



4

Ethics in International Business

Introduction
Ethical Issues in International Business
Employment Practices
Human Rights
Environmental Pollution
Corruption
Moral Obligations
Ethical Dilemmas
The Roots of Unethical Behavior
Philosophical Approaches to Ethics
Straw Men
Utilitarian and Kantian Ethics
Rights Theories
Justice Theories
Ethical Decision Making
Hiring and Promotion
Organization Culture and Leadership
Decision-Making Processes
Ethics Officers
Moral Courage
Summary of Decision-Making Steps
Chapter Summary
Critical Thinking and Discussion
Questions
Closing Case: Mired in Corruption—
Kellogg Brown & Root in Nigeria

Nike

Nike is in many ways the quintessential global corporation. Established in 1972 by former University of Oregon track star Phil Knight, Nike is now one of the leading marketers of athletic shoes and apparel in the world. The company has \$10 billion in annual revenues and sells its products in some 140 countries. Nike does not do any manufacturing. Rather, it designs and markets its products, while contracting for their manufacture from a global network of 600 factories owned by subcontractors that employ some 550,000 people. This huge corporation has made Knight one of the richest people in America. Nike's marketing phrase "Just Do It!" has become as recognizable in popular culture as its "swoosh" logo or the faces of its celebrity sponsors, such as Tiger Woods.

For all of its successes, the company has been dogged for more than a decade by repeated and persistent accusations that its products are made in sweatshops where workers, many of them children, slave away in hazardous conditions for wages that are below subsistence level. Nike's wealth, its detractors claim, has been built upon the backs of the world's poor. Many see Nike as a symbol of the evils of globalization—a rich Western corporation exploiting the world's poor to provide expensive shoes and apparel to the pampered consumers of the developed world. Niketown stores have become standard targets for antiglobalization protesters. Several nongovernmental organizations, such as San Francisco-based Global Exchange, a human rights organization dedicated to promoting environmental, political, and social justice around the world, have targeted Nike for repeated criticism and protests. News programs, such as CBS-TV's *48 Hours*, have run exposés on working conditions in foreign factories that supply Nike. Students on the campuses of several major U.S. universities with which Nike has lucrative sponsorship deals have protested the ties, citing Nike's use of sweatshop labor.

Typical of the allegations were those detailed in *48 Hours* program that aired in 1996. The report painted a picture of young women at a Vietnamese subcontractor who worked with toxic materials six days a week in poor conditions for only 20 cents an hour. The report also stated that a living wage in Vietnam was at least \$3 a day, an income that could not be achieved at the subcontractor without working substantial overtime. Nike and its subcontractors were not breaking any laws, but this report, and others like it, raised questions about the ethics

of using sweatshop labor to make what were essentially fashion accessories. It may have been legal, but was it ethical to use subcontractors who by Western standards clearly exploited their workforce? Nike's critics thought not, and the company found itself the focus of a wave of demonstrations and consumer boycotts.

Adding fuel to the fire, in November 1997 Global Exchange obtained and leaked a confidential report by Ernst & Young of a Nike-commissioned audit of a Vietnam factory owned by a Nike subcontractor. The factory had 9,200 workers and made 400,000 pairs of shoes a month. The Ernst & Young report painted a dismal picture of thousands of young women, most under age 25, laboring 10 1/2 hours a day, six days a week, in excessive heat and noise and in foul air, for slightly more than \$10 a week. The report also found that workers with skin or breathing problems had not been transferred to departments free of chemicals. More than half the workers who dealt with dangerous chemicals did not wear protective masks or gloves. The report stated that in parts of the plant, workers were exposed to carcinogens that exceeded local legal standards by 177 times and that, overall, 77 percent of the employees suffered from respiratory problems.

These exposés surrounding Nike's use of subcontractors forced the company to reexamine its policies. Realizing that, even though it was breaking no law, its subcontracting policies were perceived as unethical, Nike's management took a number of steps. These included establishing a code of conduct for Nike subcontractors and instituting annual monitoring by independent auditors of all subcontractors. Nike's code of conduct included requiring that all employees at footwear factories be at least 18 years old and that exposure to potentially toxic materials does not exceed the permissible exposure limits established by the Occupational Safety and Health Administration (OSHA) for workers in the United States. In short, Nike concluded that behaving ethically required going beyond the requirements of the law. It required the establishment and enforcement of rules that adhere to accepted moral principles of right and wrong.

Sources: CBS News, "Boycott Nike," October 17, 1996; D. Jones, "Critics Tie Sweatshop Sneakers to 'Air Jordan,'" *USA Today*, June 6, 1996, p. 1B; Global Exchange Special Report, "Nike Just Don't Do It," www.globalexchange.org/education/publications/newsltr6.97p2.html#nike; S. Greenhouse, "Nike Shoe Plant in Vietnam Is Called Unsafe for Workers," *The New York Times*, November 8, 1997; and V. Dobnik, "Chinese Workers Abused Making Nikes, Reeboks," *Seattle Times*, September 21, 1997, p. A4.



Introduction

The previous two chapters detail how societies differ in terms of their economic, political, and legal systems, and their culture. We also mapped out some of these implications for the practice of international business. This chapter focuses on the ethical issues that arise when companies do business in different nations. Many of these ethical issues arise precisely because of differences in economic development, politics, legal systems, and culture. The term *ethics* refers to accepted principles of right or wrong that govern the conduct of a person, the members of a profession, or the actions of an organization. **Business ethics** are the accepted principles of right or wrong governing the conduct of businesspeople, and an **ethical strategy** is a strategy, or course of action, that does not violate these accepted principles.

In our society and others, many ethical principles are codified into law—prohibitions against murder, stealing, and incest, for example—but many others are not, such as the principle that an author should not plagiarize another's work. As long as it does not involve word-for-word copying, plagiarism does not technically violate copyright law, but it surely is unethical. Similarly, the history of science is replete with examples of researchers who claim their idea was “stolen” by an unscrupulous colleague for his own personal gain before the originator had the chance to file for a patent or publish the idea himself. Such behavior is not illegal, but it is obviously unethical.

The opening case nicely illustrates the issue. Nike broke no laws when it subcontracted work to factories in Southeast Asia that had very poor working conditions, but many argued that it was acting unethically. Nike no doubt made its decisions regarding subcontracting to drive down its costs and therefore maximize the corporation's long-run profitability. Originally, ethical issues probably did not enter into the company's decision-making calculus. Like managers at many other companies, those at Nike may have reasoned it was the subcontractor's responsibility to make sure local laws were followed, and Nike managers may have naively believed that those laws safeguarded the interests of the subcontractor's employees. In reality, the legal structure in many developing nations is weak and incomplete compared to that found in a developed country. Local laws often do not provide what would be considered adequate safeguards for employees, and even when they do, those laws may not be actively enforced. Given this, the right and proper thing for Nike to do when it decided to subcontract work to firms in developing nations was to establish an ethical code that articulated basic guidelines with regard to the working conditions that subcontractors should meet. Nike ultimately did do this, and then went beyond this, hiring independent auditors to make sure subcontractors adhered to the guidelines. But it took several years of vocal protests before Nike acted. Those protests damaged Nike's reputation, which is one of a corporation's most important intangible assets. One might argue, therefore, that it was in the enlightened self-interest of Nike to proactively insert ethical considerations into its decision-making calculus. More fundamentally, it was just the right thing to do!

This chapter looks at how ethical issues can and should be incorporated into decision making in an international business. We start by looking at the source and nature of ethical issues and dilemmas in an international business. Next, we review the reasons for poor ethical decision making in international businesses. Then we discuss the different philosophical approaches to business ethics. We close the chapter by reviewing the different processes that managers can adopt to make sure that ethical considerations are incorporated into decision making in an international business firm.



Ethical Issues in International Business

Many of the ethical issues and dilemmas in international business are rooted in the fact that political systems, law, economic development, and culture vary significantly from nation to nation. Consequently, what is considered normal practice in one nation may

be considered unethical in others. Because they work for an institution that transcends national borders and cultures, managers in a multinational firm need to be particularly sensitive to these differences and able to choose the ethical action in those circumstances where variation across societies creates the potential for ethical problems. In the international business setting, the most common ethical issues involve employment practices, human rights, environmental regulations, corruption, and the moral obligation of multinational corporations.

EMPLOYMENT PRACTICES

As we saw in the opening case, ethical issues may be associated with employment practices in other nations. When work conditions in a host nation are clearly inferior to those in a multinational's home nation, what standards should be applied? Those of the home nation, those of the host nation, or something in between? While few would suggest that pay and work conditions should be the same across nations, how much divergence is acceptable? For example, while 12-hour workdays, extremely low pay, and a failure to protect workers against toxic chemicals may be common in some developing nations, does this mean that it is OK for a multinational to tolerate such working conditions in its subsidiaries there, or to condone it by using local subcontractors?

As the Nike case demonstrates, a strong argument can be made that such behavior is not appropriate. But this still leaves unanswered the question of what standards should be applied. We shall return to and consider this issue in more detail later in the chapter. For now, note that as in the case of Nike, establishing minimal acceptable standards that safeguard the basic rights and dignity of employees, auditing foreign subsidiaries and subcontractors on a regular basis to make sure those standards are met, and taking corrective action if they are not is a good way to guard against ethical abuses. Another apparel company, Levi Strauss, has long taken such an approach. In the early 1990s, the company terminated a long-term contract with one of its large suppliers, the Tan family. The Tans were allegedly forcing 1,200 Chinese and Filipino women to work 74 hours per week in guarded compounds on the Mariana Islands.¹

HUMAN RIGHTS

Beyond employment issues, questions of human rights can arise in international business. Basic human rights still are not respected in many nations. Rights that we take for granted in developed nations, such as freedom of association, freedom of speech, freedom of assembly, freedom of movement, freedom from political repression, and so on, are by no means universally accepted (see Chapter 2 for details). One of the most obvious examples was South Africa during the days of white rule and apartheid, which did not end until 1994. Among other things, the apartheid system denied basic political rights to the majority nonwhite population of South Africa, mandated segregation between whites and nonwhites, reserved certain occupations exclusively for whites, and prohibited blacks from being placed in positions where they would manage whites. Despite the odious nature of this system, Western businesses operated in South Africa. By the 1980s, however, many questioned the ethics of doing so. They argued that inward investment by foreign multinationals, by boosting the South African economy, supported the repressive apartheid regime.

Several Western businesses started to change their policies in the late 1970s and early 1980s.² General Motors, which had significant activities in South Africa, was at the forefront of this trend. GM adopted what came to be called the *Sullivan principles*, named after Leon Sullivan, a black Baptist minister and a member of GM's board of directors. Sullivan argued that it was ethically justified for GM to operate in South Africa so long as two conditions were fulfilled: first, that the company should not obey the apartheid laws in its own South African operations (a form of passive resistance), and second, that the company should do everything within its power to actively promote

the abolition of apartheid laws. Sullivan's principles were widely adopted by U.S. firms operating in South Africa. Their violation of the apartheid laws was ignored by the South Africa government, which clearly did not want to antagonize important foreign investors.

However, after 10 years, Leon Sullivan concluded that simply following the principles was not sufficient to break down the apartheid regime and that any American company, even those adhering to his principles, could not ethically justify a continued presence in South Africa. Over the next few years, numerous companies divested their South African operations, including Exxon, General Motors, Kodak, IBM, and Xerox. At the same time, many state pension funds signaled they would no longer hold stock in companies that did business in South Africa, which helped to persuade several companies to divest their South African operations. These divestments, coupled with the imposition of economic sanctions from the U.S. and other governments, contributed to the abandonment of white minority rule and apartheid in South Africa and the introduction of democratic elections in 1994. Thus, adopting an ethical stance was argued to have helped improve human rights in South Africa.³

Although change has come in South Africa, many repressive regimes still exist in the world. Is it ethical for multinationals to do business in them? It is often argued that inward investment by a multinational can be a force for economic, political, and social progress that ultimately improves the rights of people in repressive regimes. This position was first discussed in Chapter 2, when we noted that economic progress in a nation can create pressure for democratization. In general, this belief suggests it is ethical for a multinational to do business in nations that lack the democratic structures and human rights records of developed nations. Investment in China, for example, is frequently justified on the grounds that although China's human rights record is often questioned by human rights groups, and although the country is not a democracy, continuing inward investment will help boost economic growth and raise living standards. These developments will ultimately create pressures from the Chinese people for more participative government, political pluralism, and freedom of expression and speech.

But there is a limit to this argument. As in the case of South Africa, some regimes are so repressive that investment cannot be justified on ethical grounds. A current example would be Myanmar (formally known as Burma). Ruled by a military dictatorship for more than 40 years, Myanmar has one of the worst human rights records in the world. Beginning in the mid-1990s, many Western companies exited Myanmar, judging the human rights violations to be so extreme that doing business there cannot be justified on ethical grounds. (In contrast, the accompanying Management Focus looks at the controversy surrounding one company, Unocal, that chose to stay in Myanmar.) However, a cynic might note that Myanmar has a small economy and that divestment carries no great economic penalty for Western firms, unlike, for example, divestment from China.

Nigeria is another country where serious questions have arisen over the extent to which foreign multinationals doing business in the country have contributed to human rights violations. Most notably, the largest foreign oil producer in the country, Royal Dutch/Shell, has been repeatedly criticized.⁴ In the early 1990s, several ethnic groups in Nigeria, which was ruled by a military dictatorship, protested against foreign oil companies for causing widespread pollution and failing to invest in the communities from which they extracted oil. Shell reportedly requested the assistance of Nigeria's Mobile Police Force (MPF) to quell the demonstrations. According to the human rights group Amnesty International, the results were bloody. In 1990, the MPF put down protests against Shell in the village of Umuechem, killing 80 people and destroying 495 homes. In 1993, following protests in the Ogoni region of Nigeria that were designed to stop contractors from laying a new pipeline for Shell, the MPF raided the area to quell the unrest. In the chaos that followed, it has been alleged that 27 villages were razed, 80,000 Ogoni people displaced, and 2,000 people killed.

Critics argued that Shell shouldered some of the blame for the massacres. Shell never acknowledged this, and the MPF probably used the demonstrations as a pretext for punishing an ethnic group that had been agitating against the central government for some time. Nevertheless, these events did prompt Shell to look at its own ethics and to set up internal mechanisms to ensure that its subsidiaries acted in a manner that was consistent with basic human rights.⁵

More generally, the question remains, What is the responsibility of a foreign multinational when operating in a country where basic human rights are trampled on? Should the company be there at all, and if it is there, what actions should it take to avoid the situation Shell found itself in?



Nigerian women and children protest Royal Dutch/Shell in April 2004.

ENVIRONMENTAL POLLUTION

Ethical issues arise when environmental regulations in host nations are far inferior to those in the home nation. Many developed nations have substantial regulations governing the emission of pollutants, the dumping of toxic chemicals, the use of toxic materials in the workplace, and so on. Developing nations often lack those regulations, and according to critics, the result can be higher levels of pollution from the operations of multinationals than would be allowed at home. For example, consider again the case of foreign oil companies in Nigeria. According to a 1992 report prepared by environmental activists in Nigeria, in the Niger Delta region,

Apart from air pollution from the oil industry's emissions and flares day and night, producing poisonous gases that are silently and systematically wiping out vulnerable airborne biota and endangering the life of plants, game, and man himself, we have widespread water pollution and soil/land pollution that results in the death of most aquatic eggs and juvenile stages of the life of fin fish and shell fish on the one hand, whilst, on the other hand, agricultural land contaminated with oil spills becomes dangerous for farming, even where they continue to produce significant yields."⁶

The implication inherent in this description is that pollution controls applied by foreign companies in Nigeria were much laxer than those in developed nations.

Should a multinational feel free to pollute in a developing nation? (To do so hardly seems ethical.) Is there a danger that amoral management might move production to a developing nation precisely because costly pollution controls are not required, and the company is therefore free to despoil the environment and perhaps endanger local people in its quest to lower production costs and gain a competitive advantage? What is the right and moral thing to do in such circumstances? Pollute to gain an economic advantage, or make sure that foreign subsidiaries adhere to common standards regarding pollution controls?

These questions take on added importance because some parts of the environment are a public good that no one owns but anyone can despoil. No one owns the atmosphere or the oceans, but polluting both, no matter where the pollution originates, harms all.⁷ The atmosphere and oceans can be viewed as a global commons from which everyone benefits but for which no one is specifically responsible. In such cases, a phenomenon known as the *tragedy of the commons* becomes applicable. The tragedy of the commons occurs when a resource held in common by all, but owned by no one, is overused by individuals, resulting in its degradation. The phenomenon was first named by Garrett Hardin when describing a particular problem in 16th-century England. Large open areas, called commons, were free for all to use as pasture. The poor put out livestock on these commons and supplemented their meager incomes. It was advantageous for each to put out more and more livestock, but the social consequence

MANAGEMENT FOCUS

In 1995, Unocal, an oil and gas enterprise based in California, took a 29 percent stake in a partnership with the French oil company Total and state-owned companies from both Myanmar and Thailand to build a gas pipeline from Myanmar to Thailand. At the time, the \$1 billion project was expected to bring Myanmar about \$200 million in annual export earnings, a quarter of the country's total. The gas used domestically would increase Myanmar's generating capacity by 30 percent. This investment was made when a number of other American companies were exiting Myanmar. Myanmar's government, a military dictatorship, had a reputation for brutally suppressing internal dissent. Citing the political climate, the apparel companies Levi Strauss and Eddie Bauer had both withdrawn from the country. But as far as Unocal's management was concerned, the giant infrastructure project would generate healthy returns for the company and, by boosting economic growth, a better life for Myanmar's 43 million people. Moreover, while Levi Strauss and Eddie Bauer could easily shift production of clothes to another low-cost location, Unocal argued it had to go where the oil and gas were located.

However, Unocal's investment quickly became highly controversial. Under the terms of the contract, the government of Myanmar was contractually obliged to clear a corridor for the pipeline through Myanmar's tropical forests and to protect the pipeline from attacks by the government's enemies. According to human rights groups, the Myanmar army forcibly moved villages and ordered hundreds of local peasants to work on the pipeline in conditions that were no better than slave labor. Those who refused to comply suffered retaliation. News reports cite the case of one woman who was thrown into a fire, along with her baby, after her husband tried to escape from troops forcing him to work on the

project. The baby died and she suffered burns. Other villagers reported being beaten, tortured, raped, and otherwise mistreated when the alleged slave labor conditions were occurring.

In 1996, human rights activists brought a lawsuit against Unocal in the United States on behalf of 13 Myanmar villagers who had fled to refugee camps in Thailand. The suit claimed that Unocal was aware of what was going on, even if it did not participate or condone it, and that awareness was enough to make Unocal in part responsible for the alleged crimes. The presiding judge dismissed the case on the grounds that Unocal could not be held liable for the actions of a foreign government against its own people—although the judge did note that Unocal was aware of what was going on in Myanmar. The plaintiffs appealed, and in late 2003 the case wound up at a superior court. This time, the plaintiffs' legal strategy hinged upon the use of a law that had been on the books since 1792 but was largely ignored for 200 years. Known as the Alien Tort Claims Act (ATCT) of 1792, this law allows foreigners to sue each other in U.S. courts. The ATCT law is being used to allow the foreign plaintiffs to sue the Myanmar subsidiary of Unocal for damages. At the time of this writing, the case is ongoing. Irrespective of the final outcome, however, and most legal scholars believe that Unocal may ultimately be able to dodge any legal liability, there is little doubt that one can question the ethical validity of Unocal's decision to enter into partnership with a brutal military dictatorship for financial gain.

Sources: Jim Carlton, "Unocal Trial for Slave Labor Claims Is Set to Start Today," *The Wall Street Journal*, December 9, 2003, p. A19; Seth Stern, "Big Business Targeted for Rights Abuse," *Christian Science Monitor*, September 4, 2003, p. 2; "Trouble in the Pipeline," *The Economist*, January 18, 1997, p. 39; and Irtani Evelyn, "Feeling the Heat: Unocal Defends Myanmar Gas Pipeline Deal," *Los Angeles Times*, February 20, 1995, p. D1.



was far more livestock than the commons could handle. The result was overgrazing, degradation of the commons, and the loss of this much-needed supplement.⁸

In the modern world, corporations can contribute to the global tragedy of the commons by moving production to locations where they are free to pump pollutants into the atmosphere or dump them in oceans or rivers, thereby harming these valuable global commons. While such action may be legal, is it ethical? Again, such actions seem to violate basic societal notions of ethics and social responsibility.

CORRUPTION

As noted in Chapter 2, corruption has been a problem in almost every society in history, and it continues to be one today. There always have been and always will be corrupt government officials. International businesses can gain and have gained economic advantages by making payments to those officials. A classic example concerns a well-publicized incident in the 1970s. Carl Kotchian, the president of Lockheed, made a \$12.5 million payment to Japanese agents and government officials to secure a large order for Lockheed's TriStar jet from Nippon Air. When the payments were discovered, U.S. officials charged Lockheed with falsification of its records and tax violations. Although such payments were supposed to be an accepted business practice in Japan (they might be viewed as an exceptionally lavish form of gift giving), the revelations created a scandal there too. The government ministers in question were criminally charged, one committed suicide, the government fell in disgrace, and the Japanese people were outraged. Apparently, such a payment was not an accepted way of doing business in Japan! The payment was nothing more than a bribe, paid to corrupt officials, to secure a large order that might otherwise have gone to another manufacturer, such as Boeing. Kotchian clearly engaged in unethical behavior, and to argue that the payment was an "acceptable form of doing business in Japan" was self-serving and incorrect.

The Lockheed case was the impetus for the 1977 passage of the **Foreign Corrupt Practices Act** in the United States, which we first discussed in Chapter 2. The act outlawed the paying of bribes to foreign government officials to gain business. Some U.S. businesses immediately objected that the act would put U.S. firms at a competitive disadvantage (there is no evidence that subsequently occurred).⁹ The act was subsequently amended to allow for "facilitating payments." Sometimes known as speed money or grease payments, facilitating payments are *not* payments to secure contracts that would not otherwise be secured, nor are they payments to obtain exclusive preferential treatment; rather they are payments to ensure receiving the standard treatment that a business ought to receive from a foreign government but might not due to the obstruction of a foreign official.

In 1997, the trade and finance ministers from the member states of the Organization for Economic Cooperation and Development (OECD) followed the U.S. lead and adopted the **Convention on Combating Bribery of Foreign Public Officials in International Business Transactions**.¹⁰ The convention, which went into force in 1999, obliges member states to make the bribery of foreign public officials a criminal offense. The convention excludes facilitating payments made to expedite routine government action from the convention. To be truly effective, however, the convention must be translated into domestic law by each signatory nation, and that is still in process.

While facilitating payments, or speed money, are excluded from both the Foreign Corrupt Practices Act and the OECD convention on bribery, the ethical implications of making such payments are unclear. In many countries, payoffs to government officials in the form of speed money are a part of life. One can argue that not investing because government officials demand speed money ignores the fact that such investment can bring substantial benefits to the local populace in terms of income and jobs. From a pragmatic standpoint, giving bribes, although a little evil, might be the price that must be paid to do a greater good (assuming the investment creates jobs where none existed and assuming the practice is not illegal). Several economists advocate this reasoning, suggesting that in the context of pervasive and cumbersome regulations in developing countries, corruption may improve efficiency and help growth! These economists theorize that in a country where preexisting political structures distort or limit the workings of the market mechanism, corruption in the form of black-marketeering, smuggling, and side payments to government bureaucrats to "speed up" approval for business investments may enhance welfare.¹¹ Arguments such as this persuaded the U.S. Congress to exempt facilitating payments from the Foreign Corrupt Practices Act.

In contrast, other economists have argued that corruption reduces the returns on business investment and leads to low economic growth.¹² In a country where corruption is common, unproductive bureaucrats who demand side payments for granting the enterprise permission to operate may siphon off the profits from a business activity. This reduces businesses' incentive to invest and may retard a country's economic growth rate. One study of the connection between corruption and economic growth in 70 countries found that corruption had a significant negative impact on a country's growth rate.¹³

Given the debate and the complexity of this issue, one again might conclude that generalization is difficult and the demand for speed money creates a genuine ethical dilemma. Yes, corruption is bad, and yes, it may harm a country's economic development, but yes, there are also cases where side payments to government officials can remove the bureaucratic barriers to investments that create jobs. However, this pragmatic stance ignores the fact that corruption tends to corrupt both the bribe giver and the bribe taker. Corruption feeds on itself, and once an individual starts down the road of corruption, pulling back may be difficult if not impossible. This argument strengthens the ethical case for never engaging in corruption, no matter how compelling the benefits might seem.

Many multinationals have accepted this argument. The large oil multinational, BP, for example, has a zero-tolerance approach toward facilitating payments. Other corporations have a more nuanced approach. For example, consider the following from the code of ethics at Dow Corning:

Dow Corning employees will not authorize or give payments or gifts to government employees or their beneficiaries or anyone else in order to obtain or retain business. Facilitating payments to expedite the performance of routine services are strongly discouraged. In countries where local business practice dictates such payments and there is no alternative, facilitating payments are to be for the minimum amount necessary and must be accurately documented and recorded.¹⁴

This statement allows for facilitating payments when “there is no alternative,” although they are strongly discouraged.

MORAL OBLIGATIONS

Multinational corporations have power that comes from their control over resources and their ability to move production from country to country. Although that power is constrained not only by laws and regulations, but also by the discipline of the market and the competitive process, it is nevertheless substantial. Some moral philosophers argue that with power comes the social responsibility for multinationals to give something back to the societies that enable them to prosper and grow. The concept of **social responsibility** refers to the idea that businesspeople should consider the social consequences of economic actions when making business decisions, and that there should be a presumption in favor of decisions that have both good economic and social consequences.¹⁵ In its purest form, social responsibility can be supported for its own sake simply because it is the right way for a business to behave. Advocates of this approach argue that businesses, particularly large successful businesses, need to recognize their *noblesse oblige* and give something back to the societies that have made their success possible. *Noblesse oblige* is a French term that refers to honorable and benevolent behavior considered the responsibility of people of high (noble) birth. In a business setting, it is taken to mean benevolent behavior that is the responsibility of *successful* enterprises. This has long been recognized by many businesspeople, resulting in a substantial and venerable history of corporate giving to society and in businesses making social investments designed to enhance the welfare of the communities in which they operate.

However, some multinationals have abused their power for private gain. The most famous historic example relates to one of the earliest multinationals, the British East India Company. Established in 1600, the East India Company grew to dominate the entire Indian subcontinent in the 19th century. At the height of its power, the company deployed

MANAGEMENT FOCUS

Rupert Murdoch

built News Corporation into one of the largest media conglomerates in the world with interests that include newspapers, publishing, and television broadcasting. According to critics, however, Mr. Murdoch abused his power to gain preferential access to the Chinese media market by systematically suppressing media content that was critical of China and publishing material designed to ingratiate the company with the Chinese leadership.

In 1994, News Corporation excluded BBC news broadcasts from Star TV coverage in the region after it had become clear that Chinese politicians were unhappy with the BBC's continual reference to repression in China, and most notably, the 1989 massacre of student protesters for democracy in Beijing's Tiananmen Square. In 1995, News Corporation's book publishing subsidiary, HarperCollins, published a flattering biography of Deng Xiaoping, the former leader of China, written by his daughter. Then in 1998, HarperCollins dropped plans to publish the memoirs of Chris Patten, the last governor of Hong Kong before its transfer to the Chinese. Mr. Patten, a critic of Chinese leaders, had aroused their wrath by attempting to introduce a degree of democracy into the administration of the old British territory before its transfer back to China in 1997.

In a 1998 interview in *Vanity Fair*, Mr. Murdoch took another opportunity to ingratiate himself with the Chinese leadership when he described the Dalai Lama, the exiled leader of Chinese-occupied Tibet, as "a very political old monk shuffling around in Gucci shoes." On the heels of this, in 2001 Mr. Murdoch's son James, who was in charge of running Star TV, made disparaging remarks about Falun Gong, a spiritual movement involving breathing exercises and meditation that had become so popular in China that the Communist regime regarded it as a political threat, and suppressed its activities. According to James Murdoch, Falun Gong was a "dangerous," "apocalyptic cult" which "clearly does not have the success of China at heart."

Critics argued that these events were all part of a deliberate and unethical effort on the part of News Corporation to curry favor with the Chinese. The company received its reward in 2001 when Star TV struck an agreement with the Chinese government to launch a Mandarin-language entertainment channel for the affluent southern coastal province of Guangdong. Earlier that year, China's leader, Jiang Zemin, had publicly praised Rupert Murdoch and Star TV for their efforts "to present China objectively and to cooperate with the Chinese press."

Source: Daniel Litvin, *Empires of Profit* (New York: Texere, 2003).

more than 40 warships, possessed the largest standing army in the world, was the de facto ruler of India's 240 million people, and even hired its own church bishops, extending its dominance into the spiritual realm.¹⁶

Power itself is morally neutral. It is how power is used that matters. It can be used in a positive way to increase social welfare, which is ethical, or it can be used in a manner that is ethically and morally suspect. Consider the case of News Corporation, one of the largest media conglomerates in the world, which is profiled in the accompanying Management Focus. The power of media companies derives from their ability to shape public perceptions by the material they choose to publish. News Corporation founder and CEO Rupert Murdoch has long considered China to be one of the most promising media markets in the world and has sought permission to expand News Corporation's operations in China, particularly the satellite broadcasting operations of Star TV. Some critics believe that Murdoch used the power of News Corporation in an unethical way to attain this objective.

Some multinationals have acknowledged a moral obligation to use their power to enhance social welfare in the communities where they do business. BP, one of the world's largest oil companies, has made it part of the company policy to undertake "social investments" in the countries where it does business.¹⁷ In Algeria, BP has been investing in a major project to develop gas fields near the desert town of Salah. When the company noticed the lack of clean water in Salah, it built two desalination plants to provide drinking water for the local

community and distributed containers to residents so they could take water from the plants to their homes. There was no economic reason for BP to make this social investment, but the company believes it is morally obligated to use its power in constructive ways. The action, while a small thing for BP, is a very important thing for the local community.



Ethical Dilemmas

The ethical obligations of a multinational corporation toward employment conditions, human rights, corruption, environmental pollution, and the use of power are not always clear cut. There may be no agreement about accepted ethical principles. From an international business perspective, some argue that what is ethical depends upon one's cultural perspective.¹⁸ In the United States, it is considered acceptable to execute murderers, but in many cultures this is not acceptable—execution is viewed as an affront to human dignity and the death penalty is outlawed. Many Americans find this attitude very strange, but many Europeans find the American approach barbaric. For a more business-oriented example, consider the practice of “gift giving” between the parties to a business negotiation. While this is considered right and proper behavior in many Asian cultures, some Westerners view the practice as a form of bribery, and therefore unethical, particularly if the gifts are substantial.

Managers must confront very real ethical dilemmas. For example, imagine that a visiting American executive finds that a foreign subsidiary in a poor nation has hired a 12-year-old girl to work on a factory floor. Appalled to find that the subsidiary is using child labor in direct violation of the company's own ethical code, the American instructs the local manager to replace the child with an adult. The local manager dutifully complies. The girl, an orphan, who is the only breadwinner for herself and her 6-year-old brother, is unable to find another job, so in desperation she turns to prostitution. Two years later she dies of AIDS. Meanwhile, her brother takes up begging. He encounters the American while begging outside the local McDonald's. Oblivious that this was the man responsible for his fate, the boy begs him for money. The American quickens his pace and walks rapidly past the outstretched hand into the McDonald's, where he orders a quarter-pound cheeseburger with fries and cold milk shake. A year later the boy contracts tuberculosis and dies.

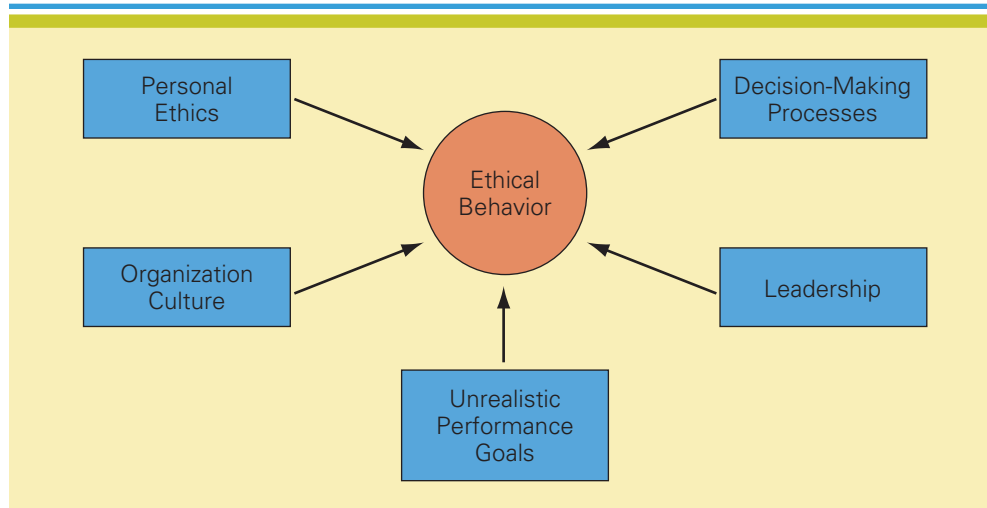
Had the visiting American understood the gravity of the girl's situation, would he still have requested her replacement? Perhaps not! Would it have been better, therefore, to stick with the status quo and allow the girl to continue working? Probably not, because that would have violated the reasonable prohibition against child labor found in the company's own ethical code. What then would have been the right thing to do? What was the obligation of the executive given this ethical dilemma?

There is no easy answer to these questions. That is the nature of **ethical dilemmas**—they are situations in which none of the available alternatives seems ethically acceptable.¹⁹ In this case, employing child labor was not acceptable, but given that she was employed, neither was denying the child her only source of income. What the American executive needed, what all managers need, was a moral compass, or perhaps an ethical algorithm, that would guide him through such an ethical dilemma to find an acceptable solution. Later in this chapter we will outline what such a moral compass, or ethical algorithm, might look like. For now, it is enough to note that ethical dilemmas exist because many real-world decisions are complex, difficult to frame, and involve first-, second-, and third-order consequences that are hard to quantify. Doing the right thing, or even knowing what the right thing might be, is often far from easy.



The Roots of Unethical Behavior

Examples abound of managers behaving in a manner that might be judged unethical in an international business setting. A group of American investors became interested in restoring the SS *United States*, at one time a luxurious ocean liner.²⁰ The first step in the

**FIGURE 4.1**

Determinants of Ethical Behavior

project involved stripping the ship of its asbestos lining. Asbestos is a highly toxic material that produces a fine dust that when inhaled can cause scarring and result in lung disease, cancer, and death. Accordingly, very tight standards in developed countries govern the removal of asbestos. A bid from a U.S. company, based on the standards established in the United States, priced the job at more than \$100 million. A company in the Ukraine offered to do the job for \$2 million, so the ship was towed to the Ukrainian port of Sevastopol. Agreeing to do the work for \$2 million implied that the Ukrainian company could not have adopted standards even remotely close to those required in the United States. As a consequence, its employees were at a significant risk of developing asbestos-related disease. If this was the case, the desire to limit costs had resulted in the American investors acting in an unethical manner, for they were knowingly rewarding a company that exposed its workers to a significant health risk.

Why do managers behave in a manner that is unethical? There is no simple answer to this question, for the causes are complex, but a few generalizations can be made (see Figure 4.1).²¹ First, business ethics are not divorced from *personal ethics*, which are the generally accepted principles of right and wrong governing the conduct of individuals. As individuals, we are typically taught that it is wrong to lie and cheat—it is unethical—and that it is right to behave with integrity and honor, and to stand up for what we believe to be right and true. This is generally true across societies. The personal ethical code that guides our behavior comes from a number of sources, including our parents, our schools, our religion, and the media. Our personal ethical code exerts a profound influence on the way we behave as businesspeople. An individual with a strong sense of personal ethics is less likely to behave in an unethical manner in a business setting. It follows that the first step to establishing a strong sense of business ethics is for a society to emphasize strong personal ethics.

Home-country managers working abroad in multinational firms (expatriate managers) may experience more than the usual degree of pressure to violate their personal ethics. They are away from their ordinary social context and supporting culture, and they are psychologically and geographically distant from the parent company. They may be based in a culture that does not place the same value on ethical norms important in the manager's home country, and they may be surrounded by local employees who have less rigorous ethical standards. The parent company may pressure expatriate managers to meet unrealistic goals that can be fulfilled only by cutting corners or acting unethically. For example, to meet centrally mandated performance goals, expatriate managers might give bribes to win contracts or might implement working conditions and environmental controls that are below minimal acceptable standards. Local managers might encourage the



Former Enron CEO Kenneth Lay was charged with a variety of criminal deeds.


expatriate to adopt such behavior. And due to its geographical distance, the parent company may be unable to see how expatriate managers are meeting goals, or may choose not to see how they are doing so, allowing such behavior to flourish and persist.

Also, many studies of unethical behavior in a business setting have concluded that businesspeople sometimes do not realize they are behaving unethically, primarily because they simply fail to ask, Is this decision or action ethical?²² Instead, they apply a straightforward business calculus to what they perceive to be a business decision, forgetting that the decision may also have an important ethical dimension. The fault lies in processes that do not incorporate ethical considerations into business decision making. This may have been the case at Nike when managers originally made subcontracting decisions (see the opening case). Those decisions were probably made on the basis of good economic logic. Subcontractors were probably chosen on the basis of business variables such as cost, delivery, and product quality, and the key managers simply failed to ask, How does this subcontractor treat its workforce? If they thought about the question at all, they probably reasoned that it was the subcontractor's concern, not theirs. (For another example of a business decision that may have been unethical, see the accompanying Management Focus describing Pfizer's decision to test an experimental drug on children suffering from meningitis in Nigeria.)

Unfortunately, the climate in some businesses does not encourage people to think through the ethical consequences of business decisions. This brings us to the third cause of unethical behavior in businesses—an organizational culture that deemphasizes business ethics, reducing all decisions to the purely economic. The term **organization culture** refers to the values and norms that are shared among employees of an organization. You will recall from Chapter 3 that values are abstract ideas about what a group believes to be good, right, and desirable, while norms are the social rules and guidelines that prescribe appropriate behavior in particular situations. Just as societies have cultures, so do business organizations. Together, values and norms shape the culture of a business organization, and that culture has an important influence on the ethics of business decision making.

Author Robert Bryce has explained how the organization culture at now-bankrupt multinational energy company Enron was built on values that emphasized greed and deception.²³ According to Bryce, the tone was set by top managers who engaged in self-dealing to enrich themselves and their own families. He tells how former Enron CEO Kenneth Lay made sure his own family benefited handsomely from Enron. Much of Enron's corporate travel business was handled by a travel agency part owned by Lay's sister. When an internal auditor recommended that the company could do better by using another travel agency, he soon found himself out of a job. In 1997, Enron acquired a company owned by Kenneth Lay's son, Mark Lay, which was trying to establish a business trading paper and pulp products. At the time, Mark Lay and another company he controlled were targets of a federal criminal investigation of bankruptcy fraud and embezzlement. As part of the deal, Enron hired Mark Lay as an executive with a three-year contract that guaranteed him at least \$1 million in pay over that period, plus options to purchase about 20,000 shares of Enron. Bryce also details how Kenneth Lay's grown daughter used an Enron jet to transport her king-sized bed to France. With Kenneth Lay as an example, it is perhaps not surprising that self-dealing soon became endemic at Enron. The most notable example was Chief Financial Officer Andrew Fastow, who set up "off-balance-sheet" partnerships that not only hid Enron's true financial condition from investors, but also paid tens of millions of dollars directly to Fastow. (Fastow was subsequently indicted by the government for criminal fraud and went to jail.)

The fourth cause of unethical behavior has already been hinted at—it is pressure from the parent company to meet unrealistic performance goals that can be attained only by cutting corners or acting in an unethical manner. Again, Bryce discusses how this may have occurred at Enron. Kenneth Lay's successor as CEO, Jeff Skilling, put a performance



MANAGEMENT FOCUS The drug development process is long, risky, and expensive. It can take 10 years and cost in excess of \$500 million to develop a new drug. Also, between 80 and 90 percent of drug candidates fail in clinical trials. Pharmaceutical companies rely upon a handful of successes to pay for their failures. Among the most successful of the world's pharmaceutical companies is New York-based Pfizer. Given the risks and costs of developing a new drug, pharmaceutical companies will jump at opportunities to reduce them, and in 1996 Pfizer thought it saw one.

Pfizer had been developing a novel antibiotic, Trovan, that was proving to be useful in treating a wide range of bacterial infections. Wall Street analysts were predicting that Trovan could be a blockbuster, one of a handful of drugs capable of generating sales of more than \$1 billion a year. In 1996, Pfizer was pushing to submit data on Trovan's efficacy to the Food and Drug Administration (FDA) for review. A favorable review would allow Pfizer to sell the drug in the United States, the world's largest market. Pfizer wanted the drug to be approved for both adults and children, but it was having trouble finding sufficient numbers of sick children in the United States to test the drug on. Then in early 1996, a researcher at Pfizer read about an emerging epidemic of bacterial meningitis in Kano, Nigeria. This seemed like a quick way to test the drug on a large number of sick children.

Within weeks, a team of six doctors had flown to Kano and were administering the drug, in oral form, to children with meningitis. Desperate for help, Nigerian authorities had given the go-ahead for Pfizer to give the drug to children (the epidemic would ultimately kill nearly 16,000 people). Over the next few weeks, Pfizer treated 198 children. The protocol called for half the patients to get Trovan and half to get a comparison antibiotic already approved for the treatment of children. After a few weeks, the Pfizer team left, the experiment complete. Trovan seemed to be about as effective and safe as the already approved antibiotic. The data from the trial were put into a package with data from other trials of Trovan and delivered to the FDA.

Questions were soon raised about the nature of Pfizer's experiment. Allegations charged that the Pfizer team kept children on Trovan even after they failed to show a response to the drug, instead of switching them quickly to another drug. The result, according to critics, was that some children died who might have been saved had they

been taken off Trovan sooner. Questions were also raised about the safety of the oral formulation of Trovan, which some doctors feared might lead to arthritis in children. Fifteen children who took Trovan showed signs of joint pain during the experiment, three times the rate of children taking the other antibiotic. Then there were questions about consent. The FDA requires that patient (or parent) consent be given before patients are enrolled in clinical trials, no matter where in the world the trials are conducted. Critics argue that in the rush to get the trial established in Nigeria, Pfizer did not follow proper procedures, and that many parents of the infected children did not know their children were participating in a trial for an experimental drug. Many of the parents were illiterate, could not read the consent forms, and had to rely upon the questionable translation of the Nigerian nursing staff. Pfizer rejected these charges and contends that it did nothing wrong.

Trovan was approved by the FDA for use in adults in 1997, but it was never approved for use in children. It was launched in 1998, and by 1999 there were reports that up to 140 patients in Europe had suffered liver damage after taking Trovan. The FDA subsequently restricted the use of Trovan to those cases where the benefits of treatment outweighed the risk of liver damage. European regulators banned sales of the drug. In 2003, two dozen Nigerian families sued Pfizer in a federal court in New York. The families claim their children either died or were injured because Pfizer did not adequately inform them of the risks and alternatives for treatment with Trovan. The case is still ongoing.

Did Pfizer behave unethically by rushing to take advantage of an epidemic in Nigeria to test an experimental drug on children? Should it have been less opportunistic and proceeded more carefully? Were corners cut with regard to patient consent in the rush to establish a trial? And did doctors keep patients on Trovan too long, when they should have switched them to another medication? Is it ethical to test an experimental drug on children in a crisis setting in the developing world, where the overall standard of health care is so much lower than in the developed world and proper protocols might not be followed? These questions are all raised by the Pfizer case, and they remain unanswered, by the company at least.

Source: Joe Stephens, "Where Profits and Lives Hang in the Balance," *Washington Post*, December 17, 2000, p. A1; Andra Brichacek, "What Price Corruption?" *Pharmaceutical Executive* 21, no. 11 (November 2001), p. 94; and Scott Hensley, "Court Revives Suit against Pfizer on Nigeria Study," *The Wall Street Journal*, October 13, 2004, p. B4.

evaluation system in place that weeded out 15 percent of underperformers every six months. This created a pressure-cooker culture with a myopic focus on short-run performance, and some executives and energy traders responded to that pressure by falsifying their performance—inflating the value of trades, for example—to make it look as if they were performing better than was actually the case.

The lesson from the Enron debacle is that an organizational culture can legitimize behavior that society would judge as unethical, particularly when this is mixed with a focus on unrealistic performance goals, such as maximizing short-term economic performance, no matter what the costs. In such circumstances, there is a greater than average probability that managers will violate their own personal ethics and engage in unethical behavior. By the same token, an organization culture can do just the opposite and reinforce the need for ethical behavior. At Hewlett-Packard, for example, Bill Hewlett and David Packard, the company's founders, propagated a set of values known as The HP Way. These values, which shape the way business is conducted both within and by the corporation, have an important ethical component. Among other things, they stress the need for confidence in and respect for people, open communication, and concern for the individual employee.

The Enron and Hewlett-Packard examples suggest a fifth root cause of unethical behavior—leadership. Leaders help to establish the culture of an organization, and they set the example that others follow. Other employees in a business often take their cue from business leaders, and if those leaders do not behave in an ethical manner, they might not either. It is not what leaders say that matters, but what they do. Enron, for example, had a code of ethics that Kenneth Lay himself often referred to, but Lay's own actions to enrich family members spoke louder than any words.



Philosophical Approaches to Ethics

We shall look at several different approaches to business ethics here, beginning with some that can best be described as straw men, which either deny the value of business ethics or apply the concept in a very unsatisfactory way. Having discussed, and dismissed, the straw men, we then move on to consider approaches that are favored by most moral philosophers and form the basis for current models of ethical behavior in international businesses.

STRAW MEN

Straw men approaches to business ethics are raised by business ethics scholars primarily to demonstrate that they offer inappropriate guidelines for ethical decision making in a multinational enterprise. Four such approaches to business ethics are commonly discussed in the literature. These approaches can be characterized as the Friedman doctrine, cultural relativism, the righteous moralist, and the naive immoralist. All of these approaches have some inherent value, but all are unsatisfactory in important ways. Nevertheless, sometimes companies adopt these approaches.

The Friedman Doctrine

Nobel Prize-winning economist Milton Friedman wrote an article in 1970 that has since become a classic straw man that business ethics scholars outline only to then tear down.²⁴ Friedman's basic position is that the only social responsibility of business is to increase profits, so long as the company stays within the rules of law. He explicitly rejects the idea that businesses should undertake social expenditures beyond those mandated by the law and required for the efficient running of a business. For example, his arguments suggest that improving working conditions beyond the level required by the law *and* necessary to maximize employee productivity will reduce profits and are therefore not appropriate. His belief is that a firm should maximize its profits because that is the way to maximize the

returns that accrue to the owners of the firm, its stockholders. If stockholders then wish to use the proceeds to make social investments, that is their right, according to Friedman, but managers of the firm should not make that decision for them.

Although Friedman is talking about social responsibility, rather than business ethics per se, most business ethics scholars equate social responsibility with ethical behavior, and thus believe Friedman is also arguing against business ethics. However, the assumption that Friedman is arguing against ethics is not quite true, for Friedman does state,

There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say that it engages in open and free competition without deception or fraud.²⁵

In other words, Friedman states that businesses should behave in an ethical manner and not engage in deception and fraud.

Nevertheless, Friedman's arguments do break down under examination. This is particularly true in the realm of international business where the "rules of the game" are not well established or differ substantially from country to country. Consider again the case of sweatshop labor. Child labor may not be against the law in a developing nation, and maximizing productivity may not require that a multinational firm stop using child labor in that country, but it is still immoral to use child labor because the practice conflicts with widely held views about what is the right and proper thing to do. Similarly, there may be no rules against pollution in a developed nation and spending money on pollution control may reduce the profit rate of the firm, but generalized notions of morality would hold that it is still unethical to dump toxic pollutants into rivers or foul the air with gas releases. In addition to the local consequences of such pollution, which may have serious health effects for the surrounding population, there is also a global consequence as pollutants degrade those two global commons so important to us all—the atmosphere and the oceans.

Cultural Relativism

Another straw man often raised by business ethics scholars is **cultural relativism**, which is the belief that ethics are nothing more than the reflection of a culture—all ethics are culturally determined—and that accordingly, a firm should adopt the ethics of the culture in which it is operating.²⁶ This approach is often summarized by the maxim *when in Rome do as the Romans*. As with Friedman's approach, cultural relativism does not stand up to a closer look. At its extreme, cultural relativism suggests that if a culture supports slavery, it is OK to use slave labor in a country. Clearly it is not. Cultural relativism implicitly rejects the idea that universal notions of morality transcend different cultures, but, as we shall argue later in the chapter, some universal notions of morality are found across cultures.

While dismissing cultural relativism in its most sweeping form, some ethicists argue there is residual value in this approach.²⁷ As we noted in Chapter 3, societal values and norms do vary from culture to culture, customs do differ, so it might follow that certain business practices are ethical in one country, but not another. Indeed, the facilitating payments allowed in the Foreign Corrupt Practices Act can be seen as an acknowledgment that in some countries, the payment of speed money to government officials is necessary to get business done, and if not ethically desirable, it is at least ethically acceptable.

However, not all ethicists or companies agree with this pragmatic view. As noted earlier, oil company BP explicitly states it will not make facilitating payments, no matter what the prevailing cultural norms are. In 2002, BP enacted a zero-tolerance policy for facilitation payments, primarily on the basis that such payments are a low-level form of corruption, and thus cannot be justified because corruption corrupts both the bribe giver and the bribe taker and perpetuates the corrupt system. As BP notes on its Web site, as a result of its zero-tolerance policy:

Some oil product sales in Vietnam involved inappropriate commission payments to the managers of customers in return for placing orders with BP. These were stopped during

2002 with the result that BP failed to win certain tenders with potential profit totalling \$300k. In addition, two sales managers resigned over the issue. The business, however, has recovered using more traditional sales methods and has exceeded its targets at year-end.

BP in India has been working in an environment where facilitation payments are commonplace. The business unit took measures not only to eliminate direct facilitation payments but also extended the policy application to agents, consultants, sales distributors, and suppliers. Workshops covering suppliers, distributors, and agents were held and key third parties provided signed statements confirming their compliance with our ethics policy. Contracts with three distributors and one freight agent were terminated for unethical behaviour. The main lesson learnt was that perseverance is eventually rewarded despite delays. A plant was connected to the national grid, an office co-location project was approved, and a major income tax refund was received—all without making the facilitation payments that would have been required in the past.²⁸

BP's experience suggests that companies should not use cultural relativism as an argument for justifying behavior that is clearly based upon suspect ethical grounds, even if that behavior is both legal and routinely accepted in the country where the company is doing business.

The Righteous Moralist

A **righteous moralist** claims that a multinational's home-country standards of ethics are the appropriate ones for companies to follow in foreign countries. This approach is typically associated with managers from developed nations. While this seems reasonable at first blush, the approach can create problems. Consider the following example: An American bank manager was sent to Italy and was appalled to learn that the local branch's accounting department recommended grossly underreporting the bank's profits for income tax purposes.²⁹ The manager insisted that the bank report its earnings accurately, American style. When he was called by the Italian tax department to the firm's tax hearing, he was told the firm owed three times as much tax as it had paid, reflecting the department's standard assumption that each firm underreports its earnings by two-thirds. Despite his protests, the new assessment stood. In this case, the righteous moralist has run into a problem caused by the prevailing cultural norms in the country where he is doing business. How should he respond? The righteous moralist would argue for maintaining the position, while a more pragmatic view might be that in this case, the right thing to do is to follow the prevailing cultural norms, since there is a big penalty for not doing so.

The main criticism of the righteous moralist approach is that its proponents go too far. While there are some universal moral principles that should not be violated, it does not always follow that the appropriate thing to do is adopt home-country standards. For example, U.S. laws set down strict guidelines with regard to minimum wage and working conditions. Does this mean it is ethical to apply the same guidelines in a foreign country, paying people the same as they are paid in the United States, providing the same benefits and working conditions? Probably not, because doing so might nullify the reason for investing in that country and therefore deny locals the benefits of inward investment by the multinational. Clearly, a more nuanced approach is needed.

The Naive Immoralist

A **naive immoralist** asserts that if a manager of a multinational sees that firms from other nations are not following ethical norms in a host nation, that manager should not either. The classic example to illustrate the approach is known as the drug lord problem. In one variant of this problem, an American manager in Colombia routinely pays off the local drug lord to guarantee that his plant will not be bombed and that none of his employees will be kidnapped. The manager argues that such payments are ethically defensible because everyone is doing it.

The objection is twofold. First, to simply say that an action is ethically justified if everyone is doing it is not sufficient. If firms in a country routinely employ 12-year-olds and makes them work 10-hour days, is it therefore ethically defensible to do the same?

Obviously not, and the company does have a clear choice. It does not have to abide by local practices, and it can decide not to invest in a country where the practices are particularly odious. Second, the multinational must recognize that it does have the ability to change the prevailing practice in a country. It can use its power for a positive moral purpose. This is what BP is doing by adopting a zero-tolerance policy with regard to facilitating payments. BP is stating that the prevailing practice of making facilitating payments in countries such as India is ethically wrong, and it is incumbent upon the company to use its power to try to change the standard. While some might argue that such an approach smells of moral imperialism and a lack of cultural sensitivity, if it is consistent with widely accepted moral standards in the global community, it may be ethically justified.

To return to the drug lord problem, an argument can be made that it is ethically defensible to make such payments, not because everyone else is doing so but because not doing so would cause greater harm (i.e., the drug lord might seek retribution and engage in killings and kidnappings). Another solution to the problem is to refuse to invest in a country where the rule of law is so weak that drug lords can demand protection money. This solution, however, is also imperfect, for it might mean denying the law-abiding citizens of that country the benefits associated with inward investment by the multinational (i.e., jobs, income, greater economic growth). Clearly, the drug lord problem constitutes one of those intractable ethical dilemmas where there is no obvious right solution, and managers need a moral compass to help them find an acceptable solution to the dilemma.

UTILITARIAN AND KANTIAN ETHICS

In contrast to the straw men just discussed, most moral philosophers see value in utilitarian and Kantian approaches to business ethics. These approaches were developed in the 18th and 19th centuries, and although they have been largely superseded by more modern approaches, they also form part of the tradition upon which newer approaches have been constructed.

The utilitarian approach to business ethics dates to philosophers such as David Hume (1711–1776), Jeremy Bentham (1784–1832), and John Stuart Mill (1806–1873). **Utilitarian approaches** to ethics hold that the moral worth of actions or practices is determined by their consequences.³⁰ An action is judged to be desirable if it leads to the best possible balance of good consequences over bad consequences. Utilitarianism is committed to the maximization of good and the minimization of harm. It recognizes that actions have multiple consequences, some of which are good in a social sense and some of which are harmful. As a philosophy for business ethics, it focuses attention on the need to carefully weigh all of the social benefits and costs of a business action and to pursue only those actions where the benefits outweigh the costs. The best decisions, from a utilitarian perspective, are those that produce the greatest good for the greatest number of people.

Many businesses have adopted specific tools such as cost–benefit analysis and risk assessment that are firmly rooted in a utilitarian philosophy. Managers often weigh the benefits and costs of an action before deciding whether to pursue it. An oil company considering drilling in the Alaskan wildlife preserve must weigh the economic benefits of increased oil production and the creation of jobs against the costs of environmental degradation in a fragile ecosystem. An agricultural biotechnology company such as Monsanto must decide whether the benefits of genetically modified crops that produce natural pesticides outweigh the risks. The benefits include increased crop yields and reduced need for chemical fertilizers. The risks include the possibility that Monsanto's insect-resistant crops might make matters worse over time if insects evolve a resistance to the natural pesticides engineered into Monsanto's plants, rendering the plants vulnerable to a new generation of super bugs.

For all of its appeal, utilitarian philosophy has some serious drawbacks as an approach to business ethics. One problem is measuring the benefits, costs, and risks of an action before deciding to pursue it. In the case of an oil company considering drilling in Alaska, how

does one measure the potential harm done to the region's ecosystem? In the Monsanto example, how can one quantify the risk that genetically engineered crops might ultimately result in the evolution of super bugs that are resistant to the natural pesticide engineered into the crops? In general, utilitarian philosophers recognize that the measurement of benefits, costs, and risks is often not possible due to limited knowledge.

The second problem with utilitarianism is that the philosophy omits the consideration of justice. The action that produces the greatest good for the greatest number of people may result in the unjustified treatment of a minority. Such action cannot be ethical, precisely because it is unjust. For example, suppose that in the interests of keeping down health insurance costs, the government decides to screen people for the HIV virus and deny insurance coverage to those who are HIV positive. By reducing health costs, such action might produce significant benefits for a large number of people, but the action is unjust because it discriminates unfairly against a minority.

Kantian ethics are based on the philosophy of Immanuel Kant (1724–1804). **Kantian ethics** hold that people should be treated as ends and never purely as *means* to the ends of others. People are not instruments, like a machine. People have dignity and need to be respected as such. Employing people in sweatshops, making them work long hours for low pay in poor work conditions, is a violation of ethics, according to Kantian philosophy, because it treats people as mere cogs in a machine and not as conscious moral beings who have dignity. Although contemporary moral philosophers tend to view Kant's ethical philosophy as incomplete—for example, his system has no place for moral emotions or sentiments such as sympathy or caring—the notion that people should be respected and treated with dignity still resonates in the modern world.

RIGHTS THEORIES

Developed in the 20th century, **rights theories** recognize that human beings have fundamental rights and privileges that transcend national boundaries and cultures. Rights establish a minimum level of morally acceptable behavior. One well-known definition of a fundamental right construes it as something that takes precedence over or “trumps” a collective good. Thus, we might say that the right to free speech is a fundamental right that takes precedence over all but the most compelling collective goals and overrides, for example, the interest of the state in civil harmony or moral consensus.³¹ Moral theorists argue that fundamental human rights form the basis for the *moral compass* that managers should navigate by when making decisions that have an ethical component. More precisely, they should not pursue actions that violate these rights.

The notion that there are fundamental rights that transcend national borders and cultures was the underlying motivation for the United Nations **Universal Declaration of Human Rights**, which has been ratified by almost every country on the planet and lays down basic principles that should always be adhered to irrespective of the culture in which one is doing business.³² Echoing Kantian ethics, Article 1 of this declaration states:

Article 1: All human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood.

Article 23 of this declaration, which relates directly to employment, states:

1. Everyone has the right to work, to free choice of employment, to just and favorable conditions of work, and to protection against unemployment.
2. Everyone, without any discrimination, has the right to equal pay for equal work.
3. Everyone who works has the right to just and favorable remuneration ensuring for himself and his family an existence worthy of human dignity, and supplemented, if necessary, by other means of social protection.
4. Everyone has the right to form and to join trade unions for the protection of his interests.

Clearly, the rights to “just and favorable work conditions,” “equal pay for equal work,” and remuneration that ensures an “existence worthy of human dignity” embodied in Ar-

ticle 23 imply that it is unethical to employ child labor in sweatshop settings and pay less than subsistence wages, even if that happens to be common practice in some countries. These are fundamental human rights that transcend national borders.

It is important to note that along with *rights* come *obligations*. Because we have the right to free speech, we are also obligated to make sure that we respect the free speech of others. The notion that people have obligations is stated in Article 29 of the Universal Declaration of Human Rights:

Article 29: Everyone has duties to the community in which alone the free and full development of his personality is possible.

Within the framework of a theory of rights, certain people or institutions are obligated to provide benefits or services that secure the rights of others. Such obligations also fall upon more than one class of moral agent (a moral agent is any person or institution that is capable of moral action such as a government or corporation).

For example, to escape the high costs of toxic waste disposal in the West, in the late 1980s several firms shipped their waste in bulk to African nations, where it was disposed of at a much lower cost. In 1987, five European ships unloaded toxic waste containing dangerous poisons in Nigeria. Workers wearing sandals and shorts unloaded the barrels for \$2.50 a day and placed them in a dirt lot in a residential area. They were not told about the contents of the barrels.³³ Who bears the obligation for protecting the safety of workers and residents in a case like this? According to rights theorists, the obligation rests not on the shoulders of one moral agent, but on the shoulders of all moral agents whose actions might harm or contribute to the harm of the workers and residents. Thus, it was the obligation not just of the Nigerian government but also of the multinational firms that shipped the toxic waste to make sure it did no harm to residents and workers. In this case, both the government and the multinationals apparently failed to recognize their basic obligation to protect the fundamental human rights of others.

JUSTICE THEORIES

Justice theories focus on the attainment of a just distribution of economic goods and services. A **just distribution** is one that is considered fair and equitable. There is no one theory of justice, and several theories of justice conflict with each other in important ways.³⁴ Here we shall focus on one particular theory of justice that both is very influential and has important ethical implications. The theory is attributed to philosopher John Rawls.³⁵ Rawls argues that all economic goods and services should be distributed equally except when an unequal distribution would work to everyone's advantage.

According to Rawls, valid principles of justice are those with which all persons would agree if they could freely and impartially consider the situation. Impartiality is guaranteed by a conceptual device that Rawls calls the *veil of ignorance*. Under the veil of ignorance, everyone is imagined to be ignorant of all of his or her particular characteristics, for example, race, sex, intelligence, nationality, family background, and special talents. Rawls then asks what system people would design under a veil of ignorance. Under these conditions, people would unanimously agree on two fundamental principles of justice.

The first principle is that each person be permitted the maximum amount of basic liberty compatible with a similar liberty for others. Rawls takes these to be political liberty (e.g., the right to vote), freedom of speech and assembly, liberty of conscience and freedom of thought, the freedom and right to hold personal property, and freedom from arbitrary arrest and seizure.

The second principle is that once equal basic liberty is assured, inequality in basic social goods—such as income and wealth distribution, and opportunities—is to be allowed *only* if such inequalities benefit everyone. Rawls accepts that inequalities can be just if the system that produces inequalities is to the advantage of everyone. More precisely, he formulates what he calls the *difference principle*, which is that inequalities are justified if they benefit the position of the least-advantaged person. So, for example, wide variations

in income and wealth can be considered just if the market-based system that produces this unequal distribution also benefits the least-advantaged members of society. One can argue that a well-regulated, market-based economy and free trade, by promoting economic growth, benefit the least-advantaged members of society. In principle at least, the inequalities inherent in such systems are therefore just (in other words, the rising tide of wealth created by a market-based economy and free trade lifts all boats, even those of the most disadvantaged).

In the context of international business ethics, Rawls's theory creates an interesting perspective. Managers could ask themselves whether the policies they adopt in foreign operations would be considered just under Rawls's veil of ignorance. Is it just, for example, to pay foreign workers less than workers in the firm's home country? Rawls's theory would suggest it is, so long as the inequality benefits the least-advantaged members of the global society (which is what economic theory suggests). Alternatively, it is difficult to imagine that managers operating under a veil of ignorance would design a system where foreign employees were paid subsistence wages to work long hours in sweatshop conditions and where they were exposed to toxic materials. Such working conditions are clearly unjust in Rawls's framework, and therefore, it is unethical to adopt them. Similarly, operating under a veil of ignorance, most people would probably design a system that imparts some protection from environmental degradation to important global commons, such as the oceans, atmosphere, and tropical rain forests. To the extent that this is the case, it follows that it is unjust, and by extension unethical, for companies to pursue actions that contribute toward extensive degradation of these commons. Thus, Rawls's veil of ignorance is a conceptual tool that contributes to the moral compass that managers can use to help them navigate through difficult ethical dilemmas.



Ethical Decision Making

What then is the best way for managers in a multinational firm to make sure that ethical considerations figure into international business decisions? How do managers decide upon an ethical course of action when confronted with decisions pertaining to working conditions, human rights, corruption, and environmental pollution? From an ethical perspective, how do managers determine the moral obligations that flow from the power of a multinational? In many cases, there are no easy answers to these questions, for many of the most vexing ethical problems arise because there are very real dilemmas inherent in them and no obvious correct action. Nevertheless, managers can and should do many things to make sure that basic ethical principles are adhered to and that ethical issues are routinely inserted into international business decisions.

Here we focus on five things that an international business and its managers can do to make sure ethical issues are considered in business decisions. These are (1) favor hiring and promoting people with a well-grounded sense of personal ethics; (2) build an organizational culture that places a high value on ethical behavior; (3) make sure that leaders within the business not only articulate the rhetoric of ethical behavior, but also act in a manner that is consistent with that rhetoric; (4) implement decision-making processes that require people to consider the ethical dimension of business decisions; and (5) develop moral courage.

HIRING AND PROMOTION

It seems obvious that businesses should strive to hire people who have a strong sense of personal ethics and would not engage in unethical or illegal behavior. Similarly, you would rightly expect a business to not promote people, and perhaps to fire people, whose behavior does not match generally accepted ethical standards. But actually doing so is very difficult. How do you know that someone has a poor sense of personal ethics? People hide a lack of personal ethics from public view because unethical people are no longer trusted.

Some probing questions to ask about a prospective employer:

1. Is there a formal code of ethics? How widely is it distributed? Is it reinforced in other formal ways such as through decision-making systems?
2. Are workers at all levels trained in ethical decision making? Are they also encouraged to take responsibility for their behavior or to question authority when asked to do something they consider wrong?
3. Do employees have formal channels available to make their concerns known confidentially? Is there a formal committee high in the organization that considers ethical issues?
4. Is misconduct disciplined swiftly and justly within the organization?
5. Is integrity emphasized to new employees?
6. How are senior managers perceived by subordinates in terms of their integrity? How do such leaders model ethical behavior?

TABLE 4.1

A Job Seeker's Ethics Audit

Source: Linda K. Trevino, chair of the Department of Management and Organization, Smeal College of Business, Pennsylvania State University. Reported in K. Maher, "Career Journal. Wanted: Ethical Employer," *The Wall Street Journal*, July 9, 2002, p. B1. Copyright 2002 by Dow Jones & Co. Inc. Reproduced with permission of Dow Jones & Co. Inc. via Copyright Clearance Center.

Is there anything that businesses can do to make sure they do not hire people who subsequently turn out to have poor personal ethics (the unethical person may lie about his or her nature)? Businesses can give potential employees psychological tests to try to discern their ethical predisposition, and they can check with prior employees regarding someone's reputation (e.g., by asking for letters of reference and talking to people who have worked with the prospective employee). The latter is common and does influence the hiring process. Promoting people who have displayed poor ethics should not occur in a company where the organization culture values the need for ethical behavior and where leaders act accordingly.

Not only should businesses strive to identify and hire people with a strong sense of personal ethics, but it also is in the interests of prospective employees to find out as much as they can about the ethical climate in an organization. Who wants to work at a multinational such as Enron, which ultimately entered bankruptcy because unethical executives had established risky partnerships that were hidden from public view and that existed in part to enrich those same executives? Table 4.1 lists questions job seekers might want to ask a prospective employer.

ORGANIZATION CULTURE AND LEADERSHIP

To foster ethical behavior, businesses need to build an organization culture that values ethical behavior. Three things are particularly important in building such a culture. First, the businesses must explicitly articulate values that emphasize ethical behavior. Many companies now do this by drafting a **code of ethics**, which is a formal statement of the ethical priorities a business adheres to. Often, the code of ethics draws heavily upon documents such as the UN Universal Declaration of Human Rights, which is grounded in Kantian and rights-based theories of moral philosophy. Others have incorporated ethical statements into documents that articulate the values or mission of the business. For example, the food and consumer products multinational Unilever has a code of ethics that includes the following points:³⁶

Employees: Unilever is committed to diversity in a working environment where there is mutual trust and respect and where everyone feels responsible for the performance and reputation of our company. We will recruit, employ, and promote employees on the sole basis of the qualifications and abilities needed for the work to be performed. We are committed to safe and healthy working conditions for all employees. We will not use any form of forced, compulsory, or child labor. We are committed to working with employees to develop and enhance each individual's skills and capabilities. We respect the dignity of

the individual and the right of employees to freedom of association. We will maintain good communications with employees through company-based information and consultation procedures.

Business Integrity: Unilever does not give or receive, whether directly or indirectly, bribes or other improper advantages for business or financial gain. No employee may offer, give, or receive any gift or payment which is, or may be construed as being, a bribe. Any demand for, or offer of, a bribe must be rejected immediately and reported to management. Unilever accounting records and supporting documents must accurately describe and reflect the nature of the underlying transactions. No undisclosed or un-recorded account, fund, or asset will be established or maintained.

It is clear from these principles, that among other things, Unilever will not tolerate substandard working conditions, use child labor, or give bribes under any circumstances. Note also the reference to respecting the dignity of employees, a statement that is grounded in Kantian ethics. Unilever's principles send a very clear message about appropriate ethics to managers and employees.

Having articulated values in a code of ethics or some other document, leaders in the business must give life and meaning to those words by repeatedly emphasizing their importance *and then acting on them*. This means using every relevant opportunity to stress the importance of business ethics and making sure that key business decisions not only make good economic sense but also are ethical. Many companies have gone a step further, hiring independent auditors to make sure the company is behaving in a manner consistent with its ethical codes. Nike, for example, has hired independent auditors to determine whether subcontractors used by the company are living up to Nike's code of conduct.

Finally, building an organization culture that places a high value on ethical behavior requires incentive and benefit systems, including promotions, that benefit people who engage in ethical behavior and sanction those who do not. At General Electric, for example, the former CEO Jack Welch has described how he reviewed the performance of managers, dividing them into several groups. These included overperformers who displayed the right values and were singled out for advancement and bonuses and overperformers who displayed the wrong values and were let go. Welch was not willing to tolerate leaders within the company who did not act in accordance with the central values of the company, even if they were in all other respects skilled managers.³⁷

DECISION-MAKING PROCESSES

In addition to establishing the right kind of ethical culture in an organization, businesspeople must be able to think through the ethical implications of decisions in a systematic way. To do this, they need a moral compass, and both rights theories and Rawls's theory of justice help to provide such a compass. Beyond these theories, some experts on ethics have proposed a straightforward practical guide—or ethical algorithm—to determine whether a decision is ethical.³⁸ According to these experts, a decision is acceptable on ethical grounds if a businessperson can answer yes to each of these questions:

1. Does my decision fall within the accepted values or standards that typically apply in the organizational environment (as articulated in a code of ethics or some other corporate statement)?
2. Am I willing to see the decision communicated to all stakeholders affected by it—for example, by having it reported in newspapers or on television?
3. Would the people with whom I have a significant personal relationship, such as family members, friends, or even managers in other businesses, approve of the decision?

Others have recommended a five-step process to think through ethical problems (this is another example of an ethical algorithm).³⁹ In Step 1, businesspeople should identify

which stakeholders a decision would affect and in what ways. A firm's **stakeholders** are individuals or groups that have an interest, claim, or stake in the company, in what it does, and in how well it performs.⁴⁰ They can be divided into internal stakeholders and external stakeholders. **Internal stakeholders** are individuals or groups who work for or own the business. They include all employees, the board of directors, and stockholders. **External stakeholders** are all other individuals and groups that have some claim on the firm. Typically, this group comprises customers, suppliers, lenders, governments, unions, local communities, and the general public.

All stakeholders are in an exchange relationship with the company. Each stakeholder group supplies the organization with important resources (or contributions), and in exchange each expects its interests to be satisfied (by inducements).⁴¹ For example, employees provide labor, skills, knowledge, and time and in exchange expect commensurate income, job satisfaction, job security, and good working conditions. Customers provide a company with its revenues and in exchange they want quality products that represent value for money. Communities provide businesses with local infrastructure and in exchange they want businesses that are responsible citizens and seek some assurance that the quality of life will be improved as a result of the business firm's existence.

Stakeholder analysis involves a certain amount of what has been called *moral imagination*.⁴² This means standing in the shoes of a stakeholder and asking how a proposed decision might impact that stakeholder. For example, when considering outsourcing to subcontractors, managers might need to ask themselves how it might feel to be working under substandard health conditions for long hours.

Step 2 involves judging the ethics of the proposed strategic decision, given the information gained in Step 1. Managers need to determine whether a proposed decision would violate the *fundamental rights* of any stakeholders. For example, we might argue that the right to information about health risks in the workplace is a fundamental entitlement of employees. Similarly, the right to know about potentially dangerous features of a product is a fundamental entitlement of customers (something tobacco companies violated when they did not reveal to their customers what they knew about the health risks of smoking). Managers might also want to ask themselves whether they would allow the proposed strategic decision if they were designing a system under Rawls's veil of ignorance. For example, if the issue under consideration was whether to outsource work to a subcontractor with low pay and poor working conditions, managers might want to ask themselves whether they would allow for such action if they were considering it under a veil of ignorance, where they themselves might ultimately be the ones to work for the subcontractor.

The judgment at this stage should be guided by various moral principles that should not be violated. The principles might be those articulated in a corporate code of ethics or other company documents. In addition, certain moral principles that we have adopted as members of society—for instance, the prohibition on stealing—should not be violated. The judgment at this stage will also be guided by the decision rule that is chosen to assess the proposed strategic decision. Although maximizing long-run profitability is the decision rule that most businesses stress, it should be applied subject to the constraint that no moral principles are violated—that the business behaves in an ethical manner.

Step 3 requires managers to establish moral intent. This means the business must resolve to place moral concerns ahead of other concerns in cases where either the fundamental rights of stakeholders or key moral principles have been violated. At this stage, input from top management might be particularly valuable. Without the proactive encouragement of top managers, middle-level managers might tend to place the narrow economic interests of the company before the interests of stakeholders. They might do so in the (usually erroneous) belief that top managers favor such an approach.

Step 4 requires the company to engage in ethical behavior. Step 5 requires the business to audit its decisions, reviewing them to make sure they were consistent with ethical principles, such as those stated in the company's code of ethics. This final step is

critical and often overlooked. Without auditing past decisions, businesspeople may not know if their decision process is working and if changes should be made to ensure greater compliance with a code of ethics.

ETHICS OFFICERS

To make sure that a business behaves in an ethical manner, a number of firms now have ethics officers. These individuals are responsible for making sure that all employees are trained to be ethically aware, that ethical considerations enter the business decision-making process, and that the company's code of ethics is adhered to. Ethics officers may also be responsible for auditing decisions to make sure they are consistent with this code. In many businesses, ethics officers act as an internal ombudsperson with responsibility for handling confidential inquiries from employees, investigating complaints from employees or others, reporting findings, and making recommendations for change.

For example, United Technologies, a multinational aerospace company with worldwide revenues of more than \$28 billion, has had a formal code of ethics since 1990.⁴³ Some 160 business practice officers within United Technologies (this is the company's name for ethics officers) are responsible for making sure the code is followed. United Technologies also established an ombudsperson program in 1986 that lets employees inquire anonymously about ethics issues. The program has received some 56,000 inquiries since 1986, and 8,000 cases have been handled by an ombudsperson.

MORAL COURAGE

Finally, it is important to recognize that employees in an international business may need significant *moral courage*. Moral courage enables managers to walk away from a decision that is profitable, but unethical. Moral courage gives an employee the strength to say no to a superior who instructs her to pursue actions that are unethical. And moral courage gives employees the integrity to go public to the media and blow the whistle on persistent unethical behavior in a company. This moral courage does not come easily; individuals have lost their jobs because they blew the whistle on corporate behaviors they thought unethical, telling the media about what was occurring.⁴⁴

However, companies can strengthen the moral courage of employees by committing themselves to not retaliate against employees who exercise moral courage, say no to superiors, or otherwise complain about unethical actions. For example, consider the following extract from Unilever's code of ethics:

Any breaches of the Code must be reported in accordance with the procedures specified by the Joint Secretaries. The Board of Unilever will not criticize management for any loss of business resulting from adherence to these principles and other mandatory policies and instructions. The Board of Unilever expects employees to bring to their attention, or to that of senior management, any breach or suspected breach of these principles. Provision has been made for employees to be able to report in confidence and no employee will suffer as a consequence of doing so.⁴⁵

Clearly this statement gives permission to employees to exercise moral courage. Companies can also set up ethics hotlines, which allow employees to anonymously register a complaint with a corporate ethics officer.

SUMMARY OF DECISION-MAKING STEPS

All of the steps discussed here—hiring and promoting people based upon ethical considerations as well as more traditional metrics of performance, establishing an ethical culture in the organization, instituting ethical decision-making processes, appointing ethics officers, and creating an environment that facilitates moral courage—can help to make sure that when deciding business issues, managers are cognizant of the ethical implica-

tions and do not violate basic ethical prescripts. But not all ethical dilemmas have a clean and obvious solution—that is why they are dilemmas. In these cases, a premium is placed on managers' ability to make sense out of complex situations and make balanced decisions that are as just as possible.

Chapter Summary

This chapter has discussed the source and nature of ethical issues in international businesses, the different philosophical approaches to business ethics, and the steps managers can take to ensure that ethical issues are respected in international business decisions. The chapter made the following points:

1. The term *ethics* refers to accepted principles of right or wrong that govern the conduct of a person, the members of a profession, or the actions of an organization. Business ethics are the accepted principles of right or wrong governing the conduct of businesspeople, and an ethical strategy is one that does not violate these accepted principles.
2. Ethical issues and dilemmas in international business are rooted in the variations among political systems, law, economic development, and culture from nation to nation.
3. The most common ethical issues in international business involve employment practices, human rights, environmental regulations, corruption, and the moral obligation of multinational corporations.
4. Ethical dilemmas are situations in which none of the available alternatives seems ethically acceptable.
5. Unethical behavior is rooted in poor personal ethics, the psychological and geographical distances of a foreign subsidiary from the home office, a failure to incorporate ethical issues into strategic and operational decision making, a dysfunctional culture, and failure of leaders to act in an ethical manner.
6. Moral philosophers contend that approaches to business ethics such as the Friedman doctrine, cultural relativism, the righteous moralist, and the naive immoralist are unsatisfactory in important ways.
7. The Friedman doctrine states that the only social responsibility of business is to increase profits, as long as the company stays within the rules of law. Cultural relativism contends that one should adopt the ethics of the culture in which one is doing business. The righteous moralist monolithically applies home-country ethics to a foreign situation, while the naive immoralist believes that if a manager of a multinational sees that firms from other nations are not following ethical norms in a host nation, that manager should not either.
8. Utilitarian approaches to ethics hold that the moral worth of actions or practices is determined by their consequences, and the best decisions are those that produce the greatest good for the greatest number of people.
9. Kantian ethics state that people should be treated as ends and never purely as *means* to the ends of others. People are not instruments, like a machine. People have dignity and need to be respected as such.
10. Rights theories recognize that human beings have fundamental rights and privileges that transcend national boundaries and cultures. These rights establish a minimum level of morally acceptable behavior.
11. The concept of justice developed by John Rawls suggests that a decision is just and ethical if people would allow for it when designing a social system under a veil of ignorance.
12. To make sure that ethical issues are considered in international business decisions, managers should (a) favor hiring and promoting people with a well-grounded sense of personal ethics; (b) build an organization culture that places a high value on ethical behavior; (c) make sure that leaders within the business not only articulate the rhetoric of ethical behavior, but also act in a manner that is consistent with that rhetoric; (d) put decision-making processes in place that require people to consider the ethical dimension of business decisions; and (e) be morally courageous and encourage others to do the same.

Critical Thinking and Discussion Questions

- Review the Management Focus on testing drugs in the developing world and discuss the following questions:
 - Did Pfizer behave unethically by rushing to take advantage of a Nigerian epidemic to test an experimental drug on sick children? Should the company have proceeded more carefully?
 - Is it ethical to test an experimental drug on children in emergency settings in the developing world where the overall standard of health care is much lower than in the developed world, and where proper protocols might not be followed?
- A visiting American executive finds that a foreign subsidiary in a poor nation has hired a 12-year-old girl to work on a factory floor, in violation of the company's prohibition on child labor. He tells the local manager to replace the child and tell her to go back to school. The local manager tells the American executive that the child is an orphan with no other means of support, and she will probably become a street child if she is denied work. What should the American executive do?
- Drawing upon John Rawls's concept of the veil of ignorance, develop an ethical code that will
 - guide the decisions of a large oil multinational toward environmental protection, and
 - influence the policies of a clothing company outsourcing its manufacturing.
- Under what conditions is it ethically defensible to outsource production to the developing world where labor costs are lower when such actions also involve laying off long-term employees in the firm's home country?
- Are facilitating payments ethical?

Research Task globaledge.msu.edu

Use the globalEDGE™ site to complete the following exercises:

- Promoting respect for universal human rights is a central dimension of all countries' foreign policy. As history has repeatedly shown, human rights abuses are everybody's concern. The United States stands ready to work with other governments and civil society to prevent the abuses of power. Begun in 1977, the annual Country Reports on Human Rights Practices are designed to assess the state of democracy and human rights around the world, call attention to violations, and—where needed—prompt needed changes in our policies toward particular countries. Find the annual Country Reports on Human Right Practices, and provide information on how the reports are prepared.
- The *Corruption Perceptions Index (CPI)* is a comparative assessment of country's integrity performance, alongside related academic research on corruption. Provide a description of this index and its ranking. Identify the five countries with the lowest as well as the highest CPI scores according to this index.

Mired in Corruption—Kellogg Brown & Root in Nigeria

CLOSING CASE In 1998 the large Texas-based oil and gas service firm, Halliburton, acquired Dresser Industries. At the time the CEO of Halliburton was Dick Cheney, who subsequently became the vice president of the United States under George W. Bush. Among other businesses, Dresser owned M. W. Kellogg, one of the world's largest general contractors for construction projects in distant parts of the globe. After the acquisition, Kellogg was combined with an existing Halliburton business and renamed Kellogg Brown & Root, or KBR. At the time it looked like

a good deal for Halliburton. Among other things, Kellogg was involved in a four-firm consortium that was building a series of liquefied natural gas (LNG) plants in Nigeria. By early 2004, the total value of the contracts associated with these plants had exceeded \$8 billion.

In early 2005, however, Halliburton put KBR up for sale. The sale was seen as an attempt by Halliburton to distance itself from several scandals that had engulfed KBR. One of these concerned allegations that KBR had systematically overcharged the Pentagon for services it provided to the U.S. military in Iraq. Another scandal

centered on the Nigerian LNG plants and involved KBR employees, several former officials of the Nigeria government, and a mysterious British lawyer called Jeffrey Tesler.

The roots of the Nigerian scandal date to 1994 when Kellogg and its consortium partners were trying to win an initial contract from the Nigerian government to build two LNG plants. The contract was valued at about \$2 billion. Each of the four firms held a 25 percent stake in the consortium, and each had veto power over its decisions. Kellogg employees held many of the top positions at the consortium, and two of the other members, Technip of France and JGC of Japan, have claimed that Kellogg managed the consortium (the fourth member, ENI of Italy, has not made any statement regarding management).

The Kellogg consortium was one of two to submit a bid on the initial contract, and its bid was the lower of the two. By early 1995, the consortium was deep in final negotiations on the contract when Nigeria's oil minister had a falling out with the country's military dictator, General Abacha, and was replaced by Dan Etete. Etete proved to be far less accommodating to the Kellogg group, and suddenly the entire deal looked to be in jeopardy. According to some observers, Dan Etete was a tough customer who immediately began to use his influence over the LNG project for personal gain. The consortium quickly entered into a contract with the British lawyer, Jeffery Tesler. The contract, signed by a Kellogg executive, called on Tesler to obtain government permits for the LNG project, maintain good relations with government officials, and provide advice on sales strategy. Tesler's fee for these services was \$60 million.

Tesler had long-standing relations with some 20 to 30 senior Nigeria government and military officials. For years he had handled their London legal affairs, helping them to purchase real estate and set up financial accounts. Kellogg had a relationship with Tesler that dated back to the mid-1980s, when it had employed him to broker the sale of Kellogg's minority interest in a Nigerian fertilizer plant to the Nigerian government.

What happened next is currently the subject of government investigations in France, Nigeria, and the United States. The suspicion is that Tesler promised to funnel big sums to Nigerian government officials if the deal was done. Investigators base these suspicions on a number of factors, including the known corruption of General Abacha's government, the size of the payment to Tesler, which seemed out of proportion to the services he was contracted to provide, and a series of notes turned up by internal investigators at Halliburton. The handwritten notes, taken by Wojciech Chodan, a Kellogg executive, document a meeting between Chodan and Tesler in which they discussed the possibility of channeling \$40 million of Tesler's \$60 million payment to General Abacha.

It is not known whether a bribe was actually paid. What is known is that in December 1995, Nigeria awarded the \$2 billion contract to the Kellogg consortium. The LNG plant soon became a success. Nigeria contracted to build a second plant in 1999, two more in 2002, and a sixth in July 2004. KBR rehired Tesler in 1999 and again in 2001 to help secure the new contracts, all of which it won. In total, Tesler was paid some \$132.3 million from 1994 through to early 2004 by the consortium.

Tesler's involvement in the project might have remained unknown were it not for an unrelated event. Georges Krammer, an employee of the consortium member Technip, was charged by the French government with embezzlement. When Technip refused to defend Krammer, he turned around and aired what he perceived to be Technip's dirty linen. This included the payments to Tesler to secure the Nigeria LNG contracts.

This led French and Swiss officials to investigate Tesler's Swiss bank accounts. They discovered that Tesler was "kicking back" some of the funds he received to executives in the consortium and at subcontractors. One of the alleged kickbacks was a transfer of \$5 million from Tesler's account to that of Albert J. "Jack" Stanley, who was head of M. W. Kellogg and then Halliburton's KBR unit. Tesler also transferred some \$2.5 million into Swiss bank accounts held under a false name by the Nigerian oil minister, Dan Etete. Other payments include a \$1 million transfer into an account controlled by Wojciech Chodan, the former Kellogg executive whose extensive handwritten notes suggest the payment of a bribe to General Abacha, and \$5 million to a German subcontractor on the LNG project in exchange for "information and advice."

After this came out in June 2004, Halliburton fired Jack Stanley and severed its long-standing relationship with Tesler, asking its three partners in the Nigeria consortium to do the same. The United States Justice Department took things further, establishing a grand jury investigation to determine if Halliburton, through its KBR subsidiary, had violated the Foreign Corrupt Practices Act. In November 2004, the Justice Department widened its investigation to include payments in connection with the Nigeria fertilizer plant that Kellogg had been involved with during the 1980s under the leadership of Jack Stanley. In March 2005, the Justice Department also stated it was looking at whether Jack Stanley had tried to coordinate bidding with rivals and fix prices on certain foreign construction projects.

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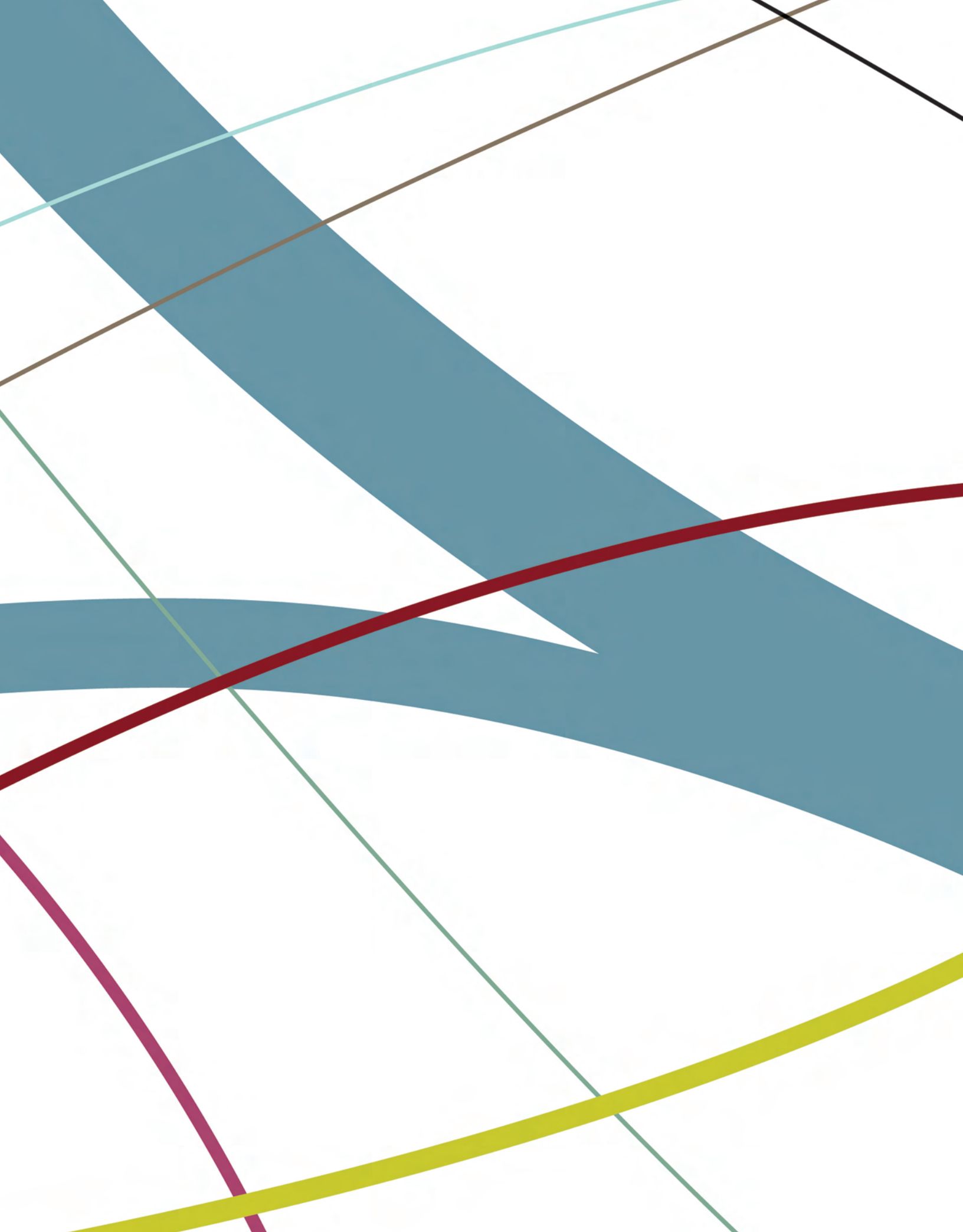
Case Discussion Questions

1. Could the alleged payment of bribes to Nigerian government officials by Jeffrey Tesler be considered “facilitating payments” or “speed money” under the terms of the Foreign Corrupt Practices Act?
2. Irrespective of the legality of any payments that may have been made by Tesler, do you think it was reasonable for KBR to hire him as an intermediary?
3. Given the known corruption of the Abacha government in Nigeria, should Kellogg and its successor, KBR, have had a policy in place to deal with bribery and corruption? What might that policy have looked like?
4. Should Kellogg have walked away from the Nigerian LNG project once it became clear that the payment of bribes might be required to secure the contract?
5. There is evidence that Jack Stanley, the former head of M. W. Kellogg and KBR, may have taken kickback payments from Tesler. At least one other former Kellogg employee, Wojciech Chodan, may have taken kickback payments. What does this tell you about the possible nature of the ethical climate at Kellogg and then KBR?
6. Should Halliburton be called into account if it is shown that its KBR unit used bribery to gain business in Nigeria? To what extent should a corporation and its officers be held accountable for ethically suspect activities by the managers in a subsidiary, particularly given that many of those activities were initiated before the subsidiary was owned by Halliburton?

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Cases

Qualcomm in China 156

Etch-A-Sketch Ethics 160



Western Drug Companies and the AIDS
Epidemic in South Africa 161



Qualcomm in China

COMPANY AND INDUSTRY BACKGROUND

Qualcomm was founded in 1985 by Dr. Irwin Jacobs, a former engineering professor. Under Jacobs's leadership, the company developed a digital communications technology for wireless phones known as code division multiple access (CDMA). Introduced in 1989, CDMA became one of the three main technologies used in digital wireless phones. CDMA and the two other digital wireless communications technologies, TDMA (which stands for time division multiple access) and GSM (which is a form of TDMA and stands for global system for mobile communications), are the digital technologies used to transmit a wireless phone user's voice or data over radio waves using the wireless phone operator's network. CDMA works by converting speech into digital information, which is then transmitted in the form of a radio signal over the phone network. These digital wireless phone networks are complete phone systems comprised primarily of base stations, or "cells," which are geographically placed throughout a service or coverage area. Once communication between a wireless phone user and a base station is established, the system detects the movement of the wireless phone user and the communication is handed off to another base station, or cell, as the wireless phone user moves throughout the service area.

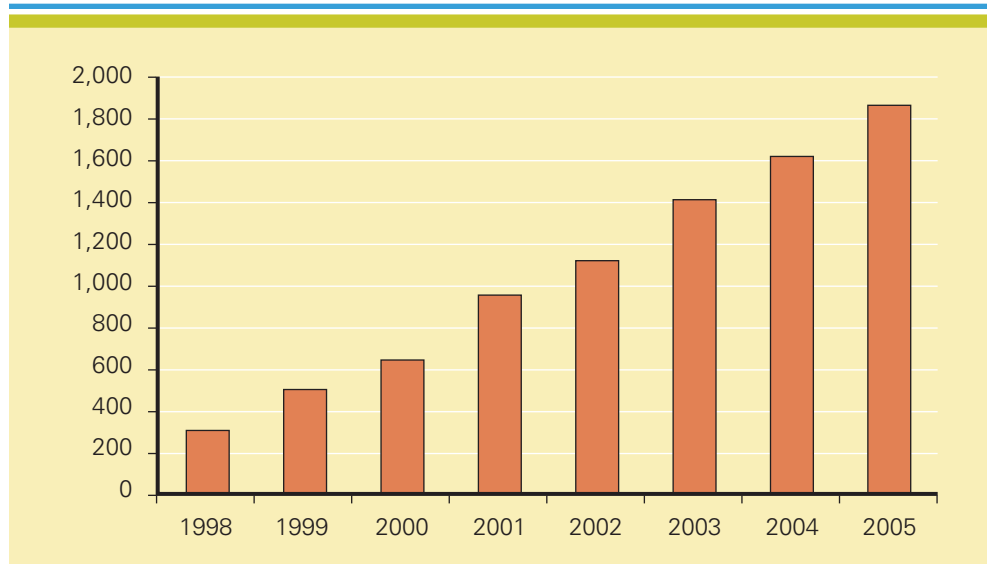
Qualcomm has more than 800 patents on CDMA, and essentially owns this standard for digital wireless phones. The company licenses its technology to equipment manufacturers in return for royalties on the sale of any equipment, such as base stations and handsets. The equipment manufacturers sell the equipment to service providers. Thus, for example, Qualcomm might license its technology to Motorola, which then makes base stations and handsets that are based on CDMA technology. In turn, Motorola might sell the CDMA equipment to a service provider, such as Verizon, which offers wireless phone service to consumers in the United States. Every time Motorola makes a sale, Qualcomm collects a royalty based on a percentage of the price of that equipment (Qualcomm has not reported that figure, but it is believed to be 4 percent of the value of the equipment). Qualcomm also makes and sells "chipsets" based on CDMA technology to equipment manufacturers who then place those chipsets into base stations and handsets. Some 90 percent of CDMA phones contain chipsets manufactured by Qualcomm. In 2004, Qualcomm generated record revenues of \$4.88 billion and net profits of \$1.72 billion.

The great advantage claimed for CDMA over competing standards is that it uses radio spectrum more efficiently than GSM or TDMA. Qualcomm states that CDMA equipment has three times the capacity of comparable GSM or TDMA equipment, thereby enabling service operators to attain the same capacity with a lower investment in network equipment such as base stations. Because the wireless service industry is very price competitive, any technology that promises to lower costs for service operators should gain an advantage in the marketplace. However, CDMA was a latecomer to the digital communications market and by 2004 was still in third place behind TDMA and GSM with 26 percent of the world market. A big reason for this was that in the early 1990s, the European Union backed GSM as the standard for digital communications technology. At the time, Europe led the world in the adoption of wireless phone technology. Since European firms such as Ericsson and Nokia were major suppliers of GSM equipment, this decision benefited them.

Although CDMA equipment can, in theory, handle more data traffic than comparable TDMA or GSM equipment, the larger installed base of TDMA and GSM subscribers means that companies making this equipment benefit from substantial economies of scale, which to some extent nullifies the cost advantage associated with CDMA technology and helps explain the continued dominance of these standards. Also, since far more GSM handsets are sold than CDMA handsets, economies of scale mean that GSM handsets are less expensive than CDMA handsets.

By the end of 2004 there were over 1.6 billion wireless subscribers worldwide, some 340 million of which used CDMA technology. Forecasts called for the total number of wireless subscribers to grow to 2.5 billion by 2009. Among the wireless technologies, CDMA was registering the fastest growth rate. CDMA is now the most widely used technology in the United States, where 47 percent of the nation's 160 million wireless phone subscribers in 2004 used CDMA equipment. CDMA also has a large and growing presence in Latin America and the Asia Pacific region. The laggard in CDMA penetration is Europe, where GSM dominates and CDMA technology had less than 10 million subscribers in 2002.

Looking forward, the success of Qualcomm will be driven by two related factors. First, there is a shift to a new generation of technology, known in the industry as 3G or third-generation wireless technology. This new generation of digital wireless technology is designed to handle much greater amounts of data at rapid down-



Worldwide Wireless Subscribers, 1998–2005 (Millions)

Source: Industry data from EMC press releases (www.emc-database.com) and Qualcomm 10K reports. The 2005 total is a forecast.

load speeds, enabling subscribers to download multimedia applications, such as streaming video or audio, onto their wireless phones, effectively turning the handsets into small computers that are able to access the Internet from anyplace at anytime. Two versions of CDMA technology have been developed for 3G, CDMA2000 and WCDMA. While Qualcomm developed CDMA2000, WCDMA was developed by rival telecommunications firms Nokia and Ericsson. However, Qualcomm's patents cover both versions of the technology, and the firm will earn royalties no matter which version is used by a particular service carrier, although Qualcomm favors CDMA2000 and reportedly makes greater royalties from it. Both CDMA 3G technologies will have to compete with a 3G version of the popular GSM technology, known as GPRS, which was introduced in 2002.

The second factor driving Qualcomm's success is the penetration of CDMA technology into developing markets where there is still large potential for new subscriber adoptions, particularly in the Asia Pacific region. Industry forecasts suggest the number of wireless phone subscribers in this region will grow from 232 million in 2000 to 780 million in 2005. Top among these expanding developing markets are China, with its 1.2 billion people, and India, with nearly 1 billion. In both nations, wireless penetration is currently low but growing rapidly. Forecasts suggest that by 2009 there will be 550 million wireless subscribers in China, up from 250 million in 2003, and 117 million in India, from less than 30 million in 2003. Given the large population base in these markets, the standard that dominates there may be the standard that dominates worldwide. China and India have thus become the

main battlegrounds for the future of digital wireless technology, and Qualcomm's future depends critically upon the outcome of this battle.

THE EARLY DAYS: GREAT WALL

Qualcomm's Irwin Jacobs was quick to recognize the importance of China in Qualcomm's future. He began making business trips to China in 1992 to try to persuade China's fledgling telecommunications providers to adopt CDMA technology. In 1994 it began to look as if he might make some headway. At the time, China's army was keen to develop a secure communications network. CDMA is well suited to this application because it was adapted from a technology developed for secure military transmissions. The Chinese army also owned the spectrum that CDMA uses, the 800 MHz band. By building a commercial CDMA network with its spare spectrum, the army believed it could dominate the nascent mobile phone market in China, and use the profits and expertise gained from that business to modernize its own communications network.

When the army announced in 1994 that it would deploy a CDMA network, China's top telephone official, Wu Jichuan, the minister of Posts and Telecommunications, was caught somewhat off guard. Wu Jichuan saw telecommunications as a national priority and favored state-owned China Telecommunications Corp. He had allowed the company to charge high long-distance rates, and then had forced it to use the profits to bring telecommunications services to remote villages. He had little use for competition that might sap China Telecommunications' profits and derail his plans.

To deal with the threat, the canny Wu invited the army into his camp, proposing that it form a 50/50 joint

venture with China Telecommunications to build a CDMA network. Called “Great Wall,” the venture won a license to run an experimental CDMA network in four cities—creating a potential boom in demand for CDMA equipment and a royalty stream for Qualcomm. However, Wu also ordered China Telecommunications to roll out as fast as possible a separate, nationwide digital network based on GSM. The Ministry of Post and Telecommunications happened to own the 900 MHz radio spectrum used by the GSM technology. Wu then refused to issue permits to the army to allow it to expand its network beyond four cities. By 1998 it was clear that Great Wall’s expansion plans had been stymied by Wu, with a corresponding loss of opportunity for Qualcomm.

CHINA UNICOM

However, the story was far from over. In the late 1990s, China separated out two wireless phone operators from China Telecommunications—China Mobile and China Unicom. Although both were initially state owned, the idea was to sell some equity to private investors and set the two entities up as competitors in China’s wireless phone market. While China Mobile inherited the bulk of existing networks and subscribers, China Unicom was left to choose its own technology, opening the door for Qualcomm to get back into China.

Irwin Jacobs had also been working the political angle in the interim. China’s leadership decided in the late 1990s that it needed to become a member of the World Trade Organization (WTO) if it was to participate in the global economy of the 21st century. If China was to enter the WTO, it would have to win the support of major trading nations who were already members, including the United States. Behind the scenes, Jacobs lobbied the U.S. government, urging it to pressure China to adopt CDMA technology as one of the conditions for U.S. support of China’s entry into the WTO. For a while the efforts were fruitless, but in March 1999 Chinese Premier Zhu Rongji decided to offer the United States a commitment to use CDMA technology in return for U.S. support of China’s entry into the WTO. Zu proposed that China Unicom work with Qualcomm and others to roll out a CDMA network in China.

However, before this deal could be finalized, Qualcomm had to negotiate a licensing framework with Wu’s ministry, which had been renamed the Ministry of Information. But the negotiations dragged on, with Qualcomm demanding a higher royalty rate on sales of CDMA equipment than Wu was allowed to sanction. Wu ordered Unicom to negotiate directly with Qualcomm. Unicom was trying to become profitable so that it could start selling equity to private investors and gain a listing on the Hong Kong and New York stock exchanges. It had already started to roll out a wireless net-

work based on GSM and was not happy about being ordered to make duplicate investments in a CDMA network. Reports suggest that like Wu, Unicom insisted that Qualcomm lower its royalty rate or nothing would happen. Qualcomm relented (the royalty agreement has not been made public), and in February 2000 Unicom announced that a deal had been reached and it would soon start construction on a CDMA network for 10 million subscribers.

The issue was far from resolved, however. At the signing ceremony it was clear that something was wrong—Wu and other cabinet officials declined to attend. In a private meeting between Wu and Jacobs it became clear why—Wu was insisting that Qualcomm must transfer the design for the chips that run the CDMA system to a Chinese firm. Qualcomm had never done this and was unlikely to do so. Jacobs said the request could not be met. A few days later China Unicom withdrew its request for bids on a CDMA network, but denied that the project was on hold. In June 2000, after the U.S. House of Representatives had approved a bill enabling China to enter the WTO, China Unicom confirmed it would continue to use a GSM network, but the company held out the possibility that it would use 3G equipment based on CDMA.

According to news reports, while politics played a part in the Unicom decision, so did pressure from local equipment manufacturers, many of whom were joint ventures between Chinese companies and foreigners, such as Ericsson, Nokia, and Motorola. Many of these joint ventures had already made investments to produce GSM equipment and were not ready to produce CDMA equipment. Some of these manufacturers reportedly pressured Unicom to stick with GSM or, at the very least, slow down the rollout of CDMA networks.

After so many years trying to break into China, Irwin Jacobs was not about to give up. In October 2000, Jacobs visited Premier Zu Rongji in Beijing. What went on in that meeting is not known, but it is speculated that Qualcomm lowered the royalty rate that Chinese equipment manufacturers would have to pay the company to 2.65 percent of handset sales, substantially lower than the 4 percent rate reportedly paid to Qualcomm elsewhere in the world. Soon after the meeting, China Unicom reversed course, announcing that it would build a CDMA network to support 10 million subscribers—although it would now be mid-2002 before that network started to generate significant handset sales, and thus royalties for Qualcomm, not 2001 as originally hoped. Analysts speculated that the small size of the network would make it hard for Qualcomm to get its favored 3G technology, CDMA2000, widely adopted in China.

By April 2001 it looked as if Qualcomm had finally cracked the Chinese market. Then, one day before China Unicom was due to sign contracts with equipment

suppliers to supply its planned CDMA network, the deal was delayed again. No reason was given. Some speculated that a rise in political tension between the United States and China was to blame. A U.S. surveillance plane had been forced down by the Chinese air force, which accused the United States of spying on China. Thrown into the mix were heightened tensions between the United States and China over the future of Taiwan. A month later Chinese President Jiang Zemin appeared to give the green light to the deal when he told a gathering of foreign business leaders that CDMA could increase competition in China. Shortly after, Unicom signed contracts to build a CDMA network with a capacity of 15.15 million subscribers.

THE ROLLOUT OF CDMA IN CHINA

After years of stop and go, China Unicom turned on its CDMA network in January 2002 following a \$2.5 billion investment in equipment. Its year-end target for 2002 was 7 million subscribers, but by June 2002 the number stood at a meager 700,000—while China overall now had 160 million wireless subscribers, the majority using GSM equipment. Critics were quick to claim that the slow rollout demonstrated Unicom's lack of commitment to CDMA, which some view as being forced on them by Chinese politicians. Unicom executives disagreed, and claimed the decision was a sound business decision made because CDMA network equipment is cheaper than GSM equipment. Unicom and Qualcomm executives did concede that they had priced CDMA phones too high in an attempt to recoup the higher cost of CDMA handsets, which cost \$350 each, some \$100 more than GSM phones.

By the second half of 2002, however, the rollout of CDMA service accelerated. In October 2002, China Unicom reported that it had more than 4 million CDMA subscribers, and that it was encountering rapid growth and should hit 7 million by year-end. By February 2005, China Unicom had almost 29 million CDMA subscribers. At the same time, subscriptions to its GSM networks were also growing. At the end of 2004, China Unicom had 112 million subscribers in China.

Meanwhile, Qualcomm continued to show its commitment to China. The company opened a 43,000-square-foot research center in China in 2002 to focus on the development of 3G CDMA technology and applications for the Chinese market, and in June 2003 the company announced it would invest \$100 million in Chinese equipment companies to help them develop CDMA equipment. Jacobs also predicted that looking forward to 3G rollout in China, China Unicom would move its network to CDMA2000, while China Mobile would adopt WCDMA technology. Either way, Qualcomm would benefit.

Case Discussion Questions

1. If CDMA is the better technology, as Qualcomm claims, why does GSM have a larger share of the wireless subscribers worldwide? To what extent do political decisions explain the global leadership of GSM? To what extent do economic factors? Are the economic and political factors independent of each other?
2. What does Qualcomm's experience in China tell you about the difficulties of doing business in this nation? Do you think China is unique in this regard, or can one expect similar problems in other nations?
3. How important is China to Qualcomm's future? Given this, do you think it was right for Qualcomm to accept a lower royalty rate in China than elsewhere?
4. Do you think Qualcomm could have done anything different to accelerate the adoption of CDMA technology in China? How politically savvy has the company been? What lessons can be derived from Qualcomm's experience about the importance of business-government relations in foreign nations?
5. What should Qualcomm do strategically and politically to make sure that CDMA technology and CDMA2000, in particular, diffuse rapidly in China?

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Etch-A-Sketch Ethics

The Ohio Art Company is perhaps best known as the producer of one of the top-selling toys of all time, the venerable Etch-A-Sketch. More than 100 million of the familiar red rectangular drawing toys have been sold since it was invented in 1960. The late 1990s, however, became a troubled time for the toy's maker. Confronted with sluggish toy sales, the Ohio Art Company lost money for two years. In December 2000, it made the strategic decision to outsource production of the Etch-A-Sketch toys to Kin Ki Industrial, a leading Chinese toy maker, laying off 100 U.S. workers in the process.

The closure of the Etch-A-Sketch line was not unexpected among employees. The company had already moved the production of other toy lines to China, and most employees knew it was just a matter of time before Etch-A-Sketch went too. Still, the decision was a tough one for the company, which did most of its manufacturing in its home base, the small Ohio town of Bryan (population 8,000). As William Killgallon, the CEO of the Ohio Art Company, noted, the employees who made the product "were like family. It was a necessary financial decision we saw coming for some time, and we did it gradually, product by product. But that doesn't mean it's emotionally easy."

In a small town such as Bryan, the cumulative effect of outsourcing to China has been significant. The tax base is eroding from a loss of manufacturing and a population decline. The local paper is full of notices of home foreclosures and auctions. According to former employees, the biggest hole in their lives after Etch-A-Sketch moved came from the death of a community. For many workers, the company was their family, and now that family was gone.

The rationale for the outsourcing was simple enough. Pressured to keep the cost of Etch-A-Sketch under \$10 by big retailers such as Wal-Mart and Toys "R" Us, the Ohio Art Company had to get its costs down or lose money. In this case, unionized workers making \$1,500 a month were replaced by Chinese factory workers who made \$75 a month. However, according to Killgallon, the main savings came not from lower wages, but from lower overhead costs for plant, maintenance, electricity, and payroll, and the ability to get out from the soaring costs of providing health benefits to U.S. manufacturing employees.

The choice of Kin Ki as manufacturer for Etch-A-Sketch was easy—the company had been making pocket-sized Etch-A-Sketch toys for nearly a decade and always delivered on cost. To help Kin Ki, the Ohio Art Company shipped some of its best equipment to the company, and it continues to send crucial raw materials, such as aluminum powder, which is hard to get in China.

The story would have ended there had it not been for an exposé in *The New York Times* in December 2003. The *Times* reporter painted a dismal picture of working conditions at the Kin Ki factory that manufactured the Etch-A-Sketch. According to official Kin Ki publications:

Workers at Kin Ki make a decent salary, rarely work nights or weekends, and often "hang out along the streets, playing Ping Pong and watching TV." They all have work contracts, pensions, and medical benefits. The factory canteen offers tasty food. The dormitories are comfortable.

Not so, according to Joseph Kahn, the *Times* reporter. He alleged that real-world Kin Ki employees, mostly teenage migrants from internal Chinese provinces, work long hours for 40 percent less than the company claims. They are paid 24 cents per hour, below the legal minimum wage of 33 cents an hour in Shenzhen province where Kin Ki is located. Most do not have pensions, medical benefits, or employment contracts. Production starts at 7:30 A.M. and continues until 10 P.M., with breaks only for lunch and dinner. Saturdays and Sundays are treated as normal workdays. This translates into a workweek of seven 12-hour days, or 84 hours a week, well above the standard 40-hour week set by authorities in Shenzhen. Local rules also allow for no more than 32 hours of overtime and stipulate that the employees must be paid 1.5 times the standard hourly wage, but Kin Ki's overtime rate is just 1.3 times base pay.

As for the "comfortable dormitories," the workers sleep head to toe in tiny rooms with windows that are covered with chicken wire. To get into and out of the factories, which are surrounded by high walls, workers must enter and leave through a guarded gate. As for the tasty food, it is apparently a mix of boiled vegetables, beans, and rice, with meat or fish served only twice a month.

The workers at Kin Ki have apparently become restless. They went on strike twice in 2003, demanding higher wages and better working conditions. The company responded by raising wages a few cents and allotting an extra dish of food to each worker per day (but still no more meat)! However, Kin Ki simultaneously made "fried squid" of two workers who were ringleaders of the strike ("fried squid" is apparently a popular term for dismissal). Johnson Tao, a senior executive at the company, denies that the two were dismissed for organizing the strikes. He said they were well-known troublemakers who left the factory of their own accord. But he acknowledges the low wages at the company, stating, "I know that I need to

increase wages to comply with the law. I have the intention of doing this and will raise all wages in 2004.”

Meanwhile, in Ohio, William Killgallon, Ohio Art Company’s CEO, stated to the *Times* reporter that he considered Kin Ki’s executives to be honest and that he had no knowledge of labor problems there. But he said he intended to visit China soon to make sure “they understand what we expect.”

Case Discussion Questions

1. Was it ethical of the Ohio Art Company to move production to China? What were the economic and social costs and benefits of this decision? What would have happened if production had not been moved?
2. Assuming that the description of working conditions given in *The New York Times* is correct, is it ethical for the Ohio Art Company to continue using Kin Ki to manufacture Etch-A-Sketch toys?
3. Is it possible, as Mr. Killgallon claims, that the Ohio Art Company had no knowledge of labor problems

at Kin Ki? Do you think company executives had any knowledge of the working conditions?

4. What steps can executives at the Ohio Art Company take to make sure they do not find the company profiled in *The New York Times* again as an enterprise that benefits from sweatshop labor?

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Western Drug Companies and the AIDS Epidemic in South Africa

In December 1997, the government of South Africa passed a law that authorized two controversial practices. One, called parallel importing, allowed importers in South Africa to purchase drugs from the cheapest source available, regardless of whether the patent holders had given their approval or not. Thus, South Africa asserted its right to import “generic versions” of drugs that are still patent protected. The government did this because it claimed to be unable to afford the high cost of medicines that were patent protected. The other practice, called compulsory licensing, permitted the South African government to license local companies to produce cheaper versions of drugs whose patents are held by foreign companies, irrespective of whether the patent holder agreed.

The law seemed to violate international agreements to protect property rights, including a World Trade Organization agreement on patents to which South Africa is a signatory. South Africa, however, insisted the law was necessary given the country’s health crisis and the high cost of patented medicines. By 1997, South Africa was wrestling with an AIDS crisis of enormous proportions. It was estimated that over 3 million of the country’s 45 million people were infected with the virus at the time, more than in any other country. However, although the AIDS epidemic in South Africa was seen as primary reason for the new law, the law itself was applied to “communicable diseases” (of which AIDS is just one, albeit a devastating one).

Foreign drug manufacturers saw the law as an unbridled attempt to expropriate their intellectual property rights, and 39 foreign companies quickly filed a lawsuit in the country to try to block implementation of the law. Drug manufacturers were particularly concerned about the applicability of the law to all “communicable diseases.” They feared that South Africa was the thin end of the wedge, and if the law was allowed to stand, other countries would follow suit. Many Western companies also feared that if poor countries such as South Africa were allowed to buy low-priced generic versions of patent-protected drugs, in violation of intellectual property laws, American and European consumers would soon demand the same.

In defense of their patents, the drug companies argued that because drug development is a very expensive, time-consuming, and risky process, they need the protection of intellectual property laws to maintain the incentive to innovate. It can take \$800 million and 12 years to develop a drug and bring it to market. Less than one in five compounds that enter clinical trials actually become marketed drugs—the rest fail in trials due to poor efficacy or unfavorable side effects—and of those that make it to market, only 3 out of 10 earn profits that exceed their costs of capital. If drug companies could not count on high prices for their few successful products, the drug development process would dry up.

The drug companies have long recognized that countries such as South Africa face special health

challenges and lack the money to pay developed world prices. Accordingly, the industry has priced drugs low in the developing world or given them away. For example, many AIDS drugs were already being sold to developing nations at large discounts to their prices in the United States. The South African government thought this was not good enough. The government was quickly supported by various human rights and AIDS organizations, which cast the case as an attempt by the prosperous multinational drug companies of the West to maintain their intellectual property rights in the face of desperate attempts by an impoverished government to stem a deadly crisis. For their part, the drug companies stated that the case had little to do with AIDS and was really about the right of South Africa to break international law.

While the drug companies may have had international law on their side, the tie-in with the AIDS epidemic clearly put them on the public relations defensive. After a blizzard of negative publicity, and little support from Western governments that were keen not to touch this political “hot potato,” several leading manufacturers of AIDS drugs, while still opposing the South African law, started to change their policies. In May 2000, five large manufacturers of AIDS medicines—Merck, Bristol-Myers Squibb, Roche, Glaxo, and Boehringer Ingelheim—announced that they would negotiate lower priced AIDS drugs in developing countries, primarily in sub-Saharan Africa (some 25 million of the 36 million people infected with the HIV virus in 2000 lived in that region). Still the protests continued.

In February 2001, an Indian drug company, Cipla Ltd., offered to sell a cocktail of three AIDS drugs to poor African nations for \$600 per patient per year, and for \$350 a year to Doctors without Borders (AIDS is commonly treated with a cocktail that combines up to 10 antiviral drugs). The patents for these drugs were held by Western companies, but Indian law allowed local companies to produce generic versions of patent-protected drugs.

The Cipla announcement seemed to galvanize Western drug companies into further action. In March 2001, Merck announced that it would cut the prices of its two AIDS drugs, Crixivan and Stocrin. Crixivan, which sold for \$6,016 per year in the United States, would be sold in developing countries for \$600 a year. Stocrin, which cost \$4,730 a year in the United States, would be sold for \$500. Both drugs were often used together as part of an AIDS cocktail. Officials at Doctors without Borders, the Nobel Peace Prize-winning relief agency, welcomed the announcement, but pointed out that in a region where many people lived on less than a dollar a day, the price was still out of reach of many AIDS patients.

A few days later, Bristol-Myers Squibb went further, announcing it would sell its AIDS drug Zerit to poor

nations in Africa for just \$0.15 a day, or \$54 a patient per year, which was below Zerit's production costs. In the United States and Europe, Zerit was selling for \$3,589 per patient per year. This was followed by an announcement from Abbott Laboratories that it would sell two of its AIDS drugs at “no profit” in sub-Saharan Africa.

None of these moves, however, were enough to satisfy critics. In April 2001, the drug companies seemed to conclude that they were losing the public relations war, and they agreed to drop their suit against the South African government. This opened the way for South Africa to start importing cheap generic versions of patented medicines from producers such as Cipla of India. The decision to drop the suit was widely interpreted in the media as a defeat for the drug companies and a reaffirmation of the ability of the South African government to enforce compulsory licensing. At the same time, the pharmaceutical companies appear to have gotten assurances from South Africa that locally produced generic versions of patented drugs would be sold only in sub-Saharan Africa, and not exported to other regions of the world.

In 2003, Aspen Pharmaceuticals, a South African drugmaker, took advantage of the 1997 law to introduce a generic version of Stavudine, and it asked South African authorities for permission to produce up to six more AIDS drugs. Aspen had licensed the rights to produce these drugs from Bristol-Myers Squibb and Glaxo, the large British company. Bristol and Glaxo had waved their rights to royalties from sales of the drugs in sub-Saharan Africa. At the same, the companies noted that Aspen was able to sell the drugs only within the sub-Saharan region.

Despite these moves, critics still urged Western drug companies to do more to fight the global AIDS epidemic, which by 2003 was estimated to afflict some 50 million people. For example, in a 2003 *New York Times* op-ed article, noted playwright and AIDS activist Larry Kramer stated, “It is incumbent upon every manufacturer of every HIV drug to contribute its patents or its drugs free for the salvation of these people. . . . I believe it is evil for drug companies to possess a means of saving lives and then not provide it to the desperate people who need it. What kind of hideous people have we become? It is time to throw out the selfish notion that these companies have the right not to share their patents.”

Meanwhile in South Africa, the AIDS epidemic continued on its relentless course. By 2004 some 5.3 million South Africans were estimated to have been infected with HIV, and 600 people a day were dying from AIDS-related complications. In 2003, the South African government had committed itself to offering at low or no cost antiviral drugs to everyone with AIDS. By working

with pharmaceutical companies such as Aspen and three Indian producers of generic drugs, the government was able to purchase a cocktail of antiviral HIV drugs for \$65 per patient per month. However, by late 2004, only one out of 50 AIDS patients who were ready for the drugs was getting them, according to news reports. The problem now was distribution and a chronic shortage of clinics, doctors, and nurses. Estimates suggested that it would still be years before cheap AIDS drugs were available to all those who needed them in South Africa.

Case Discussion Questions

1. Why is it so important for the drug companies to protect their patents?
2. What should the policy of drug companies be toward the pricing of patent-protected drugs for AIDS in poor developing nations such as South Africa?
3. What should the policy be in developed nations? Is it ethical to charge a high price for drugs that treat a life-threatening condition, such as AIDS?
4. In retrospect, could the large Western pharmaceuticals have responded differently to the 1997 South African law? How might they have better taken the initiative?
5. Is AIDS a special case, or should large drug companies make it normal practice to price low or give away patent-protected medicines to those who cannot afford them in poor nations?

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