

RONALD R. SIMS

# ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

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WHY GIANTS FALL



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# Ethical Business Missteps: The Former and Current State of Affairs

## INTRODUCTION

No matter which way we turn, it appears that the entire population is whirling within a vortex of mistrust, distrust, misinformation, disinformation, and disclosures. Corporate managements, meanwhile, are scrambling to mend miles of fences between themselves and their boards of directors, banks, investment bankers, stockbrokers, auditors, the media, Senate and House committees, the Justice Department, and the Securities and Exchange Commission (SEC). An array of scandals afflicting corporations and Wall Street over the last few years have created what has been referred to as “a triple-tier Who’s Who” for officials under investigation—those who are jail bound, those who might be sentenced and those who have the good luck merely to be greatly embarrassed (Hahn 2002).<sup>1</sup> For example, Timothy Ganley, former VP of software maker Critical Path Inc., was sentenced to six months in federal prison plus two months of supervised release for insider trading. The former president, David Thatcher, has pleaded guilty to one count of conspiring to commit securities fraud and awaits sentencing, as do two vice presidents (Jonathan Beck and Kevin Clark) who have admitted guilt on insider-trading charges; a third veep got six-months jail sentence. Ganley also paid \$107,908 in a civil case brought by the SEC.

Tyco International CEO Dennis Kozlowski, former CFO Mark Swartz, and former general counsel Mark Belnick were all indicted on charges that Kozlowski and Swartz, among others, stole \$170 million from the company and pocketing \$430 million from the fraudulent sale of Tyco stock. Belnick was charged with hiding \$14 million in loans to himself. Tyco's management fired back as well. It filed a lawsuit against Kozlowski looking to recoup \$244 million in pay and benefits.

Finally, some officials found themselves simply having to deal with bad publicity. Former General Electric CEO Jack Welch was revealed to have received such lifetime perks as front-row seats to New York Knicks games and the use of a company jet, according to his wife's divorce filings. Adelphia Corp. chief executive John Rigas, whose \$4.2 million cash severance package was revoked by Adelphia's new board (his severance agreement can be revoked in the case of a felony conviction), has been another official on the ropes. Although Martha Stewart skirted legal problems for a while, the House Energy and Commerce Committee turned over its investigation of Stewart to the Justice Department after her attorneys said she would refuse to testify about the sales of ImClone Systems stock hours before the stock value plummeted. In June 2003 Stewart was indicted by a federal grand jury on five criminal counts of securities fraud, conspiracy and making false statements to federal agents.

Salomon Smith Barney chairman and CEO Michael Carpenter was left more than embarrassed from his firm's recent troubles: he was ousted and replaced with former general counsel and current chief operating officer (and Citigroup chairman Sanford Weill's right arm) Charles Prince. Salomon is currently embroiled in a congressional probe into the firm's IPO practices during the telecom bubble. Carpenter took over Citigroup's global investment group, while speculation mounted that Prince was on a path that could lead him ultimately to succeed Weill as Citigroup head. One would think that Salomon would have learned not to raise suspicion that it might be outside ethical bounds, given its problems with the bond-trading scandal in the 1990s that helped lead to its eventual fall as a giant in the bond-trading industry.

Citigroup was also nearing a possible \$200 million settlement with the Federal Trade Commission (FTC) over a lawsuit alleging predatory lending to consumers by Associates First Capital Corp., the Dallas-based sub-prime lender the firm bought for \$27 billion in 2000. The \$200 million could be the largest ever consumer-protection settlement with the FTC.

Such news stories as the fall of the once giant Enron continue to bring to the attention of the public social and ethical issues that help to frame the relationship between society and business organizations. The reporting of these stories is highlighted by criticisms of various actions,

decisions, and practices on the part of business leaders. Criticisms have included exposé of Beech-Nut Nutrition Company's practices of selling adulterated apple juice and passing it off to the public as "100% fruit juices," accusations against H. B. Fuller Co. that it was selling glue in Honduras that was being recklessly used for "sniffing" by Honduran street children, allegations that Sears Roebuck & Co. engaged in sales abuses at its auto centers by pressuring customers to purchase unneeded or unwanted services, lawsuits against Dow Corning for its sale of defective silicone breast implants, and lawsuits against the tobacco industry for manufacturing and marketing what an increasing number of people consider to be an inherently dangerous product. Though the litany of concerns raised about the safety of cell phones, SUVs, and other issues could go on and on, these examples illustrate the continuing tensions between society and business organizations, which can be traced to specific incidents or events. However, despite the media coverage, organizations and their respective leaders still find ways to further decrease stakeholder confidence in their ability to "do the right things."

This book is concerned with "doing the right thing" and more specifically with increasing our understanding of why organizations stray from "doing the right thing." Such behavior often leads to an ethical and financial fall, a fall that they find themselves unable to recover from. As for Humpty Dumpty, all the king's horses and all the king's men are unable to help many organizations to get up from their ethical fall. Today's organizations increasingly confront many issues that carry social or ethical implications that result from a more visible relationship between business and the broader society. Issues such as toxic waste disposal, sexual harassment in the workplace, AIDS in the workplace, drug testing, insider trading, political action committees supported by business to influence the outcome of legislation, whistle-blowing, and the use of lie detectors typify the stories about society and business that the media focus on in television, newspapers, and magazines.

Some situations that seem to capture the headlines almost daily are situations in which the public or some segment of the public (e.g., various stakeholders) believes that an organization has done wrong or has treated some individual or group unfairly. Ethical questions are typically raised in such situations. In some cases, major laws have been broken. In most, questions have arisen of whether or not the organizations have been socially responsible or ethical. Organizations find themselves frequently on the defensive in today's socially aware environment, being criticized for some action they have taken or failed to take. Whether these organizations are right or wrong sometimes does not matter. Powerful stakeholder groups, aided by a cooperative media with a flair for the dramatic, are often able to exert enormous pressure

on these organizations and wield significant influence on public opinion, causing organizations to take or not to take particular courses of action.

In other instances, organizations are attempting to deal with broad societal concerns (such as AIDS in the workplace, discrimination in the workplace, and the employee "rights" movement). Today's organizations must increasingly weigh the pros and cons of these issues and adopt the best postures, given the conflicting points of view expressed by key stakeholders. Organizations must respond and be willing to live with the consequences, even though correct responses are not always easy to identify.

At a broad level, we are discussing the role of business in society. In our effort to understand why giants fall, we will address such issues as what an organization must do to be considered socially responsible and what organizational leaders must do to be considered ethical. The ethical missteps, the societal responses, and our need to be proactive in preventing the ethical fall of organizations require immediate attention and definite courses of actions, which may become the next subject of debate in years to come.

As we move further into the twenty-first century, there is every indication that times will continue to be turbulent; the future will be characterized by significant changes in the economy, in society, in technology, and in the global marketplace. Against this continuing turbulence it is important to set forth briefly some ideas that will be discussed in more detail later in this book; they are fundamental to increasing our understanding of why giants fall.

## THE CHALLENGE OF BUSINESS ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

As evidenced by the number of ethical missteps in the news, today we pay the piper as we tally the sorry record of organizational wrongdoings, infractions, and white-collar crimes, all of which can be traced to a diminishing interest in standards, controls, integrity, and that nineteenth-century commodity known as good reputation. Yet as a society, we define ourselves by the values we choose to emphasize. Beginning in the 1980s, a frenzied quest for efficiency led to the endorsement of individualism over community. The resulting emphasis on short-term returns encouraged a speculative frenzy in the stock markets and merger mania on Wall Street, variously described as "the casino society"<sup>2</sup> and a "circus of ambition,"<sup>3</sup> attacked in the Oliver Stone film *Wall Street*, and satirized in Tom Wolfe's popular book *The Bonfire of the Vanities*.<sup>4</sup> The reputation of the business community as a whole fell to

an all-time low. On into the 1990s and today, companies like E. F. Hutton, Drexel Burnham Lambert, and Salomon Brothers committed very public ethical wrongdoings, while others saw their reputations become severely tarnished. Once-giant organizations took a fall, never to recover to their previous grandeur. As suggested by Fombrun,<sup>5</sup> the corporate world has squandered much of its reputational capital and its ability to survive and thrive in the years to come.<sup>6</sup>

### **Business Ethics Missteps**

While several business ethics scandals piqued the public's attention, two notable examples are worth brief mention here. The Salomon Brothers bond-trading scandal helped to usher in the 1990s. Salomon Brothers, the world's fourth-largest underwriter of securities, admitted in 1991 to repeatedly violating Treasury rules against buying more than 35 percent of a Treasury issue of securities at auction. The scandal led to the resignation of three top officials, among other consequences.<sup>7</sup> It should not have come as a surprise that the U.S. Sentencing Commission in 1991 created new federal sentencing guidelines designed to deter corporate crime by creating incentives for corporations to report and accept responsibility for unlawful behavior.

In the second half of the 1990s, many of the ethical scandals found in business involved massive charges of sexual harassment and racial discrimination. Among the well-known companies that experienced such allegations were Mitsubishi, Coca-Cola, Home Depot, and Texaco. The Texaco case involved a \$196 million settlement in a class-action race discrimination lawsuit brought by employees fighting for equal pay and a chance for promotions. Bari-Ellen Roberts, lead plaintiff in the case against the oil company, revealed a dark side of corporate America in her 1998 book, *Roberts vs. Texaco: A True Story of Race and Corporate America*.<sup>8</sup>

During the first years of the new century, business ethics scandals continued in the headlines. Archer Daniels Midland pleaded guilty to a price-fixing conspiracy that cost consumers millions in higher prices for soft drinks and detergents. ADM agreed to pay a \$100 million fine. Royal Dutch Shell scrapped its plans for sinking a North Sea oilrig that environmentalists said was contaminated. They were later accused of colluding with the Nigerian government in the oppression of the Ogoni people and of failing to speak out against the execution of one of its leaders. In 2001, Bridgestone/Firestone and the Ford Motor Company apologized to consumers for a pattern of deadly tire failures, while blaming each other for the debacle.<sup>9</sup> Once again, major corporations are enveloped in ethics scandals that are generating new tremors of public distrust of large corporations.

## **Corporate Social Responsibility**

About public interest in business ethics and corporate social responsibility (CSR) during the past three or four decades, two conclusions can be drawn. First, interest in business ethics and social responsibility has heightened during each of the past forty years. Second, interest in business ethics and CSR seems to have been spurred by major headline-grabbing scandals. Certainly, society has taken an on-again, off-again interest, but lately this interest has grown to a preoccupation or obsession.

Because of ethical missteps like those just alluded to, business has been undergoing the most intense scrutiny it has ever received from the public. As a result of the many allegations—charges that it has little concern for the consumer, cares nothing about the deteriorating social order, has no concept of acceptable behavior, and is indifferent to the problems of minorities and the environment—concern continues to be expressed as to what responsibilities business has to the society in which it resides. These concerns have generated an unprecedented number of pleas for CSR, more recently included in the broad term of corporate citizenship.

The basic CSR issue can be framed in terms of two key questions: Does business have a social responsibility? If so, how much and what kind? This book explores several facets of CSR and provides some insights into these questions. Chapter 3 is dedicated to the CSR issue and concepts that have emerged from it because that core idea underlies a great deal of the discussion in this book.

No one would argue that life in most business organizations was much simpler in the past, in a less complex period, with minimal and clearly understood expectations among the various parties. Investors put up money to start or finance the business, owners and employees kept the business running, suppliers made raw materials available for production, and customers purchased the product or services. In today's society, organizations face a more complex state of affairs. The public recognizes that today's business organization has evolved to a point where it is no longer the sole property or interest of the founder, the founder's family, or even a group of owner-investors. That development has been a principal driving force behind this societal transformation.

## **Today's Organization and Stakeholders**

Today's modern organization in many instances is the institutional centerpiece of a complex society made up of many people with a multitude of interests and with many expectations as to what orga-

nizations ought to provide. As highlighted in this book, the social contract between organizations and various stakeholders (e.g., employers and employees) has continually changed, producing new demands that all parties rethink their relationships. Those organizations likely to survive in the future will pay particular attention to how to successfully respond to ever-changing expectations. These organizations will need to meet many legal, ethical, and social or philanthropic expectations while still being able to change proactively in response to economic incentives.

Ethical and socially responsible employee behavior is important to the viability of all organizations as they attempt to change and respond to stakeholder expectations. "Doing what's right" matters to organizations, related stakeholders, and the public-at-large. To organizations and employees, acting ethically and legally means saving billions of dollars each year in theft, lawsuits, and settlements. Research has shown that corporations also have paid significant financial penalties for acting unethically. Carnival Cruise Lines realized that illegally dumping wastes from its ships into the world's waterways wasn't worth the \$18 million fine it recently paid. The tobacco industry discovered that lying about nicotine could be costly to business. Dow Corning paid heavy penalties for manufacturing and selling unsafe products, and Arthur Andersen has not recovered from its shredding of documents involved with the Enron debacle.

It has been estimated that workplace theft costs U.S. businesses \$40 billion each year. In particular, some have found that employees accounted for a higher percentage of retail thefts than did customers; it has been estimated that one in every fifteen employees steals from his or her employer. Costs to businesses also include ineffective information flow throughout the organization; deterioration of relationships; declining productivity, creativity, and loyalty; and absenteeism. Organizations that have a reputation for unethical and uncaring behavior toward employees also have a difficult time recruiting and retaining valued professionals.

Today's organizations must be responsive to an increasingly diverse audience, made up of individuals and groups that they may have been able to ignore in the past. The growing importance of the role of stakeholders in the organizational equation over the past few decades has made it apparent that organizations must address the legitimate needs and expectations of stakeholders if they want to be successful in the long run. "Stakeholder inclusion" is the key to company success in the twenty-first century. Today's businesses must continuously address stakeholders; it is the ethical course of action to take, and stakeholders clearly have claims, rights, and expectations that should be honored. A stakeholder approach to understanding organizational situations like

the Enron debacle can help us to understand better why such ethical organizational demises occur.

Organizational management that truly cares about business and corporate social responsibility is proactive rather than reactive in linking strategic action and ethics. It steers away from ethically and morally questionable business opportunities and business practices. It goes to considerable lengths to ensure that its actions reflect integrity and high ethical standards such as Warren Buffett attempted to introduce in Salomon Brothers following its ethical fall. If an organization's stakeholders conclude that management is not measuring up to ethical standards, they have recourse. For example, concerned investors can protest at the annual shareholders' meeting, appeal to the board of directors, or sell their stock. Concerned employees can unionize and bargain collectively, or they can seek employment elsewhere. Customers can switch to competitors. Suppliers can find other buyers. The community and society can do anything from staging protest marches and urging boycotts to stimulating political and governmental action.

## THE FOCUS OF THIS BOOK

Being socially responsible, ethical, and a good corporate citizen is important to meeting and exceeding the expectations of any organization's stakeholders. Unless today's organizations recognize the importance of developing and sustaining a reputation that is built on "doing the right things" and "doing things right" as viewed by their key stakeholders, they will not survive or thrive, as has been the case with several organizations over the last few decades. This book is intended to help readers better understand some of the organizational sins of the past, with the goal of preventing more "Enrons" in the future. The book assumes that individuals, groups, and organizations of all sizes will at some point find themselves confronted with challenges to do the right ethical things; and if they fail, they may not recover from their ethical fall. The book also offers some insights into how organizations can get up from such falls by restoring their ethical reputation, being proactive by institutionalizing ethics and building and maintaining ethical employer-employee relationships.

The issues surrounding business ethics, corporate social responsibility, and stakeholder management are treated at various points in this book. Special treatment is also given to Salomon Brothers and related organizational missteps at Enron to gain insight into why such social irresponsible and unethical behavior occurs. The role of various stakeholders (internal and external) and the impact of such missteps on these stakeholders make up the focus of several chapters. Workplace issues

like employee rights are considered important topics in our efforts to make sense of organizational missteps and attempts to resurrect organizational reputation. Readers will gain an appreciation of how important it is that organizational decision makers integrate socially responsible and ethical wisdom with management wisdom in all they do.

For those interested in understanding what contributed to organizational debacles and ethical falls like the Enron's and Archer Daniels Midland's of today and the Salomon Brothers and E. F. Hutton a decade or so ago, this book provides some answers. This book employs a stakeholder framework for emphasizing business's social and ethical responsibilities to both external and internal stakeholder groups. An analytical perspective is embedded within the book's themes of business ethics, corporate social responsibility, and stakeholder management. The book stresses that these perspectives are essential because they require organizations and their leaders to recognize the importance of socially responsible and ethical decision making and behavior that continually incorporates the stakeholders (e.g., customers, employees, government, suppliers, and the public-at-large) into the organizations' strategic initiatives and plans.

Clearly, there is every indication that the American society of today is clamoring for a renewed emphasis on values, morals, and ethics and that the business ethics and social responsibility debates of this period are but a subset of this larger societal concern. Whether organizations and their leaders will be able to respond and ratchet their reputation to a new plateau remains to be seen. One thing is sure: The renewed interest in business ethics and corporate social responsibility is accompanied by increased calls for ethical accountability. We hope that, this time, that accountability will be institutionalized in the fabric of our society and each organization in hopes that no more giants will fall.

Given the notoriety of the Enron demise, discussions will continue on the why and how of the situation. Pundits will also undoubtedly focus on Enron specifically and offer various views on why the company fell so far so fast. This book suggests that organizations like Enron take ethical falls because of failed leadership, an unethically oriented culture, socially irresponsible behavior and operational activities that lead to unethical employee practices.

Against the backdrop of the Enron disaster, this book discusses business ethics, specifically, in Chapter 2. In Chapters 3 and 4 the discussion turns to corporate social responsibility and stakeholder management. Chapter 5 focuses on why unethical behavior occurs in organizations. Chapters 6–8 address specific examples of unethical behavior in action, in an effort to answer to questions like, "What brings a giant like Enron to its knees?" Chapters 9–11 attempt to answer questions like, "How