earnings that yielded increases in stock process. This assured resources for strategic initiatives and executive compensation bonuses. Thus, accounting reforms like the Sarbanes-Oxley Act may be more needed where ethical egoism is dominant than in situations where the ethics of caring is found.

Business should be a voice in our pluralistic society and needs to be heard. SIM is the primary instrument to exercise this voice, but it too should be shaped by corporate ethics. An effective SIM in the hands of aggressive and powerful organizations, like Enron, can enable abusive and irresponsible executive behavior. Social reforms like campaign finance laws that seek to keep the big
money of corporate influence from dominating election results have not proven successful. Smart managers with an inclination to avoid control can always find loopholes. Alternatively, SIM in the hands of a corporation that recognizes legitimate stakeholder interests could do much to shape and encourage constructive and responsible public policy. Ethical behavior is important for SIM in the public policy area, as it is for corporate competitive strategy in the marketplace.

Competitive strategy would be best for society if applied in an ethical manner. The ethics of such activities can be controlled by law and regulations but work best with the cooperation and engagement of ethical corporate leaders. Corporations often call for trust and for society to allow self-control of their activities. For this to work, executives must be trustworthy. Scandals and abusive practices undermine such trust and increase the call for governmental remedies, and justifiably so. Legal regulation of corporations is often necessary even if ethical behavior could be an effective alternative to legislation. Executives could be encouraged to act ethically, to adopt a broader framework CSR, and to be mindful of the power and potential of its stakeholder culture to maintain legitimacy.