Activity 5.1 What does 'corporate responsibility' mean?

Before reading the chapter, write some notes on what you think 'corporate responsibility' means. Choose the organisation or people you hope may be able to help you learn about the topic. You may find it helpful to discuss the topic with a manager you know, or reflect on an activity you have managed.

- Make brief notes on what, if any, issues of 'ethics' or 'corporate responsibility' those running the business have had to deal with.
- What factors appeared to have affected the decisions they made?
- Did the outcomes relate to wider organisational strategies?

Keep these notes as you will be able to use them later.

5.1 Introduction

Ford managers dealing with the Pinto chose to put profit before safety. Yet they did not act illegally, and customers then were not as interested in safety features as they are today. A manager who tried to delay the model launch would have damaged their career, their family economy – and the livelihood of other Ford workers. But the managers' decisions led to death and injury.

Most people are only aware of corporate responsibility (or the lack of it) when there is a controversy about (say) food safety or the use of child labour. They also take note of events like the collapse of Enron (Swartz and Watkins, 2002) and Arthur Andersen (Toffler and Reingold, 2003). The high salary and pension paid to Fred Goodwin, whose leadership almost destroyed The Royal Bank of Scotland in 2008, increase distrust of corporate bodies. While these situations seem clear-cut, many controversies about corporate behaviour are ambiguous:

> there is no consensus on what constitutes virtuous corporate behavior. Is sourcing overseas to take advantage of lower labor costs responsible? Are companies morally obligated to insist that their contractors pay a 'living wage' rather than market wages? Are investments in natural resources in poor countries with corrupt governments always, sometimes or never irresponsible? (Vogel, 2005, pp. 4–5)

Should BP gain credit for acknowledging climate change before many of its competitors, or criticised for its poor safety record? Is Shell acting responsibly by extracting oil in Nigeria which supports the nation's development, but which may damage local communities?

These issues arise at each stage of the value-adding chain. They arise over

- inputs (e.g. whether to use existing staff or to outsource work);
- transformation (e.g. treatment of employees, use of energy, transport and other resources); and
- outputs (e.g. pollution, treatment of customers, effects on reputation).

The chapter begins with examples of contrasting business practice, and shows the practical topics which managers face in the area of corporate responsibility. It outlines models for evaluating actions by individuals and organisations, and follows this with three 'contextual' perspectives – ethical decision-making models, stakeholders and strategy. A further section illustrates practices which organisations use to support their policies on corporate responsibility.

Management in practice — Bernard Madoff – the biggest fraud ever? FT

In 2009 Bernard Madoff (71) was sentenced to 150 years in prison for running a fraudulent investment scheme in the United States that took £39bn from thousands of investors around the world. He attracted investors by offering unusually large returns and by cultivating an image of competence and trustworthiness – clients were eager for him to accept their money. Instead of investing it, he used it to pay dividends to earlier investors – so the scheme depended on continually attracting new ones. When the world economic decline began in 2008 many asked for their money back – revealing that it was no longer there. Individuals and charitable foundations lost large amounts of money.

A remarkable feature of the story was that regulatory bodies set up after previous financial frauds failed to see what Madoff was doing: the agency responsible for regulating that part of the financial services industry was understaffed, and never inspected his accounts.

Source: *Financial Times*, 24 June 2009, 30 June 2009.

5.2 Contrasts in business practice

The Pinto case is a prominent example of questionable corporate actions, and Table 5.1 notes some recent cases – some of which were illegal while others, though dubious, were not. There is an equally long tradition of ethical behaviour in business: Robert Owen (Chapter 2 case study) campaigned against the employment of children in the mines and mills of nineteenth-century Britain. From the start of the Industrial Revolution some entrepreneurs acted philanthropically:

1803–76	Titus Salt	Textiles	Employee welfare; Saltaire Village
1830–98	Jeremiah Coleman	Mustard	Charities; Salvation Army; YMCA
1839–1922	George Cadbury	Chocolate	Employee welfare; Bournville Village
1836–1925	Joseph Rowntree	Chocolate	Employee welfare; New Earswick Village
1851–1925	William Lever	Soap	Employee welfare; Port Sunlight Village

Table 5.1 Recent financial scandals at major companies

Company	Incident	Outcome
Bernard Madoff, 2009, US investment company	Fraudulent investment company, paying early investors dividends with money raised from new ones	Thousands of investors, including charities, lost money. Madoff sentenced to 150 years in jail
The Royal Bank of Scotland, 2008, UK Bank	Used short-term borrowing to fund high-risk investments. The investments failed, and the company almost collapsed	UK government buys majority stake. Fred Goodwin, chief executive, retires with £800,000 annual pension
Volkswagen, 2007, German car manufacturer	Former head of personnel admits illegal payments to trade union leaders, managers and prostitutes	Initially denies involvement, then resigns and pleads guilty; receives short jail sentence. Trade union leaders charged
Ahold, 2006, Dutch retailer	Conceals documents about joint ventures from auditors, so that revenues appeared higher than they should have been	Chief Executive and Chief Financial officer convicted for fraud. Shareholder groups criticised lenient sentences

Case study The Ford Pinto

In the late 1960s, Lee Iacocca, then president of Ford, sought to improve the company's market position by having a new car, the Ford Pinto, on the market by the 1971 model year. This would be a basic vehicle selling for $2000, which meant that it had to be produced very cheaply, with a small margin between production costs and selling price.

The designers placed the petrol tank at the back of the car, six inches from a flimsy rear bumper. Bolts were placed just three inches from the tank. Other sharp metal edges surrounded the tank, and the filler pipe tended to break loose from the tank in low-speed crashes. These features could have been re-designed, but the extra expense would go against Iacocca's aim of 'a 2000 pound car for $2000'.

In testing its new design Ford found that when it was struck from behind at 20 mph the bumper would push the bolts into the tank, causing it to rupture. This posed a significant risk to those inside and contravened proposed legislation which required cars to withstand an impact at 30 mph without fuel loss. No one informed Iacocca of these findings, for fear of being fired. He was fond of saying 'safety doesn't sell'.

The car went on sale and in 1976 a magazine exposed the dangers of the Pinto petrol tank. This prompted the National Highway Traffic Safety Administration (NHTSA) to launch an investigation, which in 1977 identified 28 rear-end crashes in which petrol had leaked and caused a fire. Twenty-seven occupants had died and 24 suffered burns.

Feeling some pressure to fix the tank, Ford officials devised a polythene shield to prevent it from being punctured by the bolts, and a jacket to cushion it against impact. The engineers calculated that these improvements would cost $11 per car, and had to decide whether to recall the cars to make these repairs. They conducted a cost–benefit analysis. Using NHTSA figures for the cost to society of death or serious injury, and an estimate of the likely number of future deaths and serious injuries, Ford's calculations were:

Benefits of altering design

Savings:	180 deaths; 180 serious injuries; 2100 vehicles
Unit cost:	$200,000 per death; $67,000 per serious injury; $700 per vehicle
Total benefit:	$49.5 million

Costs of altering the design

Sales:	11 million cars; 1.5 million light trucks
Unit cost:	$11 per car; $11 per truck
Total cost:	$137.5 million

Since the costs of recalling and altering the cars outweighed the benefits they decided not to do so, continuing to produce the Pinto in its original form. They reasoned that the current design met federal safety standards at the time. While it did not meet proposed legislation, it was as safe as current competing models.

In 1977 the proposed fuel tank legislation was adopted and Ford decided to recall all 1971–76 Pintos to modify their fuel tanks. A month before the recall began three people in a Pinto were struck from behind in a low-speed crash and burned to death. A $120 million lawsuit followed, but Ford escaped on a technicality. Ford won the lawsuit, but its reputation suffered badly.

Court records showed that Ford's top managers knew that the Pinto was unsafe, but concluded that it was cheaper to incur the losses from lawsuits than to fix the cars. Production staff also knew of the risks, but were never given the opportunity to tell top management about it. Fords 'profit drives principle' philosophy of the time discouraged staff from drawing attention to risks. Actions were guided by the original aim for the Pinto – '2000 pounds for $2000' – and a 'safety doesn't sell' mindset. Insiders believed they were acting in line with company values. Richard Pascale (1990) noted that during the 1970s:

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The company was financially focussed. Cost accounting drove suboptimal design decisions at the front edge of the product development process. In the factories, a system tied a large percentage of plant managers' compensation to volume, driving plants to build cars as rapidly as possible and worry about the defects later. (Pascale, 1990, pp. 116–117)

These practices were rooted in the distant past, and did not address the issues the company was facing in the late 1970s, when consumers were more concerned about safety and less concerned about price.

When a new chief executive took over, he went to great lengths to consult with top managers about major decisions. He wanted to break away from the previously autocratic 'do as I say' style of management, and to encourage debate and discussion: which may enable people to raise ethical issues early in the decision-making process.

Sources: Pascale (1990); Shaw (1991); Nutt (2002).

Questions

1 Imagine you worked for Ford as an engineer and were aware of this potential design fault. What would you do? What, if any, are your responsibilities to the customer and/or your employer? (Refer to Sections 5.2, 5.3.)

2 Evaluate the actions of Ford's managers in this case. (Refer to Section 5.4.)

3 Does the ethical decision-making model help explain the decisions made by Ford at that time? How did the style of the new chief executive alter the likelihood of a similar scandal arising? (Refer to Section 5.5.)

4 Consider how Ford's actions at the time may have related to their strategy at the time, and then consider how the company would be likely to manage a similar situation if it arose today. (Refer to Section 5.6.)