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Encouraging Ethical Conduct for Multinational Businesses

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Steven C. Bahls, President of Augustana College

As most of you know, I was a law professor for 18 years. Let's do tonight what we do in law school. Let's consider a case.

This is not a real case, but the hypothetical case of Acme Clothing. Acme Clothing faces the same dilemma that many American businesses face with outsourcing. Assume you are the CEO of Acme Clothing, a manufacturer of men's pants. Your company lost money for the last five years and laid off 50 percent of its workforce. It costs the company \$7 per pair of pants that it manufactures at its plant in Illinois. Wage rates here are \$10 an hour, with another \$3 an hour for benefits. Most of Acme's competitors now manufacture most of their clothing in Southeast Asia.

Now suppose that a business agent in Southeast Asia, whom you met at a clothing industry trade show, sets forth a proposal for you. She is offering to incorporate a subsidiary in Southeast Asia to manufacture pants to Acme's current specifications. A good wage in Southeast Asia is 70 cents an hour, which is better than the average hourly wage there of only 50 cents. Employees expect few benefits, if any. Unemployment in Southeast Asia is high, so there will be ample willing workers. The cost of doing business is much lower, in part due to the fact that there are few environmental regulations and very little government regulation, once the proper business permit is acquired. The agent mentions that the government officials who issue permits in this Southeast Asian country are poorly paid and are overworked. To obtain the necessary permits to do business in this country usually takes up to a year. For a payment of \$50,000 in cash to the government official, the permits can be obtained in 48 hours.

The way things are going, Acme Clothing faces bankruptcy within the next year. The company has reduced its workforce to 400 employees--300 in the factory and 100 in sales and administrative jobs in the front office. Moving the plant to Southeast Asia will save 75 of the sales and administrative jobs. Further, it would preserve some of the value of the company for shareholders. The largest shareholders in the company are retirement plans, including Acme's own retirement plan.

What are the issues here? How would you approach them? Are you subject to a lawsuit by the shareholders if you don't move the plant? May you pay the bribe to expedite the permit? Do any U.S. laws apply to overseas operations? If you conduct business overseas, are there any international codes of ethics? What standards should you subject yourself to?

The first question concerns whether management has any choice but to relocate. The answer is probably not.

As I'll discuss later, the law may require them to relocate to preserve shareholder value. Most corporate executives would move the plant to Southeast Asia, because the company's survival depends on it.

So with a foreign subsidiary, Acme Clothing is now a multinational corporation. It has joined a growing and increasing powerful club. Over one third of global output comes from multinational corporations. Two-thirds of world trade is attributable to multinational corporations. According to the Washington-based Institute for Policy Studies, 51 of the 100 largest economic units in the world are not governments, but multinational corporations.

Because of the sheer size of multinational corporations, they can engage in "regulatory arbitrage." A company engages in regulatory arbitrage when it makes a decision not primarily because of the underlying economics, but in order to reduce regulation. For instance, a company can locate high-polluting plants in the countries in a South American country, labor-intensive operations in the low-wage countries of Southeast Asia and operations that want to skirt the laws of intellectual property in China. One result of this regulatory arbitrage is that multinational corporations, individually and collectively, can select what country they want to do business in, but be free from most of the regulations of its home country-typically, the United States of America. Multinational corporations, by virtue of their power, either individually or collectively, have been able to influence countries, particularly developing countries, to relax environmental, labor and safety regulations. Political leaders and bureaucrats in developing countries, hungry to provide employment in their countries, often don't take a hard line against multinational corporations because of the fear that they will locate in another country that takes a softer line.

Multinational corporations can engage in regulatory arbitrage in a way that effectively allows them to fly above the laws of any nation. It's impossible for one country to regulate these corporations. Do U.S. laws bind corporations that are incorporated or headquartered here but do business abroad? Generally not. One exception to that rule is the global prohibitions on bribes within our Foreign Corrupt Practices Act. The U.S. Supreme Court has consistently found that U.S. laws, as a general rule, do not apply to the activities of U.S. corporations outside the United States. In 1909, the U.S. Supreme Court held in *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909), that the Sherman Antitrust Act does not apply to acts occurring outside of the United States. More recently, in 1991, in *EEOC v. Arabian American Oil Company*, 499 U.S. 244 (1991), in a divided decision, the U.S. Supreme Court held that U.S. laws prohibiting discrimination do not apply to U.S. citizens working for U.S. corporations in foreign countries. Subsequently, Congress amended the discrimination laws to apply to U.S. citizens employed by U.S. corporations but working in foreign countries. Could Congress amend more business laws to extend their reach past the United States? Probably, but doing so would encourage more corporations like Tyco International, to incorporate outside of the United States.

Back to our hypothetical: if you were the president of Acme Clothing and you made the choice to move your plant to a lower-wage country, you would now have several choices. First, do you pick the country with the lowest wages and the laxest regulation of business? If you do, how do you conduct yourself in that country? Do you simply comply with the minimum legal requirements of your new host country? Even worse, if it is the custom to do so in that country, do you pay bribes to officials who are supposed to enforce regulations so they'll look the other way? Is your objective to squeeze out the most profit from the operation or should you hold the company to higher standards?

These are issues of corporate governance. Corporate governance concerns how those managing the corporation mediate between the competing interests of various stakeholders. Management of multinational corporations must balance the competing claims of shareholders, creditors, employees, consumers, host communities and society at large, to name a few. Traditionally, courts have ruled that corporate entities owe their primary allegiance to their shareholders, more than to any other stakeholder. In a seminal case, *Dodge v. Ford Motor Co*, 204 Mich. 459, 170 N.W. 668 (1919), the Michigan Supreme Court described how far the presumption goes that a corporation must be managed for the benefit of its shareholders. Henry Ford didn't want to pay out huge dividends from the wildly successful Ford Motor Company. Instead, he wanted to lower the price of the autos and dramatically expand production to employ more workers. He wanted to bring industrial prosperity to America. The Dodge brothers, who owned a large block of stock in Ford Motor Company, wanted even greater dividends than they were already receiving. The Michigan Supreme Court sided with the Dodge Brothers, reminding Henry Ford that a corporation "exists primarily for the profit of shareholder."

Dodge v. Ford, though still having legal affect, is not the best statement of the current law. Perhaps the best statement of the current law is the American Law Institute (ALI) Principles of Corporate Government - which are considered persuasive authority by many courts. These principles reaffirm the basic holding of *Dodge v. Ford* that a corporation is to be operated primarily for the benefit of shareholders, but creates three exceptions: (1) a corporation shall comply with the law (2) make charitable contributions; and (3) may devote a reasonable amount of resources to public welfare, humanitarian, and educational purposes.

In the wake of *Dodge v. Ford* and cases like it and the ALI Principles of Corporate Governance provide powerful incentives for management to maximize profits, it became clear to policy makers that the primary vehicle for protecting the interests of employees, consumers and society against the profit motive needs to be legislation. But it unrealistic to hope that legislation will be effective in forcing the management of multinational corporations to strike a proper balance between profit and good citizenship. That is because multinational corporations can "fly above" the regulatory scheme of any given jurisdiction. And as a general rule, lawmakers have been hesitant to extend the reach of U.S. laws to foreign subsidiaries or plants elsewhere. Blanket efforts to extend the reach of U.S. laws have not enjoyed support in Congress and, when enacted, have not had the desired effect. Corporations headquartered in the United States can fairly easily escape the reach of such laws by reincorporating outside the United States, using foreign subsidiaries or contracting work out to foreign corporations. Are we, then, powerless to regulate multinational corporations? If conventional methods, such as enacting laws and regulations, are ineffective, where will we find the incentives for corporate accountability?

If it is not a system of laws that identifies the social responsibility of corporations, what guiding principles should we use? Perhaps the best starting point is the UN Global Compact, which sets out nine principles of ethical conduct of global business. The Compact states:

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

- Principle 2: make sure that they are not complicit in human rights abuses.

Labor Standards

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies

Anti-Corruption

- Principle 10: Businesses should work against all forms of corruption, including extortion and bribery.

In 2000, the United Nations General Assembly adopted a resolution to urge member countries to work together to develop a Universal Code of Conduct for Transnational Corporations. To the list of items above, the UN added "respect for the sovereignty of the host nations" and "respect for the cultural values of the host nations." Who sponsored this successful resolution was telling - the Kingdom of the Netherlands (an important economic force) and the Islamic Republic of Iran.

In terms of broad guiding principles, perhaps the most universally accepted are the Global Sullivan Principles of Social Responsibility. The Reverend Leon Sullivan created the Global Sullivan Principles to address issues of human rights, social justice and economic opportunity. These principles are subscribed to by many of the nation's leading corporations. The principles are, in some ways, a notch up from the UN Global Compact. These principles state:

- Express our support for universal human rights and, particularly, those of our employees, the communities within which we operate, and parties with whom we do business.
- Promote equal opportunity for our employees at all levels of the company with respect to issues such as color, race, gender, age, ethnicity or religious beliefs, and operate without unacceptable worker treatment such as the exploitation of children, physical punishment, female abuse, involuntary servitude, or other forms of abuse.
- Respect our employees' voluntary freedom of association.
- Compensate our employees to enable them to meet at least their basic needs and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities.
- Provide a safe and healthy workplace; protect human health and the environment; and promote sustainable development.
- Promote fair competition including respect for intellectual and other property rights, and not offer, pay or

accept bribes.

- Work with governments and communities in which we do business to improve the quality of life in those communities-- their educational, cultural, economic and social well being--and seek to provide training and opportunities for workers from disadvantaged backgrounds.
- Promote the application of these Principles by those with whom we do business.

Both the UN Global Compact and the Sullivan Principles serve to begin a conversation within corporate America about global responsibilities. These codes, however, have limitations. They are often quite general and do not provide the detail necessary to flesh out specific commitments. Though the Sullivan Principles and the Global Compact purport to help companies with best practices, their descriptions of best practices is general and not inspiring.

The best hope for a more specific set of best practices is the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises. These principles are designed to achieve highly sustainable economic growth and employment and a rising standard of living. The principles seek to contribute to the development of the world economy. The OECD is made up of most the United States and most countries in Europe, as well as Japan, Mexico, Australia and New Zealand. The Principles are much more detailed. And provisions of the plan as they address corporate responsibility are more expansive than U.S. law. Consider these provisions, none of which are mandated by U.S. law:

- The OECD Principles encourage providing training to local personnel to employ local personnel to the great extent possible
- Under the OECD Principles companies must determine which part of the company has the highest environmental standards (often that part which operates in the U.S.) and apply it across the entire multinational operation
- U.S. law prohibits only the payment of bribes to government officials - the OECD Principles prohibit any payment of bribes (including to other companies).
- OECD Principles contemplate U.S. companies permitting the "transfer and rapid diffusion of technologies and know-how" and grant license for use of intellectual property "on reasonable terms and condition in a manner that contributes to the long term development prospect of the host country".
- OECD Principles anticipate that multinationals will "contribute to the public finances of host countries by making timely payment of taxes" in an amount is "in accordance with both the letter and spirit of" the tax laws.

The preface to the OECD Principles recognizes the obvious: "Observance of the Guidelines by enterprises is voluntary and not legally enforceable."

If OECD Principles, United Nations Compact and Sullivan Global Principles are voluntary and not enforceable, is it likely that corporations will voluntarily adopt the principles? Surprisingly, the record of corporations in adopting principles such as these, at first blush, is good. There are substantial incentives for corporations to adopt these codes. Doing so protects brand reputation (including reducing adverse publicity), increases trust, and can strengthen legal compliance (and in some cases provide a valuable defense against civil and criminal penalties). One only need visit the web pages of major corporations to see that most have a code of ethics and

that most of these have a global reach. But a 2001 study by the OCED, entitled Corporate Responsibility: Results of a Fact-finding Mission on Private Initiatives, leads one to the conclusion that most codes of corporate responsibility are fairly general and many may be ineffective. For example, of the corporate codes of conduct relating to labor, 75% mentioned reasonable working environments, but fewer than half committed to fair compensation and freedom of association. Fewer than 35 committed to specifics on how compliance would be monitored and fewer than 10% included a plan to aggressively promote the codes. Further, most codes did not address important areas. Fewer than half the codes address issues of consumer protection and bribery. Few corporate codes of conduct contain aggressive education programs, internal audit procedures, public disclosure provisions, and whistleblower provisions.

What incentives are there for corporations to adopt aggressive codes of conduct, particularly governing conducting business abroad?

I believe that there are several steps that might be taken. None of these steps, for the reasons set forth above, attempts to require all corporations to apply U.S. law to businesses based abroad. Instead, each creates incentives for responsible conduct. Each relies on the assumption that the profit motive for corporations is a strong one, so it's hard for most managers to be bold in putting community interests ahead of profits. Each also relies on the assumption that most managers of most multinational corporations genuinely desire not only to make a profit, but to improve the quality of life in countries in which they do business. These proposals seek to align those goals - finding ways to create financial incentives for multinational corporations to act responsibly. I agree with Professor Daniel Fischel and Judge Frank Easterbrook when they wrote, in *The Economic Structure of Corporate Law*, that "Society thus takes advantage of the wealth-maximizing incentives built into the firm in order to alter its behavior at least cost." How do we encourage those wealth-maximizing behaviors?

In thinking about how to do so, I am influenced by the book, *The Tipping Point: How Little Things Can Make a Big Difference*, by Malcolm Gladwell. We required our first year students to read this book. The book told a series of stories about how just a few people could spread a new idea, trend or way of looking at things. It told, for example of how a few people turned Hush Puppies from a brand that was dying a slow, agonizing death to a hot new fashion trend. It takes a few exceptional people looking things differently.

A first step is encouraging ethically-minded leaders at leading multinational corporations to not only adopt their own codes of ethics, but create incentives for their suppliers to do so as well. In this way a few corporate leaders could "tip" the larger business community to holding itself to a higher standard.

Here is how this idea works. Ethical industry leaders should not only hold themselves to high ethical standards, but require their suppliers to do so also. If effective systems can be found to encourage (and require) suppliers to conduct themselves ethically, then virtually every plant that supplies multinational corporations would not only have a profit motive, but also would have incentives for contributing to the community.

Many multinational companies have adopted these supplier codes. Most require contractors to provide reasonable working conditions, free from discrimination. They prohibit child labor and insist on prevailing industry wages, as well as environmental, safety and health requirements.

But having a code alone is not enough, because some codes appear to be little more than window dressing. According to a study released in 2002 by the Organisation for Economic Co-operation and Development, entitled Roundtable on Corporate Responsibility: Supply Chains and the OECD Guidelines for Multinational Enterprises, many supply-chain codes were deficient. Only 15% provide for significant education and training about code requirements. Only 18% provide for a specific body to have code administration responsibilities. Many of the codes did not provide for a clear communication strategy and active monitoring of suppliers. In fact, less than one third of the codes provided for on-site inspection and special channel for reporting concerns. Less than 2% had a formal complaint body. Fewer than half provide for either internal or external reporting how the level of compliance with the codes.

What if corporations like Wal-Mart not only adopted an effective code for themselves, but required everyone they purchased from to do the same? What if those supplier codes had teeth - independent audits, protection for whistleblowers, strong investigations of complaints, unannounced spot checks? The actions of a few could have a cascading effect.

A few companies are already doing something like this. Toys R Us and Avon state that they will only purchase from companies that are SA-8000-certified suppliers. SA-8000-certified suppliers agree to abide by widely-accepted international labor rights - but they go one step further. They agree to independent verification of compliance by auditing bodies accredited by Social Accountability International (SAI). Similarly, these companies report to the public their annual progress reports as verified by SAI.

The United States government should consider doing the same thing that Avon has done. Bills like HR 2782, the Corporate Code on Conduct Act introduced by Georgia Congresswoman McKinney in 2001, create a framework for doing this very thing. The bill seeks to establish minimum standards for multinational corporations, consistent with evolving international norms. The bill provides, among other things, that corporations doing business with the United States government must ensure fair employment practices, pay a living wage to all workers, provide a safe and health work place, protect the environment and comply with international human rights standards and provide a safe and healthy workplace. This is a step in the right direction because it provides incentives for appropriate conduct.

I've suggested that those who purchase from multinational corporations, if they insist on proper conduct from their suppliers, can make a huge difference. But can you and I - as individuals - make a difference? I believe we can.

I believe that a small number of individuals can be effective in organizing to mobilize public opinion and public pressure on corporations. Individuals who position themselves in the right place at the right time can effectively tip public opinion against those businesses who do not comply with international norms. Here are a few ideas:

1. Shareholder resolutions can be of some help. Groups like the Interfaith Center on Corporate Responsibility routinely sponsor shareholder resolutions to encourage corporate responsibility. Its priorities include international contract suppliers, environmental justice and human rights. Only two of its hundred-plus

resolutions were adopted, but putting resolutions on the agenda gained valuable access to the corporate board room for productive dialogs. Many of these dialogs were successful in convincing corporate management to heighten corporate responsibility.

2. People in the media have tremendous potential to mobilize public opinion. Businesses care about public relations and want to avoid unfavorable media coverage. The media should ask whether local businesses have strong codes of ethics with the provisions I described above. It is not enough to simply have a code. Ask whether it is a good code, with whistle-blower protection and an officer charged with investigation and enforcement. Does the business have supplier codes that are effectively enforced?
3. The Internet creates opportunities for activists and activist groups to disseminate information about corporations that do not hold themselves to high standards. Enter "worst corporations" in Google and you get 3,500 hits. If bloggers "in their pajamas" can nearly bring down Dan Rather, a symbol of the media establishment, can not they also change corporate conduct?
4. Enlightened leadership of trade associations and non-governmental organizations has been effective in some cases of encouraging corporations to hold themselves to higher standards. The Worldwide Responsible Apparel Production program and the International Council of Toy Industries have taken good first steps under the guidance of small, but effective staffs. The Fair Labor Association and Workers Rights Consortium have encouraged many colleges and universities to inquire about labor conditions before buying clothing for their college book stores. Augustana College, through its apparel buying group, complies with the standards of the Fair Labor Association.

With increasing globalization, there is an opportunity for a new dialog on what constitutes conducting business in an ethical way. We can no longer rely on government regulations to define the limits of what is acceptable. Instead, enlightened corporate leaders must set the tone for the debate. One of those leaders is Robert Lane of Deere and Company. Last year, at this time, when speaking in this room about the role of the corporation, Mr. Lane spoke of the cardinal virtues of business. He correctly noted that "the role of the corporation in society is linked to the question of how society should be organized economically to serve human beings, not how human beings should be organized to serve a political or economic system."

As we engage in a dialog about how corporations should be organized to serve society, a word of caution is in order. The world is becoming a global village. We in the United States must not be so arrogant as to think that we can dictate what makes the conduct of business ethical. We must engage in a dialog with other traditions and ways of thinking. If we can do so, we just might find that we develop a collective code of corporate responsibility that is better accepted throughout the world, and that, thanks to contributions from others, the codes are stronger.

Consider the following: In the traditions of the United States, we have viewed the corporation as essentially a contract between shareholders, with the duties and obligations of the corporation determined by the "contract" between shareholders. Other stakeholders (employees, the community, customer), in the U.S. tradition, are not parties to the contract creating the corporation. The only way they can receive protection for their interest is to bargain with the corporation for their own contract or seek protection by legislation. Other countries don't view corporations in this way. Many take a less contractarian view of corporations and a more communitarian view. Communitarian theory views the corporation as an entity that is not only accountable to the shareholders, but

also accountable to the community. Germany, for example, mandates that most corporations have employee representation on the board of directors. The rule of law created by Dodge v. Ford, that a corporation is formed for the near exclusive benefit of its shareholders, is inconsistent with the laws of other industrialized countries - particularly Japan and Germany. Professor Doug Branson, for University of Pittsburgh, puts it well: "United States corporate law and legal institutions have never traveled well and there is no reason to posit that United States-style Corporate Governance will fare any better." Douglas Branson, Teaching Comparative Corporate Governance: The Significance of "Soft Law" and International Institutions, 34 GEORGIA LAW REVIEW 669, 680 (2000). Branson observes that there is, for a number of reasons, increasing skepticism of American business law. Our success in business is viewed elsewhere as destructive of the social fabric.

Further, before imposing Western norms on other cultures, we must proceed cautiously. We believe that bribes are never acceptable. We criticize Asian cultures for traditions of gift giving that we perceive as bribery. We need to look at them and look at ourselves before we are so harsh. In China, gift giving is a sign of good faith and trust. It builds a relationship. Once a relationship is built, business can precede on little more than a handshake. In the United States, we don't build a relationship first. We rely on the lawyers to tie things up for us and then sue when relationships unwind because of lack of trust. And do we really disapprove of bribes in the United States when most in business agree that political donations can buy access to policy makers?

What attitude should business and policy makers take when engaging in a dialog of emerging norms?

International trade cannot be conquered with our military might. Business imperialism will not work. But there are many in business who believe our country should gravitate from the contractarian model to more of a communitarian model, where businesses are part of the larger society and where business leaders help mediate between competing interests in accordance with emerging global norms. For them, this is a time of extraordinary possibilities.

But, as I described, corporate CEOs are the only ones who can enhance corporate ethics. Each of us can do our part to help push business to a tipping point so they view globalization as a reason to adopt more progressive business philosophies.



Accounting	Communication Studies	Geography	Music	Pre-Optometry
Africana Studies	Computer Science	Geology	Music Education	Pre-Pharmacy
Anthropology	Creative Writing	German Studies	Music Performance	Pre-Physical Therapy
Art	Economics	Greek	Neuroscience	Pre-Physician Assistant
Art History	Elementary Education	Graphic Design	Non-Profit Leadership	Pre-Seminary
Asian Studies	Engineering	History	Development	Pre-Veterinary Medicine
Biochemistry	Engineering Physics	International Business	Philosophy	Psychology
Biology	English (Literature)	Japanese	Physics	Religion
Business Administration	English (Writing)	Landscape Architecture	Political Science	Scandinavian Studies
Chemistry	Environmental Management	Latin	Pre-Dentistry	Secondary Education
Chinese	& Forestry	Library and Information	Pre-Law	Sociology
Classics	Environmental Studies	Science	Pre-Medicine	Sociology (Social Welfare)
Communication Sciences	Ethics	Mathematics	Pre-Music Therapy	Spanish
& Disorders	French	Multimedia Journalism	Pre-Nursing	Theatre
		& Mass Communication	Pre-Occupational Therapy	Women's & Gender Studies