the ethics of global business

Denis G. Arnold

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This edition first published 2023

Registered Office(s)
John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, USA
John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, UK

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Library of Congress Cataloging-in-Publication Data applied for
Paperback ISBN 9781405134781

Cover Design: Wiley
Cover Image: © catastrophe_OL/Shutterstock

Set in 10.5/12.5pt Minion Pro by Straive, Pondicherry, India

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Chapter One

Ethics and Transnational Companies

Companies confront challenges to their legitimacy based on activities such as human rights violations, bribery, the exploitation of impoverished workers and consumers, and negative environmental externalities. Typically such cases involve publicly held companies, based in industrialized "home" nations, operating in a developing "host" nations with limited institutional resources for regulating and policing the practices of corporations and their contractors. Critical attention has also been paid to the social and environmental practices of companies based in advanced developing nations, such as Russia or China, operating in Africa and other less-developed regions. The prevalence of these cases is one indication of the fact that we live and work in an era of economic globalization. While trade among nations has been an important feature of the global economy for centuries, there has been a rapid increase in international trade since 1990. The substantial increase in foreign direct investment (FDI) is one indicator of the steadily growing economic and political influence of corporations operating internationally.

Transnational companies (TNCs) operate in a multitude of political jurisdictions and so are subject to a multitude of legal frameworks. Laws regarding such matters as the treatment of customers, the treatment of employees, and environmental protection vary significantly in different host nations. In the case of developing economies, consumer protection, worker safety, and environmental safeguards are often poorly developed. Even when robust laws exist in developing nations, the law enforcement and judicial apparatus necessary to ensure compliance is often weak or corrupt. TNCs operating in such nations are often free to determine for themselves whether or not they will adhere to host nation laws.

FDI can improve social welfare in developing nations through technology transfer, job creation, and economic growth. However, critics challenge the moral

The Ethics of Global Business, First Edition. Denis G. Arnold.

legitimacy of many companies operating in developing nations. Corporate moral legitimacy concerns the evaluation of corporate practices and outcomes from the perspective of diverse stakeholders via the application of moral or ethical norms (Suchman 1995). TNCs confront legitimacy concerns grounded in the perception that they violate basic ethical norms, especially with regard to their relationships with and impacts on base of the pyramid populations. Nongovernmental organizations (NGOs) charge companies with environmental degradation, disregard for the welfare of home-nation employees, and the illegitimate exploitation of offshore factory workers. They argue that when companies move into developing nations they often cause more harm than good for workers, pollute local environments, and illegitimately exploit the natural resources of host nations. For example, NGO and media reports criticize Apple's labor practices in China, Walmart's proactive corruption strategies in Mexico, Disney's use of child labor in supplier factories, China Non-Ferrous Metals Mining Corporation's human rights record in Zambia, and Goldcorp's human rights record in its mining operations in Guatemala, to name only a few examples.

Underlying such allegations are *empirical* claims about the impact of company activities and *normative* claims about how companies should conduct themselves in the global marketplace. The truth of a particular empirical claim about the actions of companies can be properly assessed only when the relevant facts are known and understood. Normative claims are explicitly ethical claims about whether or not the actions of companies are consistent with particular conceptions of right action or justice. Conceptions of right action and justice are the domain of ethics. This book is concerned with the ethical norms that should guide the behavior of companies in their global operations, but the arguments deployed take into account many of the empirical dimensions that are most salient to assessing business practices.

This chapter describes modern TNCs and explains why companies and their leaders are properly regarded as responsible for company policies and practices. We then turn our attention to a theory of the moral legitimacy of TNCs. In Chapter 2, a cosmopolitan perspective on international business ethics is defended. First, the claim that corporations are properly understood as agents of justice is explained and defended. Second, two domains of normative legitimacy regarding international business are distinguished. It is argued that the moral legitimacy of organizations is not persuasively accounted for by a Habermasian deliberative democracy perspective. Third, it is argued that proponents of a Rawlsian political perspective on corporate obligations regarding global justice are mistaken. Taken together, these two sections show that the "political" account of corporate social responsibility (CSR) that has proven influential among some business ethics and CSR scholars in recent years cannot provide an adequate theory of international business ethics. An alternative, "ethical" conception of CSR is then defended utilizing a cosmopolitan human rights perspective.

In Chapter 3, I defend an account of human rights cosmopolitanism. It is argued that human rights are claim rights against parties with whom one stands in a relationship. I argue that human rights are ultimately grounded in human agency or the capacity of persons to govern themselves and that the human rights that TNCs and other business enterprises have duties to protect and respect are basic rather than aspirational. In chapter 4, I provide a critical analysis of recent United Nations (UN) initiatives on business and human rights. It is argued that the UN Draft Norms initiative is properly regarded as an example of the "dark side" of human rights. It is then argued that the more recent UN tripartite framework on human rights developed by the UN Secretary-General's Special Representative for Business and Human Rights, and subsequently approved by the UN Human Rights Council, and implemented by the Organisation for Economic Co-operation and Development (OECD) and the International Finance Committee (IFC), has conceptual and analytic weaknesses. It is argued that the tripartite framework cannot be properly regarded as having a merely strategic foundation, but must be regarded as having an ethical foundation grounded in respect for basic human rights. Once this has been provided, the coherence of the tripartite framework is improved. In Chapter 5, the cosmopolitan human rights theory articulated in chapters 2–4 is defended against criticisms.

In chapter 6, this human rights framework is extended to working conditions in global supply chains. This chapter defends minimum standards for factory workers regarding the disclosure of risks and health and safety conditions and provides an analysis of wage exploitation in developing nations.

The next two chapters provide an ethical analyses of base of the pyramid (BoP) strategies. Proponents of BoP strategies argue that TNCs can reap enhanced profitability by targeting the four billion people living at the base of the economic pyramid as consumers while providing the poor with valuable goods or services. In Chapter 7, my concern is specifically with that portion of the BoP comprised of the 2.6 billion people living in moderate and extreme (MEP) poverty or less than $2 a day. It is argued that MEP populations are both cognitively and socially vulnerable, rendering them susceptible to harmful exploitation. An empowerment theory of morally legitimate BoP business ventures is defended and a multi-stage opportunity assessment process is described that allows TNC managers to determine when BoP ventures should be pursued and when they should be abandoned. This analysis is then used to criticize instrumental CSR and to defend ethical CSR. In Chapter 8, it is argued that businesses that engage in BoP activities with the ostensible goal of benefitting BoP populations may paradoxically harm BoP populations by degrading the natural environments upon that sustain BoP populations. This chapter provides a conceptual framework for understanding the environmental impacts that firm products, services, and operations can have on the poor. A pragmatic solution aimed at resolving this apparent paradox is then provided.

Transnational Companies

A variety of types and sizes of companies operate internationally. Small or medium sized firms may have supply chains that extend across national boundaries or may service foreign customers, but are based in one nation. Larger organizations that have operations and employees in many nations are the primary subject of analysis in this work. Bartlett and Ghoshal (2002) provide a conceptual framework for understanding the different types of organizational structures of large firms operating in an international context. In recent history, they argue, there have been three main types of organizational structures. First, there are multinational companies characterized by a decentralized governance structure with self-sufficient companies operating in host nations. The strategy of multinational companies is based on sensitivity and *responsiveness* to national contexts, and knowledge acquired and retained within national units. Second, there are global companies that are characterized by the centralized governance of a parent company operating from a home nation. The strategy of global companies is characterized by the *efficient* deployment of a uniform strategy in host-nations, and knowledge acquired and retained by the center. Finally, there are international companies that are characterized by a combination of centralized and decentralized core competencies. International companies utilize a strategy of *leveraging* parent company competencies grounded in knowledge acquired centrally and distributed overseas (Bartlett and Ghoshal 2002, pp. 16–18).[1]

Bartlett and Ghoshal argue that in order for modern TNCs to adapt to a global marketplace and remain competitive, they need to be responsive to national contexts, efficient in their global operations, and capable of leveraging parent company competencies. That is, they argue that companies need to adapt key attributes from each of the three types of companies operating globally in order to be economically successful. In this work, the term "transnational companies" will be utilized more broadly to encompass multinational companies, global companies, and international companies, as well as the model of TNCs that Ghoshal and Bartlett advise general managers to adapt. Each type of company is transnational in the sense that the scope of company operations, customer base, or supply chains extend across national boundaries and often into regulatory and governance gaps. While characteristics described by Ghoshal and Bartlett are important for understanding the differences between the varieties of companies operating internationally, and the strategic advantages and disadvantages of each variety, the differences are insignificant for the purpose of justifying the ethical norms that should inform business practices.

Shareholder Primacy

Bartlett and Ghoshal's typology of companies is ostensibly amoral, making no normative claims about the obligations of TNCs operating across national boundaries. Elsewhere, however, Ghoshal chastises business school faculty for teaching bad theories about the normative obligations of managers to generations of business school students. In particular, he argues that "by propagating ideologically inspired amoral theories, business schools have actively freed their students from any sense of moral responsibility" (Ghoshal 2005, p. 76). He identifies the shareholder primacy ideology, grounded in unrealistic and unfounded assumptions, as a leading example of a bad theory, which has contributed to the bad practices of managers that result in harm to a variety of stakeholders. While Bartlett and Ghoshal do not advocate shareholder primacy in their analysis of international business, their general silence on the role of ethics in international business is illustrative of much mainstream work in the field, which is primarily the domain of descriptive and empirical social science research. International business scholars have noted the need for greater integration of business ethics and international business (Doh et al. 2010). John Dunning, one of the founders of the field of international business, maintains that in the global marketplace, "human dignity and human rights" are "absolute and universal virtues" that must be recognized and protected by corporations (Dunning 2001). However, there remains little agreement regarding the theoretical framework that should guide international businesses operating in the diverse nations and cultures in which TNCs and their subsidiaries operate.

What ethical norms should guide TNCs in their global operations? This straightforward question generates lively debate among scholars, business leaders, and critics of business alike. The conventional Anglo-American story regarding the normative obligations of corporate managers holds that it is the obligation of managers to maximize profits for shareholders (or private equity holders) while adhering to the law. Sometimes it is added that corporations should also avoid deception, although this is typically stipulated as an aside and not explained or defended by proponents of the "shareholder primacy" perspective (Stout 2012). This view is sometimes summarized by the popular expression that "the business of business is business." Proponents of this view typically emphasize the importance of protecting property rights and the positive impact corporations have on social utility. They argue that managers who expend corporate resources on activities that are not focused on corporate profits are, in effect, undemocratically redistributing investor resources. They also endorse the idea that managers are agents of shareholders who must always act on behalf of shareholder interests. Defenders of this view typically adhere to broadly libertarian beliefs regarding markets emphasizing minimal regulations, private property rights, freedom, especially the freedom to enter into contracts, weak labor protections, and free trade among nations. This nexus of values is, for example, the editorial position of *The Economist*, a magazine with an influential global readership. It is also a position influential among many economists, especially those from the Chicago School of economics, as well as business school faculty influenced by such economists.

This view of the normative function of joint-stock companies may be summarized as follows. First, in democratic nations, citizens determine the rules that govern private property, contracts, and the regulation of markets via their elected and appointed representatives. The courts impartially adjudicate disputes based on precedent and foundational charters or constitutions. Second, in order to reduce transaction costs, citizens facilitate the creation of publicly held corporations that allow for the pooling of investments in business ventures with investor liability limited to the loss of the investment. Third, to efficiently manage the organization shareholders, or private equity investors, utilize boards of directors to retain executives to act as their agents. Fourth, the executives implicitly agree to follow the laws determined by the democratic process, thereby garnering moral legitimacy grounded in respect for a democratic system of government. Fifth, an economic system in which businesses maximize profits for investors within a democratically determined regulatory framework that gives priority to property rights, freedom of contracts, and competitive markets will maximize overall utility measured in monetary terms, at least in comparison to alternative political-economic systems.

The ideological bedfellow of the shareholder primacy view is the instrumental theory of corporate responsibility. Instrumental, or economic, corporate social responsibility holds that corporations should engage in pro-social or ethical conduct only when doing so will improve the return on investment of the financiers of the organization (Gond et al. 2009; McWilliams and Siegel 2001; McWilliams et al. 2006). The term "instrumental" CSR is more appropriate than the term "economic" CSR because it better reflects the idea that the exclusive duty or obligation of managers is to promote shareholder, or financier, wealth, regardless of other ethical considerations. In this sense, pro-social behavior is of instrumental value to shareholders or financiers. On the other hand, the term "economic" refers to a much broader domain of concern and might include, for example, considerations regarding public welfare beyond the narrow interests of shareholders or financiers. According to the instrumental view, the only legitimate role of managers regarding ethical or prosocial behavior is to engage in ongoing cost-benefit analysis that balances the claims and expectations of various stakeholders (both internal and external) against firm profitability. Meeting increased stakeholder expectations will sometimes result in greater demand and improved revenues.

According to the instrumental position regarding corporate responsibilities, in such cases the additional cost is justified because of increased revenues. However, ethical or pro-social behaviors that do not increase revenues are not justified and should not be undertaken. Gond et al. (2009) argue that that the logic of this position is consistent with the institutional logic of the Italian mafia, which has a similar focus on extreme profits and the exploitation of governance gaps.

This theoretical framework is surprisingly problematic given its prominence in public discourse and scholarship about business in the United States (Ghoshal 2005; Jones and Felps 2013). One might think that a view that was defended by influential scholars in finance and economics, as well as many corporate leaders and politicians, would have a firm grounding in a well-developed theory of the legitimacy of corporate practices in a global economic system, but this is not the case. Consider just three of the difficulties with this position: faulty assumptions regarding institutional frameworks, the political influence of corporations and other business interests that the ideology ignores, and the lack of democratic governments in many nations in which corporations conduct business that make the ideology largely inapplicable in many nations in which TNCs operate.

Faulty Assumptions Regarding Institutional Frameworks

The shareholder primacy ideology is grounded in a faulty interpretation of corporate law. Legal scholar Lynn Stout points out that, contrary to the shareholder primacy ideology, corporate law in the United States gives directors and executives wide discretion with regard to corporate objectives via the business judgment rule (Stout 2012). In practice, this entails that managers have the legal right to take into account the actions of their companies on other stakeholders and on society in general. Pressure from Wall Street analysts, major investors, and poorly designed executive incentive structures can encourage a myopic focus on short term stock performance and disregard for the interests of employees or customers, but this is not a legal requirement and many US companies are managed in a way that balances the interests of multiple stakeholders (for further discussion of the US legal context for corporations, see Orts (2013)).

In the United Kingdom, the revised Companies Act of 2006 requires that directors take into account the interest's of the company's employees, "the impact of the company's operations on the community and the environment," the need to maintain "a reputation for high standards of business conduct," and the need to act fairly.[2] More generally, 15 of 27 members states of the European Union have national policy frameworks for promoting corporate social responsibility. The European Commission, the executive governing body of the European Union, has recommended that all member states implement such frameworks.[3] The India Companies Act of 2013 mandates that large firms operating in India contribute 2% of net profits to CSR initiatives and monitor and report on their initiatives.[4]

The shareholder primacy view is also parochial in the context of a global marketplace in its assumption that companies are based in liberal market economies, such as the United States, while ignoring the varieties of capitalism that exist in the world. Liberal market economies (e.g. the United States, Britain, Canada, Australia, Ireland, and New Zealand) are characterized by competitive markets in which access to capital is linked to current market performance and labor markets are fluid because the institutional arrangements to provide job security are limited (Hall and Soskice 2001, pp. 8–19; Williamson 1985). Coordinated market economies (e.g. Germany, Japan, Switzerland, Sweden, Norway, and Austria) rely significantly on nonmarket forms of coordination via networks and collaborative relationships. In these markets, access to capital is independent of recent stock performance and institutional structures within the economy are designed to result in long-term employment relationships.

Institutional arrangements in coordinated economies typically require companies to take into account the interests of other stakeholders and society in general in their policies and practices. For example, in Germany, codetermination laws ensure that employees constitute one-half of the membership of the boards of directors of most companies with more than 2000 employees, and one-third of the members of the boards of directors of most companies between 500 and 2000 employees (as well as many stock companies with employees fewer than 499 employees). Codetermination laws give employees significant controlling influence over companies in the interest of protecting employee welfare (Fauver and Fuerst 2006). Additional varieties of capitalism exist in other nations or regions.[5] For example, China's economy is characterized by tight central coordination and the strategic use of state-owned enterprises.

Democratic Legitimacy

The ideal of representative democracy that is an essential feature of the shareholder primacy view, one where citizens determine the rules of the game and companies adhere to those rules while maximizing shareholder wealth, is incompatible with the reality of modern interest group politics. One way of understanding democracy is in terms of plural interest groups competing for political influence. In this view, the democratic process is comprised of shifting coalitions of interests groups that reflect the interests of their members. The disproportionately influential role that corporations and their surrogates play in shaping the rules of the game is largely ignored by proponents of the shareholder primacy view. In the United States, for example, polls consistently find that a large majority of Americans believe that corporations exert too much political influence.[6] In his classic book on the topic of corporate political influence, *Politics and Markets*, Charles Lindblom argues that corporations in democracies exert power over governments in two primary ways (Lindblom 1977; see also Epstein 1969 and Wilson 1981). First, corporations and their surrogates exert ideological power by shaping public preferences. Second, corporations exert political power through political action committees and paid lobbyists.[7] Lindblom's conclusions are well supported by social science data compiled in the United States and Great Britain (Mitchell 1997). A survey of the empirical data on this subject by political scientist Neil Mitchell found that the preponderance of evidence supports the conclusion that a disproportionate expenditure of resources by business interests has resulted in special benefits for corporations. A more recent meta-analysis of research on corporate political activity corroborates Mitchell's conclusions and finds that firms that expend more on corporate political activity financially outperform firms that expend less (Lux et al. 2011).

Proponents of shareholder primacy have yet to provide a theory of corporate political activity that situates corporate power in democratic theory and provides an account of legitimate corporate political activity. It is difficult to see how such a theory could justify an advocacy role for corporations in party politics above and beyond the rights enjoyed by individual employees, shareholders, and customers as citizens, even if corporations enjoy other certain rights. But in a global business environment this is just one challenge with respect to democracy confronting proponents of the shareholder primacy theory of the firm. A second, and more fundamental problem, is the absence of democracy in many environments in which TNCs operate.

Many of the nations in which TNCs conduct business lack important democratic institutions such as equal voting rights, multiple political parties, democratic elections, politically neutral militaries, and an independent judiciary. According to Freedom House, 57.4% of the world's sovereign states and colonial units—home to 57% of the world's population—lack civil or political freedom (Freedom House 2020). Forty percent of nations including China, Russia, and Nigeria are not electoral democracies. The shareholder primacy view presumes the existence of electoral democracies, and presumably civil and political rights that facilitate political speech and activity, so that citizens can regulate business activity. The shareholder primacy view is inapplicable in other political contexts. However, international business is conducted in all nations, and a theory of the firm that cannot provide guidance to companies operating in unfree or partially free nations is inapplicable for transnational companies operating in a global economy and can provide no guidance to firms operating primarily in nations that are not democratically governed.