Section 3.4 Influences on business decisions

18 Business ethics

Definition

Ethics are the moral principles that should underpin decision-making. A decision made on ethical grounds might reject the most profitable solution in favour of one of greater benefit to society as well as the firm.

Linked to: Corporate objectives, Ch 1; Corporate influences, Ch 15; Corporate culture, Ch 16; Shareholders versus stakeholders, Ch 17; Ethics in global business, Ch 41

18.1 What are business ethics?

Business ethics can provide moral guidelines for the conduct of business affairs. These need to be based on common understanding of what's right and what's wrong. An ethical decision means doing what is morally right. It is not a matter of scientifically calculating costs, benefit and profit. Most actions and activities in the business world have an ethical dimension. This has been highlighted recently in relation to whole industries (such as soft drinks and fast food) and to businesses that use cheap labour in less developed countries.

Among the important ethical considerations in business are:

- dealing honestly and fairly with customers and with suppliers
- protecting the environment through actions such as the use of sustainable sources of raw materials
- dealing with bullying, harassment and discrimination within the organisation
- the provision of accurate financial and other numerical information
- anti-competitive practices
- testing products on animals
- **whistleblowing** on unethical practices within the business.

Two major influences shape the moral behaviour of businesses. First, an organisation is composed of individuals, who all have their own moral codes, values and principles. Naturally they bring these to bear on the decisions that they make as part of their working lives. Second, businesses have cultures that shape corporate ethical standards. The approach taken by the leaders of the business can have a big effect on both of these factors.

The extract below about ethics at GlaxoSmithKline illustrates a situation in which individuals and the **corporate culture** proved important.

Real business

Ethics at GlaxoSmithKline (GSK)

In March 2015 the UK pharmaceuticals giant GSK fired more than a hundred of its staff in China. This came after the company was fined £300 million for its guilt in bribing doctors in China (to get them to prescribe GSK medicines).

When the story first broke in 2013, GSK denied it. But later GSK chairman Sir Christopher Gent said: 'The illegal activities of GSK China were a clear breach of GSK's governance and compliance procedures and are wholly contrary to the values and standards expected.' The company was found to have funnelled billions of renminbi to hospitals, doctors and government officials in a programme of 'massive and systemic bribery'.

In 2010, the company had been forced by an American court to pay out a world record payout of $96 million to a 'whistleblower' who was sidelined and made redundant for warning of contamination problems at one of GSK's American factories.

Ethics is not about what companies say; it's about what they do.

(Sources: Guardian, 28 October 2010; Financial Times, 6 March 2015)

18.2 The ethics of strategic decisions

A strategic decision is one that is so major and so long term that is virtually irreversible. A good example is when Nokia sold its handset business to Microsoft in 2013. At the time commentators were 'shocked' at the low price (about £4 billion). When Microsoft later wrote off the whole sum and closed the business, people realised how wise Nokia had been.

Ethics enter strategic decisions in two main ways:

1. Whether the moral aspects of the decision have been fully thought through. In 2006, British Aerospace (BAe) sold its 20 per cent stake in Airbus for £1.9 billion (one of the worst business decisions of all time). The ethics of the situation seemed not to occur to the directors. It meant that BAe would now be 100 per cent reliant on sales of military aircraft and weapons systems. Quite apart from the ethics of selling arms, the fact is that arms sales are especially prone to bribery and other corrupt practices. BAe later paid £286 million in fines for corrupt dealings.
2. The level of risk – and are the risks borne fairly? In 2013, a private equity business bought the City Link parcel delivery service for £1. With more than 2,500 staff this big business could make the new owners a fortune if things went well. In fact the business was placed into administration on 24 December 2014, leaving delivery drivers horribly out of pocket (they had been encouraged to act as self-employed van owners). If the deal had gone well, the owners would have made millions. When it went badly, ordinary staff lost their jobs.

Figure 18.1 City Link was bought by a private equity firm for £1 in 2013

As strategic decisions are so important to a business's future, it is especially important that the directors consider the morality behind their decision as well as the potential profitability.

18.3 Trade-offs between profit and ethics

Businesses need profit. It is profit that provides the capital to withstand a bad trading period, or to keep up with new technology or to finance growth. But there can be a huge difference between profit needed and profit wanted. Profit needs to be enough to provide a satisfactory return for the risks involved in investing in a business. In 2013, at the time GlaxoSmithKline was embarrassed by its corrupt practices in China, bank interest rates of 0.5 per cent might suggest that a return of 5–10 per cent on capital would have been adequate. In fact the business had a 25.7 per cent return on capital in 2013, and the company's chief executive received £7.2 million in remuneration.

In a healthily run business, there *should* be a constant tension between ethics and profit. When a clever product developer comes up with an idea like Krave chocolate cereal, it's for a senior Kellogg's executive to question whether that's the right thing to do. In a public limited company, however, there will rarely be any such debate. Staff soon learn that questioning the ethics of sweets near the checkout (Marks & Spencer plc) or excess sugar in the cans of Cola (Coca-Cola and PepsiCo) is never a good career move. Only in a privately owned, preferably family-run, business or a co-operative is there a serious chance of a true ethical debate. And even then there are many instances of career ambition overtaking moral considerations.

When writing on the subject, it is vital to distinguish between ethics and business strategies such as 'ethical' marketing. Ethics is about morality; ethical marketing is the often-cynical pursuit of product differentiation through the manipulation of consumers. In August 2015 Innocent Drinks launched 'Light & Juicy' drinks, with each pack carrying the banner: 'Naturally 30 per cent lower in sugar'. Was this decision rooted in ethics? Or was it a response to a 10.8 per cent fall in sales of Innocent Drinks in 2014 (Kantar Worldpanel, quoted in the *Grocer* 1 August 2015)? Even though the 900ml carafes of the drink contain 14–15 teaspoons of sugar, it is wrong to jump to conclusions about the motives involved. If Innocent's executives genuinely saw this as a way of lowering consumers' sugar intake, it could be argued that the decision was ethical. Please excuse my scepticism.

The ultimate test of the ethics involved in a decision is whether the ethical course of action involves a loss of profit. When Lidl removed sweets and crisps from its checkouts in January 2014, it was clearly a good thing to do. It would have made a small dent in profit without making a significant difference to the brand's image. By contrast Aldi's decision to do the same in August 2014 can only really be seen as a reactive move. It is hard to see it as ethically driven. As mentioned earlier, the real test is whether the motive was ethical, and one can only be sure of that if one is part of the discussions and the decision. Outsiders can only hypothesise; they can rarely be sure.

18.4 Pay and rewards

In 2005, Arcadia (Topshop) boss Sir Philip Green paid himself a dividend worth £1,170 million, funded by bank borrowing. In other words the business took on the debt, and Philip Green took the cash. Well, strictly speaking it was paid to his wife who – living in Monaco – paid zero tax to the UK government. This huge exercise in tax avoidance may have come at a cost to the business. In 2005 Arcadia made £326 million in profit. By 2013/2014 (latest accounts at the time of writing), the figure had fallen to £143 million – and Arcadia announced 2,000 job losses.

Few would doubt that high-risk, high-pressure jobs deserve high rewards. Still fewer would doubt the value of a really talented business boss. Ray Kelvin, founder and boss of Ted Baker plc, has taken the business from one shop in Glasgow to an international brand with a stock market value of more than £1 billion. What pay and rewards does Ray Kelvin deserve? Well, for the year ended 31 January 2015 Mr Kelvin paid himself a salary of £374,000. He received further bonus payments taking his remuneration up to £757,000. In the same year, underachieving Marc Bolland, boss of Marks & Spencer plc, received remuneration totalling £2,076,000. Was he worth it? Hmm.

In the long run, the logic is simple. Business success is a team effort. The people at the top can only succeed through the efforts of those throughout the business. Therefore it must be a strategic mistake to separate the riches at the top from the scraps at the bottom. Long-term success will come from everyone feeling that there is fairness. Not equality, perhaps; but fairness. So, yes, the person at the top may receive 20 times the income of graduate trainees, but if those at the bottom are being restricted to a 2 per cent pay rise, it is grotesque to see those at the top receiving huge bonuses.

18.5 Corporate Social Responsibility

Corporate Social Responsibility (CSR) is – at its best – a form of self-regulation by which companies exceed legal minimum requirements in an attempt to be good social citizens. Such behaviour is claimed by businesses such as John Lewis, Unilever, Marks & Spencer and the Co-op. Critics, though, suspect that CSR is often no more than a branch of a company's public relations (PR) department – concerned with image, not substance. It may be that examples exist at both extremes, but the majority of businesses are somewhere in between.

What is undeniable is that these issues are complex. In 2005 Unilever plc came joint bottom of a ranking of corporate UK's ethical standards. Perhaps in response in 2010 the company launched its Sustainable Living Plan that it still claims to be the cornerstone of the business. This helped Unilever move up to 7th in the *Guardian*'s list of graduates' most-favoured employers. Yet in February 2015, an important health story broke showing evidence that 30 years of health advice was unfounded. Saturated fats were not a health problem and butter was no worse for your heart than margarine. Well, who had put out all this research into the evils of butter, years ago? Unilever, producer of Flora and many other margarines. Companies *may* adopt high standards, but it's wise to be sceptical of what they do and say. Their **vested interest** makes it harder than they realise for them to be objective.

18.6 Reasons for and against Corporate Social Responsibility (CSR)

Reasons for CSR

Companies receive many benefits from behaving, or being seen to behave, in a responsible manner. John Lewis and its supermarket business Waitrose both gain from consumer affection based on the assumption that these employee-owned businesses behave better towards their stakeholders. Reasons for CSR include the following.

Marketing advantages

Many modern consumers expect to purchase goods and services from organisations that operate in ways that they consider morally correct. Some consumers are unwilling to buy products from businesses that behave in any other way. Some companies have developed their apparent ethical behaviour into a unique selling point (USP). They base their marketing campaigns on these perceived differences. Examples include Lush cosmetics, Innocent Drinks and Toyota (which, in January 2015, had the two top-selling cars in America – all based on the company's green image due to its Prius hybrid car).

Positive effects on the workforce

Firms that adopt strong CSR practices may experience benefits in relation to their workforce. They may be able to recruit staff who are better qualified and motivated, because larger numbers of high-quality staff apply. Innocent Drinks has had an unusually low labour turnover rate since its start-up. This cuts the employment costs associated with recruitment, selection and training. Creating a culture of social responsibility can also improve employee motivation. In turn, that may boost the productivity and profitability of the business.

> 'There needs to be a balance between business and social responsibility ... The companies that are authentic about it will wind up as the companies that make the most money.'
>
> *Howard Schulz, boss of Starbucks*

Reasons for doubting CSR

Some shareholders criticise CSR as a distraction from the real business of making profits. For them the concerns are as follows.

Reduced profitability

Any business that really embraces CSR faces higher costs. Exploiting cheap labour or very low-cost supplies from less developed countries may be very profitable. If a business wants to act with responsibility, it must accept that principle may have to override profit. This is easier to do in a family-run business than in a public limited company, with its distant, profit-focused shareholders.

Reduced growth prospects

It may also be that the company has to turn down the opportunity to invest in projects offering potentially high returns. This would limit the long-term growth potential of the business – which might allow competitors to become stronger on the back of their high profits. Following the 2013 coup by the Egyptian army against a democratic leader, some travel agencies refused to carry on sending tourists to the country's Red Sea resorts. Others carried on, ignoring the moral issues. A true sense of CSR has to include refusing business profits that are tainted morally.

The bigger critique of CSR comes from those who doubt its authenticity. Their reasons against include the following.

Rejection of CSR as a tool of public relations (PR)

The actions of banks such as Barclays, Lloyds and HSBC have shown how hollow their CSR rhetoric can be. They pretended to be acting in the interests of the wider community as a cloak for some depressingly amoral, sometimes, immoral business behaviours.

Rejection of CSR as a distraction from a truly moral purpose

During the period 2010–2014, Aldi and Lidl received praise for their low prices, while Waitrose received praise for its socially responsible way of doing business. But surely not! During a time of heavily squeezed family budgets, Waitrose was charging higher prices than any other food retailer. Surely Aldi and Lidl were being socially responsible by helping people survive the squeeze.

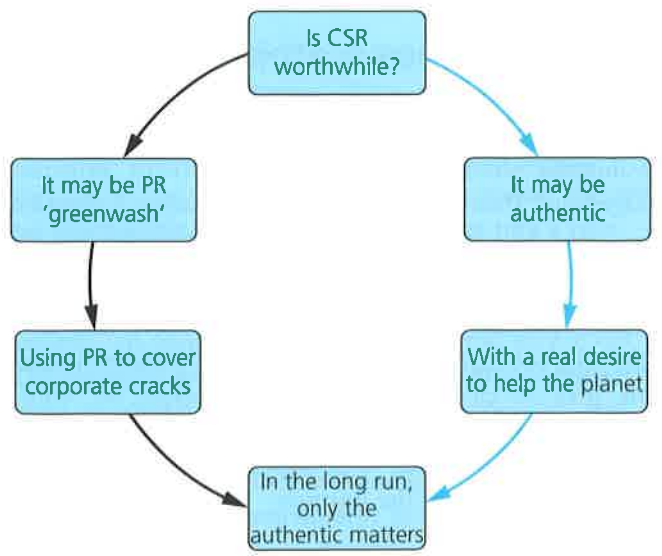

Figure 18.2 Logic circle: is CSR authentic or cosmetic?

> 'All company bosses want a policy on corporate social responsibility. The positive effect is hard to quantify, but the negative consequences of a disaster are enormous.'
>
> *Noreena Hertz, academic and athor*

> 'It takes 20 years to build a reputation and five minutes to ruin it.'
>
> *Warren Buffet, investor extraordinaire*

Five whys and a how

Questions	Answers
Why do some people believe that corporate social responsibility is a modern trend?	It's a mystery. Over a hundred years ago companies such as Cadbury and Unilever focused far more on social factors than anyone does today.
Why might ethics get in the way of profit?	By forcing a business to back down from a decision that makes money, but isn't right morally.
Why might a company choose to act with social responsibility – but without publicising it?	It might see more advantage in focusing on the good than in publicising the good, e.g. knowing that staff like pursuing a goal other than shareholders' profits.
Why are directors paid so much, even when they're underperforming?	Perhaps because the 'remuneration committees' that decide on pay are stuffed with people who are directors of other companies, i.e. it's a merry-go-round.
Why might CSR be handled by the PR department?	Because the company sees it as a tool for image-building, rather than a matter of substance.
How should a company set about being both profitable and ethical?	By identifying a product or service that has high enough value added that it is possible to pay suppliers and staff properly, while still making a reasonable profit margin.

18.7 Business ethics – evaluation

Evaluation involves making some sort of informed judgement. Businesses are required to make a judgement about the benefits of CSR. Their key question may be whether social responsibilities are profitable or not.

This chapter has put forward arguments as to why CSR might be profitable. For example, responsible behaviour can give a clear competitive advantage on which marketing activities can be based. Every John Lewis Christmas commercial is designed to make customers feel warmer towards the business.

Operating an authentic policy of social responsibility gives a USP if none of your competitors has taken the plunge. Being first may result in gaining market share before others catch up. In these circumstances a CSR policy may enhance profitability. It can also be an attractive option in a market where businesses and products are virtually indistinguishable.

Regarding ethics, however, the arguments have to be different. If the adoption of an ethical approach is down to calculation of self-interest, by definition it is not ethical. Ethics are about moral values and therefore must override calculation/profit. Many years ago, before cigarette advertising was banned, one London advertising agency took the decision to refuse to accept contracts from tobacco companies. This decision had no financial upside; it was simply based on the moral codes of the directors of the agency. That's ethics.

Key terms

Corporate culture: the culture of an organisation is the (perhaps unwritten) code that affects the attitudes, decision-making and management style of its staff.

Corporate Social Responsibility (CSR): a term intended to sum up the ethically driven activities of a business; but often it's an extension of the public relations (PR) department, making sounds that signify nothing.

Vested interest: when there's a personal, often hidden, reason for making a decision (often rooted in money).

Whistleblowing: when an employee decides they can't accept a moral dilemma (such as knowing of bribery), and exposes the unacceptable practice – perhaps first to senior management and then – if nothing is done – to the media.

18.8 Workbook

Revision questions

(25 marks; 25 minutes)

1 Define the term 'business ethics'. (2)

2 State two factors that may shape the moral behaviour of businesses. (2)

3 Outline one circumstance in which a company may face an ethical dilemma. (3)

4 Explain the difference between a business behaving legally and a business behaving ethically. (4)

5 Look at each of the following business actions and decide whether they were motivated by ethical considerations. Briefly explain your reasoning each time:

a) a private hospital refusing to accept an ill elderly person whose only income is the state pension (2)

b) a small baker refusing to accept supplies of genetically modified flour (2)

c) a small baker refusing to deliver to a restaurant known locally as a racist employer. (2)

6 Why could a policy of delegation make it more difficult for a business to behave ethically? (4)

7 Explain why a company's corporate social responsibility programme might do little to change irresponsible behaviour within the organisation. (4)

Revision activities

Data response

Virgin Galactic

With all Richard Branson's success as Britain's best-known business leader, his Virgin Group may yet achieve its greatest fame for space travel. The space-tourism project goes back to 1999 when Branson registered the name 'Virgin Galactic'. It started to take shape in 2004 when Branson adopted technology that engineers had used to win a $10 million space race prize. He was so confident at that stage that he announced that Virgin Galactic would fly within three years – and he started selling tickets at $250,000 a go.

Unfortunately three years later the programme hit the headlines only because of the detonation of a tank of nitrous oxide that killed three people and seriously injured another three. Ticketholders, including Brad Pitt and Angelina Jolie, would have to wait. In 2011 there were more glitches when a test flight malfunctioned. Far more serious, though, was the disaster on 31 October 2014, when a Virgin Galactic test flight exploded and then crashed shortly after launch at the Mojave desert. One of the pilots was killed instantly and the other (who ejected) was seriously injured. It emerged that the space ship was powered by a fuel mix that had not previously been used in flight. Branson's immediate response to the disaster was to say 'Space is hard – but worth it. We will persevere and move forward together'.

Just prior to the test flight and crash, Branson had been interviewed by the *Financial Times*. Here he set out the purpose behind his investment: 'The space company will be our flagship. Because we're the only private company in the world sending people to space, the next few months are obviously something that has a halo effect on every Virgin company.'

And after the crash, what's the future for Virgin Galactic? In April 2015 Virgin boasted that only 20 of 700 deposit-payers had asked for their money back. When an official safety report was published into the crash it blamed pilot error due to inadequate training. The safety problems may eventually force Branson to back down on his space dream. You wouldn't bet on it, though.

Questions (40 marks; 45 minutes)

1 As Branson states, the corporate objective for Virgin Galactic is to provide 'a halo effect' for every Virgin company. Assess whether this is a valid corporate objective. (10)

2 Given the safety problems the project has faced, assess whether it would be better, ethically, for Branson to close the project and return the deposits. (10)

3 Richard Branson is determined to proceed with Virgin Galactic. Evaluate whether he should first discuss this decision with Virgin Galactic's stakeholders. (20)