CHAPTER 5

Globalization and Society

OBJECTIVES

After studying this chapter, you should be able to

5-1 Describe the trade-offs among different stakeholders in MNE activities

5-2 Evaluate the major economic effects of MNEs on home and host countries

5-3 Explain the broad foundations of ethical behavior

5-4 Identify the cultural foundations of ethical behavior

5-5 Illustrate how ethical behavior is affected by different legal attitudes

5-6 Show how corruption and bribery affect and are affected by cultural, legal, and political forces

5-7 Summarize what the roles are of governments and companies in resolving environmental issues

5-8 Demonstrate how global labor issues need to be addressed by MNEs to their stakeholders

5-9 Restate how codes of conduct can help MNEs respond to concerns by stakeholders over responsible corporate behavior

Source: HollyHarry/Shutterstock

▲ Sustainable fashion promotes the use of eco-friendly and recycled textiles.

When the last tree has been cut down, the last river has been polluted and the last fish has been caught—only then do you realize that money can't buy everything.

—Native American proverb

CASE

The Battle of the Clothing Giants for Sustainable Manufacturing[1]

—Stefania Paladini

A couple of decades ago, the multibillion-dollar clothing and apparel industry was inundated in accusations of unethical practices and even the propagation of modern slavery. Many multinational corporations in the industry had offshored their production to low-income countries, shipping their final products to rich customers back home, The criticisms leveled at these corporations included appalling work conditions, abysmal wages, and unsustainable and wasteful management of resources in the manufacturing processes.

No longer.

If there is one trend in the industry that has become increasingly prominent since then, it is the conscious effort by the leading manufacturers to address the main corporate social responsibility (CSR) issues in their management practice, starting all the way from on-site production and encompassing every aspect of sustainability in business. Let's see how.

THE APPAREL MANUFACTURING GIANTS

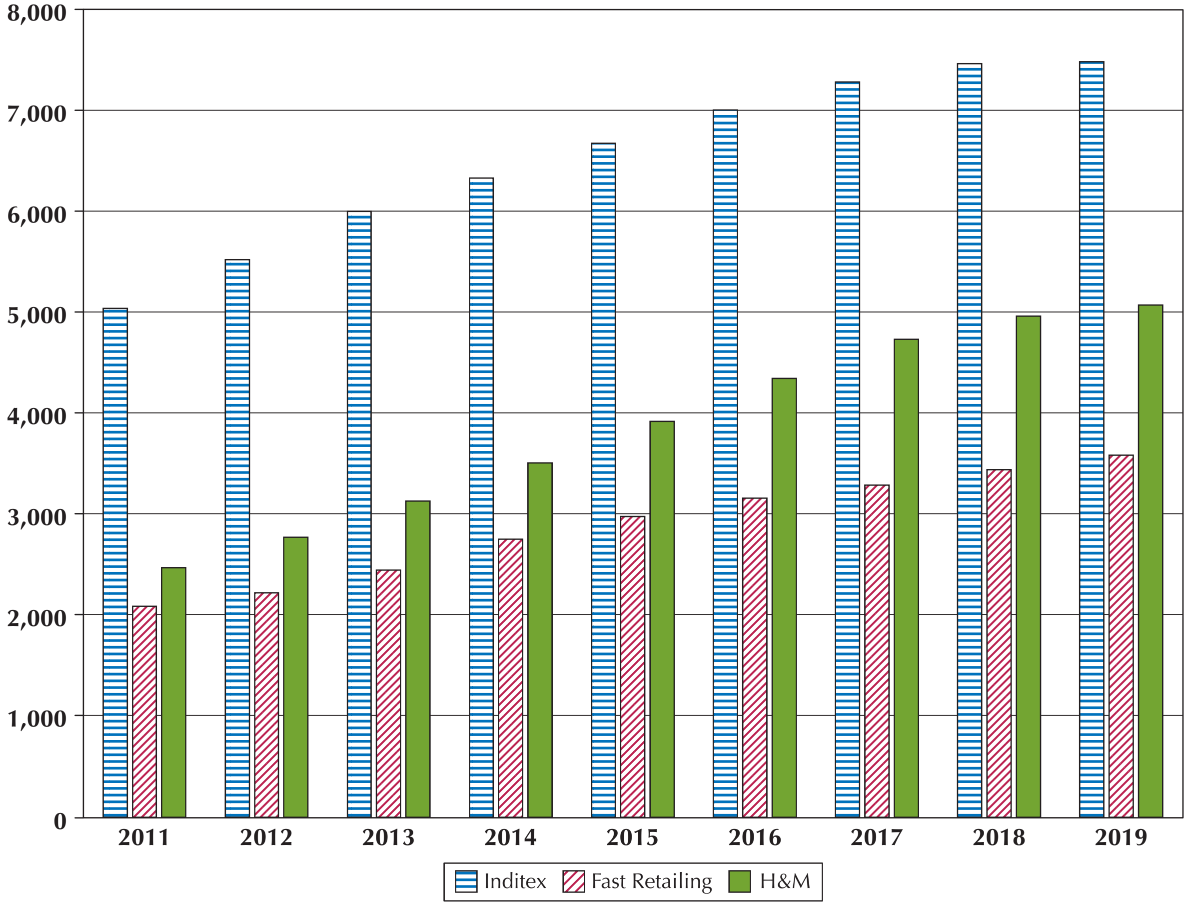
As of 2020, the clothing and apparel market is dominated by what is called the "fast fashion movement," where the supply chain is skewed toward a quick design-to-shelf time rather than dominated by brand awareness. This becomes immediately evident when one looks at the leading retailers in the apparel market, with Inditex, Fast Retailing (Uniqlo), and H&M leading the pack.

In 2019, Inditex, the Spanish company that owns brands such as Zara and Massimo Dutti, once again topped the list in worldwide sales, with a turnover of about $28.89 billion. Fast Retailing and H&M also confirmed their rankings in second and third place, respectively, with around $20 billion each.

Founded in 1975, Inditex is a relatively young company that has become an exemplar in fast fashion. Due to an increasingly short design-to-shelf time—the average being 12 weeks—the company

FIGURE 5.1 Number of stores of the major apparel companies worldwide (2011–2019)

Source: Based on data from Statista, and the annual reports and official websites of H&M, Inditex, and Fast Retailing.



can manufacture its pieces in line with the latest consumer tastes and learn from the in-store performance of its items. This is an essential component for success in the fast-fashion business model, which combines relatively lower quality (compared to a more established brand) with a customer-driven design approach, moving products from the production lines to the outlets in the shortest possible time. The model adopted by Zara, the largest company in the Inditex group, consists in in-house garment production, with Zara's plants directly manufacturing a whopping 75 percent of the company products while the rest is outsourced. (H&M, by contrast, outsources the entirety of its production.) About half of Zara's factories are located in Spain, as are all four major distribution centers, making it possible to distribute its products worldwide in a matter of weeks.

Despite being the fourth most valuable apparel brand, the slower factory-to-shelf model of the Swedish Hennes & Mauritz (H&M) has taken sales down from a height of $3,521 million in 2009 to $1,814 million a decade later. Founded in 1947, the company now operates more than 5,000 stores around the world (see Figure 5.1), including some online, and employs over 120,000 people. Even today, the designs are reserved for the Sweden HQ, from where they are then sent for production to the 1,000 or so suppliers, mainly located in Europe and Asia.

Founded in Japan in 1949, Uniqlo was acquired by Fast Retailing in 2005. Uniqlo's stores are concentrated in Japan (production in China started quite recently, in 1990s) and so are its shops.

These big chains face extraordinary pressure to adapt to fast-evolving business environments, both with respect to working conditions in the supplier markets and in terms of climate-change challenges.

CSR, WORK CONDITIONS, ENVIRONMENTAL STANDARDS

Over the past few decades, as more and more companies took advantage of lower costs in emerging economies and relocated part of their production there, CSR emerged as a fundamental issue in the communication strategy of the global supply chain. This is largely due to the subpar working conditions in those countries, including low wages and a lack of health and safety regulations, attracting criticism from all quarters. These issues gained international attention after high-profile accidents like the 2013 disaster at Rana Plaza in Bangladesh, which caused the death of more than 1,000 workers, resulting in an international outcry and a call for collective action that would uphold universal principles such as those promoted by the UN Sustainable Development Goals (SDGs).

But improvement of wages and working standards are not the only sustainability concerns the industry, as a whole, is going to face in the next decade. The environment is another concern, and possibly an even more pressing one.

According to McKinsey, embracing sustainability had become the buzzword for the clothing and apparel sector in 2017, and as a result, 42 out of 100 fashion brands disclosed their supplier information. The pressure for accountability from stakeholders and customers alike is escalating, as consumers are now becoming increasingly aware of how much energy consumption is involved as well as the significant contribution of this industry to pollution. In fact, the use of chemicals and the production of toxic waste makes this one of the most polluting industries, including about a third of all the microplastic that ends up in the ocean.

A (MORE) SUSTAINABLE PRODUCTION APPROACH

The carbon footprint of the clothing and apparel industry far exceeds that of international flights and the shipping business. Natural fibers alone consume an incredible amount of resources from farm to store, such as water for the production of cotton. A majority of natural fabrics also require what is called "wet processing," which involves bleaching, cleaning, and dyeing in an aqueous environment. On the other hand, synthetic fibers essentially come from petroleum, the use of which, as a fossil fuel, is problematic for a host of other reasons.

The major brands are now actively engaged in finding a more sustainable way of production in all phases of the supply chain, starting from the raw materials used to the manufacturing process itself.

Many in the industry are looking to innovative technology for solutions, especially new, more sustainable artificial and natural fibers that can be used in manufacturing. Prime examples here are organic hemp and linen, cultivation of which requires minimal water and little-to-no pesticides. These fibers are versatile, and little goes to waste. Moreover, the early 2000s yielded "smart textiles" with advanced artificial fabrics that can sense and respond to environmental stimuli like heat and sound or detect biological changes in the wearer like heart rate, temperature, and blood pressure, and their development has picked up speed in the last decade due to the drive for innovation and concerns over sustainability.

Yet another possibility lies in reusing the material from discarded apparel in a process called upcycling, and this is where the principle of circular economy can help (see the case "The European Union's Green Deal and Blueprint for a Circular Economy" in Chapter 4). According to the Ellen MacArthur Foundation, the fashion industry produces about 53 million tons of fiber every year, two-thirds of which regularly end up in landfills. Estimates show that in the United Kingdom alone, clothing worth about £140 million went straight into the trash bin in 2019. Moreover, the percentage of clothing currently reused by manufacturers to make new clothes is well below 1 percent. This is probably because the process of upcycling complete garments is far more expensive and technologically challenging than recycling fabrics. To make the whole effort an economic success, it is vital that the major brands pave the way by devising viable ways to accomplish this, at the technological, design, and commercial levels.

The good news is that the market leaders have already started moving in this direction to manage the environmental impact of garment manufacturing, adopting a wide range of measures aimed at extending the life cycle of fabrics, with upcycling being only one of them. In 2019, Inditex released a statement outlining its goal of achieving 100 percent sustainable manufacturing by 2025 while raising the use of sustainable cotton by 105 percent and recycled materials by 250 percent. H&M, boasting a longstanding tradition of commitment to sustainability, started recycling components over the past decade, and in 2017, about two-thirds of its cotton was sustainably sourced and about 96 percent of its electricity came from renewable energies. The company has also committed to 100 percent sustainability by 2030. H&M routinely collects old clothes from customers for recycling, and in 2017, it retrieved about 17,771 tons.

TEAMING UP WITH ACADEMIA AND THE GOVERNMENT

The goal of sustainability has translated into a number of other projects involving a variety of institutions beyond market leaders. For instance, H&M has signed a partnership with the Hong Kong Research Institute of Textiles and Apparel (HKRITA) to set up a pilot hydrothermal recycling plant. Moreover, in an attempt to combine environmental sustainability with CSR, unions and worker-led elections of representatives were instituted at the group's Bangladesh-based supplier factories after the events of 2013.

These initiatives have enjoyed a lot of public support, and governments too are welcoming these initiatives and working to make sure these pledges are transformed into action and policies. For instance, to make consumers more sensitive toward sustainable shopping behaviors, in 2020, the Norwegian Consumer Authority encouraged H&M to explicitly state the degree of pollution caused by garment manufacturing.

Meanwhile, as part of its ambitious targets for a sustainable future, the European Commission has introduced objectives related to industrial recycling in its Circular Economy Package, and textile waste represents an important component.

The Commission has also committed financial resources to fostering upcycling initiatives. Trash2Cash, which involves 17 partners across 10 countries, is aimed at finding efficient ways to separate mixed fibers. The European Union is set to offer €21 million ($23.5 million) in funding to support sustainable bio-based textiles. Other actions, such as the European Clothing Action Plan (ECAP), completed in 2019, have tried to combine environmental and economic benefits as part of their vision of a sustainable clothing sector.

Not all the initiatives and pledges have come to fruition, of course, and there is scope for more. Conservative estimates are that the global smart-textile sector will keep growing, from $93 billion in 2019 to about $475 billion by 2025, with extended benefits all over the global apparel supply chain and opportunities for future expansion.

QUESTIONS

5-1 What is upcycling, and why is it becoming so crucial in the global garment supply chain?

5-2 What is the attitude of governments toward the manufacturers' pledges of sustainability? In which way can this affect consumer behavior toward a more sustainable consumption model? Give examples.

In this chapter, we'll examine how globalization affects society and managers' judgments as they interact with different laws and cultures and try to be socially responsible. This will help you as new graduates to be better positioned to be successful in today's socially responsible environment. Doing business abroad is not easy. The greater the "distance" from one's home country, the more complicated it is to do business. Distance can be described in many different ways, but one way to identify it is the acronym CAGE: cultural (also known as psychic distance), administrative (such as political and institutional policies), geographic, and economic.[2] Given the criticisms of globalization and the challenge of companies and individuals doing business in areas of the world that are quite distant, as defined above, how can companies and individuals be successful, or at least not create serious mistakes?

STAKEHOLDER TRADE-OFFS

5-1 Describe the trade-offs among different stakeholders in MNE activities

Companies must satisfy the demands of

- shareholders,
- employees,
- customers,
- suppliers,
- society.

To prosper—indeed, to survive—a company must satisfy different groups of **stakeholders**, including shareholders, employees, customers, suppliers, and society at large. Obviously, this juggling act can be quite tricky. The shareholder (or stockholder)-versus-stakeholder dilemma pits the demands of one stakeholder against all the others. There is a debate on the idea of shared value, which implies that companies can increase profits while at the same time addressing critical social problems. It is tricky to do both successfully, but many MNEs feel it is worth the effort.[3] In essence, that is what GE is doing by trying to increase profits and positive cash flow while at the same time being environmentally responsible. The basic idea of focusing on stakeholders more broadly is that companies can consider various socially important groups when making decisions.[4] In the short term, for example, group aims often conflict. *Shareholders* want additional sales and increased productivity (which result in higher profits and returns). *Employees* want safer workplaces and higher compensation. *Customers* want higher-quality products at lower prices. *Society* would like to see more jobs, increased corporate taxes, more corporate support for social services, and more trustworthy behavior on the part of corporate executives.

In the *long* term, all of these aims must be adequately met. If they aren't, there's a good chance that none of them will be, especially if each stakeholder group is powerful enough to bring operations to a standstill. In addition, pressure groups—which may reflect the interests of any stakeholder group—lobby governments to regulate MNE activities both at home and abroad.

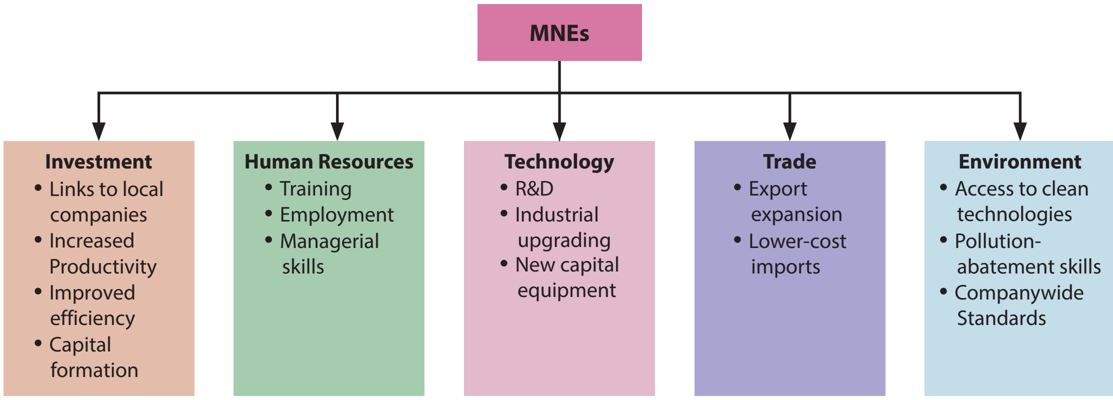
For example, GE's Ecomagination initiative has generated pressure from various constituencies, including clients and shareholders concerned about profitability, various governments concerned with drafting regulations, employees wondering about changes in the company's strategies and goals, and environmental lobbyists, NGOs, and fellow businesses trying to preserve the environment. Each group has a powerful influence on how GE does business and on how successful it is in the marketplace. However, GE has to satisfy a variety of stakeholders with different concerns. For that reason, it has many different initiatives working with different stakeholders, not just those interested in climate change.

THE ECONOMIC IMPACT OF THE MNE

5-2 Evaluate the major economic effects of MNEs on home and host countries

As we examine globalization and society, let's begin with a discussion of the impact of MNEs on the countries where they operate. As discussed in Chapter 1, there are many ways a company can do business abroad, and its success or failure can be strongly affected by the operating environment as illustrated in Figure 1.1. In addition, the MNE's activities can also affect the operating environment, such as through corruption and bribery, environmental impact (i.e., air and water pollution), and labor policies.

FIGURE 5.2 What MNEs Have to Offer



Although not all companies engage in foreign production, the dynamics involved in this decision raise lots of interesting issues. According to the eclectic paradigm of international production, there are three conditions that help explain the foreign production decision: ownership-advantages of MNEs that give them an advantage over companies in the host countries, location-specific advantages of the host country that make them attractive locations for FDI, and internalization advantages for the MNEs to utilize their specific ownership advantages rather than sell or license them to outsiders to exploit.[5] Figure 5.2 identifies some of the ownership-specific advantages of the MNE, focusing on what the MNE has to offer.

Measuring the impact of the MNE on home and host societies depends on its stakeholders, the ability to understand cause-and-effect relationships, and individual versus aggregate effects.

It is hard to determine whether or not the actions of MNEs affect societal conditions.

Cause-and-effect relationships refer to the true impact of an MNE on a host country. Opponents of FDI persist in trying to link MNE activities to such problems in host countries as inequitable income distribution, political corruption, environmental debasement, and social deprivation.[6] In contrast, proponents of MNE activities tend to assume a positive link between their activities and such effects in recipient countries as higher tax revenues, increased levels of employment and exports, and greater innovation. There may or may not be a link, but each side needs to provide evidence to back up their position.

The philosophy, goals, and actions of each MNE are unique, making it difficult to know how to deal with them.

Some countries evaluate MNEs and their activities on an individual or case-by-case basis. Other countries assume that all foreign companies affect the local economy the same way. It's probably more accurate to treat foreign investors on a case-by-case basis, but it's easier to treat all foreign companies the same. Only experience will help policy makers know which is best.

BALANCE-OF-PAYMENTS EFFECTS

The effect of an individual MNE may be positive or negative.

BOP effects refer to trade and capital flows resulting from FDI. Under different conditions, these effects may be positive or negative, either for the host country or the home country.

Host countries want capital inflows because they provide the foreign exchange needed to import goods and services and to pay off foreign debt. However, FDI results in both capital inflows and capital outflows. Money flows in with the initial investment but flows out when earnings are repatriated to the parent company.

CONCEPT CHECK

On page 163 of Chapter 4, we mention how balance of payments is a key feature of a country's economy.

Effect of Individual FDI To appreciate better why countries must evaluate the effect of each investment on their balance of payments, we can examine two extreme hypothetical scenarios reflecting the effects of FDI on a nation's balance of payments:

- *Scenario 1:* Assume that a Mexican MNE makes an FDI when purchasing a Jamaican-owned company as a portfolio investment. If the MNE makes no changes in management, capitalization, or operations, profitability remains the same for the Jamaican company. Dividends, however, now go to the Mexican owners rather than remaining in Jamaica. This results in a drain on Jamaica foreign exchange and a corresponding inflow to Mexico.

- *Scenario 2:* A Mexican MNE purchases idle resources (land, labor, materials, equipment) in Jamaica and converts them to the production of formerly imported goods. Rising consumer demand leads the MNE to reinvest its profits in Jamaica, where import substitution increases the host country's foreign-exchange reserves.

Most FDI falls somewhere between these two extreme examples. That's why they're hard to evaluate, particularly when policymakers try to apply regulations to all in-bound investments.

The formula to determine the balance-of-payments effect is simple, but the data used must be estimated and are subject to assumptions.

There is, however, a basic equation for analyzing the effect of FDI on a host country's balance of payments:

$$B = (m - m_1) + (x - x_1) + (c - c_1)$$

Where

B = balance-of-payments effect
m = import displacement
m_1 = import stimulus
x = export stimulus
x_1 = export reduction
c = capital inflow for other than import and export payment
c_1 = capital outflow for other than import and export payment

On the import side, the balance of payments is positive if the FDI results in a substitution for imports and negative if it results in an increase in imports.

Calculating Net Import Effect Even though the equation itself is pretty straightforward, determining the value for each variable can be a challenge. Let's examine the effect of the decision to locate a Toyota automobile plant in Brazil—an instance of FDI by a Japanese MNE. The easy answer is that import displacement assumes that Brazilian-made Toyotas will take the place of Toyotas previously imported into Brazil. Those locally-made Toyotas could also take the place of other brands of autos being imported into Brazil to service the Brazilian market, such as Fiats or VWs. The import stimulus of the FDI implies that Toyota has to import parts, components, and machinery into Brazil to set up the plant, assuming that it doesn't source those items inside Brazil. Once the plant is up and running, Toyota might be able to use local suppliers of parts and components, thus reducing the amount of import stimulus. In addition, Toyota's Japanese suppliers might invest in Brazil, further reducing Toyota's import of parts.

The net export effect is the *export stimulus* minus the *export reduction* $(x - x_1)$, but bear in mind that this figure is complicated. Let's go back to our Toyota example. In this case, we can make the assumption that the Brazilian plant merely substitutes for imports from and production in Japan. If, in fact, we proceed on this assumption, we get no net export effect for Brazil. For Japan, we arrive at a negative net export effect because of Toyota's export reduction (it's now selling cars made in Brazil to Brazilian consumers instead of exporting Japanese-made cars to Brazil). Toyota, however, might well defend itself on the grounds that its moves abroad are (largely) defensive. How so? Under this assumption, Toyota can argue that it is capturing sales that would otherwise go to non-Japanese carmakers in Brazil, such as Fiat or VW. In that case, Toyota's export reduction from Japan amounts only to the export replacement (loss) resulting from the decision to build a production plant in Brazil, although it is still capturing sales in Brazil, although from production in Japan. Also, Toyota might sell Brazilian-made cars to surrounding countries, thus increasing exports from Brazil.

The balance-of-payments effects in terms of capital flows for FDI are usually

- positive for the host country initially and negative for the home country,
- negative for host country and positive for the home country later.

In some cases, MNEs have argued that their overseas investments stimulate home-country exports of complementary products (say, in Toyota's case, auto parts) that they can sell in host countries through foreign-owned facilities.

Calculating Net Capital Flow *Net capital flow* $(c - c_1)$ is the easiest figure to calculate because of controls maintained by most central banks. There are, however, a few sticking points. Basing your evaluation on a given year is problematic because there's a time lag between a company's outward flow of investment funds and the inward flow of remitted earnings. Because companies eventually plan to take out more capital than they originally put in, what appears at a given time to be a favorable (or unfavorable) capital flow may prove, over a longer period, to be the opposite. The time it takes Toyota to recoup its capital outflow to Brazil depends on such factors as the need to reinvest funds in the host country, the ability to borrow locally, estimates of future exchange rates, and rules on the repatriation of capital.

As a rule, MNE investments are initially favorable to the host country and unfavorable to the home country in the short run. After some time, however, the situation usually reverses.[7] Why? Because nearly all foreign investors eventually plan to have their subsidiaries remit dividends back to the parent company in excess of the amount they sent abroad. If the net value of the FDI continues to grow through retained earnings, dividend payments for a given year may ultimately exceed the total amount of capital transfers composing the initial investment.

GROWTH AND EMPLOYMENT EFFECTS

Growth and employment effects are not a zero-sum game because MNEs may use resources that were unemployed or underemployed.

In contrast to balance-of-payments effects, MNE effects on growth and employment don't necessarily amount to *zero-sum games* (where gains must equal losses) between home and host countries. Classical economists assumed that production factors were always at full employment; consequently, any movement of any of these factors from home to abroad would result in an increase in foreign output abroad and a decrease in domestic output. Even if this assumption were realistic, it's still possible that gains in the host country will be greater or less than the losses in the home country.

The argument that both home and host countries may gain from FDI rests on two assumptions: (1) resources aren't necessarily being fully employed and (2) capital and technology can't be easily transferred from one industry to another. Let's say, for example, that a soft-drink maker is producing at maximum capacity for the domestic market but is limited (say, by high transportation costs) in generating export sales. In addition, moving into other product lines or using its financial resources to increase domestic productivity aren't viable options.

Setting up a foreign production facility is appealing because it would allow the company to develop foreign sales without reducing resource employment in its home market. In fact, it may wind up hiring additional domestic managers to oversee international operations; perhaps it will also end up earning dividends and royalties from the foreign use of its capital, brand, and technology.

For example, many U.S. and European garment manufacturers moved production operations to low-wage countries to realize cost advantages as their consumers demand lower-cost garments.[8] In the process, they shut down—or at least declined to expand—home-country operations. Thus, overseas FDI in the garment-making industry has resulted in a loss of jobs in home countries while creating jobs abroad. However, FDI into the U.S. and European countries has also taken place, creating domestic jobs in companies totally or partially owned by foreign investors. Host countries in apparel have gained through the transfer of capital and technology. If that capital is used to acquire host-country operations that are going out of business, then the foreign investor may very well save host-country jobs and, through the import of technology and managerial ability, even create new jobs.

Critics, however, contend that MNEs often make investments that domestic companies could otherwise make, thereby locking out local entrepreneurs. Likewise, they say, foreign investors often bid up prices when competing with local companies for labor and other resources. Critics also claim that FDI destroys local entrepreneurship in ways that affect national development. Because entrepreneurs are inspired by the reasonable expectation of success, the collapse in several countries of small cottage industries, especially in the face of MNE efforts to consolidate local operations, may have played a role in undermining the competitive confidence of local businesspeople.

A complicating factor is that foreign investors are constantly shifting resources to adjust to changes in market conditions. For example, Ford announced in 2019 that it was going to close down some operations in Brazil due to changes in market conditions and focus more on products that were more popular in Brazil rather than in products that could be exported back to the United States. Their decision would have a major impact on growth and employment in Brazil.[9]

THE FOUNDATIONS OF ETHICAL BEHAVIOR

5-3 Explain the broad foundations of ethical behavior

Many actions elicit universal agreement on what is right or wrong, but other situations are less clear.

Companies and those who work for them must act *responsibly* wherever they go. However, a look at ethical behavior tends to focus on individuals—those who finally make the decision of how to behave. But top management can determine the values a company espouses and to which employees must adhere. Such values are generally included in a Code of Conduct (discussed at the end of the chapter) and in the behavior of other individuals in the organization, especially peers and superiors. In order to ensure adherence to those values, management will try to hire individuals who are willing to work in the type of ethical environment it is trying to create. However, people still must make the decision about how they are going to act in any given situation, and not every situation is clear-cut.

There are three levels of moral development:

- Preconventional
- Conventional
- Postconventional, autonomous, or principled

The sections below will examine the cultural and legal dimensions of ethical behavior in a global context. First, though, let's briefly examine the broad foundations of ethical behavior. There are three levels of moral development:[10]

- Level 1, the *preconventional* level, where children learn what is right and wrong but don't necessarily understand *why* their behavior is right or wrong.
- Level 2, the *conventional* level, where we learn role conformity, first from our peers (including parents), then from societal laws. One could argue that company codes of conduct are also part of the *conventional* level of behavior in the narrow context of a company rather than a society. However, behavior espoused by companies likely reflects the values of the company's home country.
- Level 3, the *postconventional, autonomous, or principled* level, where individuals internalize moral behavior, not because they are afraid of sanctions, but because they truly believe such behavior is right.

It is possible that behaviors under Level 2 and Level 3 are the same as long as individuals accept the laws where they live, or the codes of conduct of the companies they work for.[11]

Teleological Approach: Decisions are based on the consequences of the action.

Utilitarianism: An action is right if it produces the greatest amount of good.

Deontological Approach: Moral judgments are made and moral reasoning occurs independent of consequences.

When individuals confronted with ethical decisions enter the realm of moral reasoning, they examine their moral values, especially as related to Levels 2 and 3 above, and decide what to do. One method of doing so, the **teleological approach**, holds to the idea that decisions are based on the consequences of the action. **Utilitarianism**, a consequences-based theory of moral reasoning, means that "an action is right if it produces, or if it tends to produce, the greatest amount of good for the greatest number of people affected by the action. Otherwise, the action is wrong."[12] A second method, the **deontological approach**, asserts that we make moral judgments or engage in moral reasoning independent of consequences. It implies that actions are right or wrong *per se.*[13] In other words, ethics teaches that "people have a responsibility to do what is right and to avoid doing what is wrong."[14] When individuals engage in moral reasoning, they use one or the other of these methods, or possibly some mixture of the two.

As noted in current research, there is a possibility that in addition to individuals with a strong moral compass, there are also bad apples—individuals for whom the love of money is a strong motivator and likely to result in dishonest behavior. There are two external moderating forces to counterbalance the bad apple behavior, however. One is corporate ethical values (CEV) and the other is the degree of corruption in the country where the individual is operating (CPI or the Corruption Perceptions Index as described below). When a company establishes strong CEV and the country in which the company is operating has a strong CPI, the less likely the individual is to engage in dishonest behavior.[15] Although the company cannot influence the CPI, it can establish strong CEV as we'll show below. As you begin to work in international assignments, moral reasoning becomes very complicated. Consequences may vary due to legal differences, and what is right or wrong may depend to an extent on local values. People need to figure out how make moral decisions—and so do the companies they work for. Two questions arise here: Why should companies and individuals care about ethical behavior? And what are the cultural and legal foundations of ethical behavior when it comes to adapting to a foreign environment?

WHY DO COMPANIES CARE ABOUT ETHICAL BEHAVIOR?

Why should companies worry about ethical behavior at all? From a business standpoint, ethical behavior can be instrumental in achieving one or both of two possible objectives:

1. To develop competitive advantage
2. To avoid being perceived as irresponsible

First, some argue that responsible behavior contributes to strategic and financial success because it fosters trust, which in turn encourages commitment.[16] For instance, GE's Ecomagination program reflects top managers' belief that by actively responding to social concerns about global warming, GE can gain a strategic advantage over competitors, perhaps developing an edge in emerging markets that are facing severe environmental problems.

NGOs are active in prodding companies to comply with certain standards of ethical behavior.

Second, companies are aware that more and more Non-Governmental Organizations (NGOs) and other groups and individuals are becoming active in monitoring—and publicizing—international corporate practices. Governments also want to ensure that individual and corporate behavior is consistent with the best interests of the broader community and that laws are being duly followed. Even worse than perception is reality. Unethical behavior can result in serious sanctions against companies and legal action against individuals.

THE CULTURAL FOUNDATIONS OF ETHICAL BEHAVIOR

5-4 Identify the cultural foundations of ethical behavior

RELATIVISM VERSUS NORMATIVISM

Values differ from country to country and between employees and companies.

As discussed in Chapter 2, despite the cultural differences found among countries, it is tempting to assume that there is almost universal agreement on what's right and what's wrong. In the real world, however, managers face situations in which the whys and hows of applying cultural values are less than crystal clear. Everything that complicates dilemmas in the domestic business environment tends to complicate them even further in the international arena. So, does ethical behavior vary by country, or are there uniform values that everyone should share?

CONCEPT CHECK

Recall from Chapter 2, page 76, our discussion of "cultural awareness" and the various ways in which social and cultural distinctions can characterize a country's population. We also observed that companies doing business overseas need to be sensitive to internal diversity: They should remember that people in most nations are often members of multiple cultures and in some cases have more in common with certain foreign groups than with domestic groups.

Relativism One point of view is to accept that there are significant differences from country to country that might affect our behavior. "When in Rome, do as the Romans do" is an oft-quoted expression that dates to the fourth century AD, which implies that in different environments, one must adapt to local customs out of respect for them.[17]

Applying this expression in an international environment may depend on whether we assume that decisions are based on the consequences of our actions or on a strongly held view of right and wrong. **Relativism** holds that ethical truths depend on the values of a particular society and may vary from one society or country to another.[18] The implication is that it would not be appropriate to inject or enforce one's ethical values on another, or that a foreigner must adopt local values or morals whether or not they are consistent with the foreigner's own home values and beliefs.

Relativism: Ethical truths depend on the groups holding them.

Normativism In contrast, **normativism** holds that there are indeed universal standards of behavior that, although influenced by different cultural values, should be accepted by people everywhere. Even a pluralistic society such as the United States has a large core of

CONCEPT CHECK

In discussing "guidelines for cultural adjustment" on page 89 in Chapter 2, we demonstrate that successful accommodation to a host country's culture depends not only on that culture's willingness to accept anything foreign but also on the extent to which foreign firms and their employees are able to adjust to the culture in which they find themselves.

commonly held values and norms.[19] However, people may adopt other values and norms as their own. The key is to distinguish between what is common to all and what is unique to the individual.

Walking the Fine Line Between Relative and Normative Companies and their employees struggle with the problem of how to implement their own ethical principles in foreign business environments: Do those principles reflect universally valid "truths" (the normative approach)? Or must they adapt to local conditions on the assumption that every place has its own "truths" and needs to be treated differently (the relative approach)?

Normativism: There are universal standards of behavior that all cultures should follow.

Many individuals and organizations have laid out minimum levels of business practices that they say a company (domestic or foreign) must follow regardless of the legal requirements or ethical norms prevalent where it operates.[20] One could consider this as behavior based on principles of honesty and fairness, or "ordinary decency."[21]

Managers need to exhibit ordinary decency—principles of honesty and fairness.

Social responsibility requires human judgment, which is subjective and ambiguous.

THE LEGAL FOUNDATIONS OF ETHICAL BEHAVIOR

5-5 Illustrate how ethical behavior is affected by different legal attitudes

CONCEPT CHECK

Note that on page 121 in Chapter 3 we define a country's legal system as the fundamental institution that creates a comprehensive legal network to regulate social interaction; its purpose is to stabilize political and social environments as well as to ensure a fair, safe, and efficient business environment.

Dealing with *ethical dilemmas* is often a balancing act between *means* (the actions we take, which may be right or wrong) and *ends* (the consequences of our actions, which may also be right or wrong). Legal foundations for ethical behavior can provide guidance here, but legal justification is more rooted in the teleological approach to moral reasoning and moral behavior (consequences) than in the deontological approach (right vs. wrong behavior). However, there are good reasons to consider the law as a foundation of ethical behavior, just as there are limitations to using the law. Another concern is whose laws take precedence? Should the MNE only worry about local laws, or do they have to worry about the laws of the country where their headquarters are located? If there is a conflict between home country and host country laws, which laws take precedence?

LEGAL JUSTIFICATION: PRO AND CON

According to the legal argument, an individual or company can do anything that isn't illegal. However, there are five good reasons why this is inadequate:

1. Some things that are *unethical* are not *illegal*. Some forms of interpersonal behavior, for example, can clearly be wrong even if they're not against the law.
2. The law is slow to develop in emerging areas, and it takes time to pass and test laws in the courts. Moreover, because laws essentially respond to issues that have already surfaced, they can't always anticipate dilemmas that will arise in the future.
3. The law is often based on imprecisely defined moral concepts that can't be separated from the legal concepts they underpin.
4. The law often needs to undergo scrutiny by the courts. This is especially true of case law, in which the courts create law by establishing precedent.
5. The law simply isn't very efficient. "Efficiency" in this case implies achieving ethical behavior at a very low cost, and it would be impossible to solve every ethical behavioral problem with an applicable law.[22]

In contrast, there are also several good reasons for using the law to justify ethical behavior:

Legal justification for ethical behavior may not be sufficient because not everything that is unethical is illegal.

1. The law embodies many of a country's moral principles, making it an adequate guide for proper conduct.
2. The law provides a clearly defined set of rules, and following it at least establishes a good precedent for acceptable behavior.
3. The law contains enforceable rules that apply to everyone.
4. Because the law represents a consensus derived from widely shared experience and deliberation, it reflects careful and wide-ranging discussions.[23]

The law is a good basis for ethical behavior because it embodies local cultural values.

Company codes of conduct and a manager's moral compass to do what is right are often needed to reject bribes.

Source: Kaspars Grinvald/Shutterstock

CORRUPTION AND BRIBERY

5-6 Show how corruption and bribery affect and are affected by cultural, legal, and political forces

Bribery of public officials takes place to obtain government contracts or to get officials to do what they should be doing anyway.

Bribes are payments or promises to pay cash or anything of value.

Bribery is one facet of *corruption.* The determinants of corruption include cultural, legal, and political forces.[24] As defined by Transparency International, corruption is "the abuse of entrusted power for private gain. When government officials are involved, bribes can be paid to obtain government contracts, or they can be as minor as trying to get government officials to do what they should be doing anyway. It can be grand, petty, and political depending on the amounts of money and the sector where it operates."[25] Bribes are payments or promises to pay cash or anything of value.

Figure 5.3 provides information on the Corruption Perceptions Index for 2018 by identifying the perceived levels of public-sector corruption for a small sample of the 180 countries included in the data set. Although no country is free of corruption, it is depressing to note that the most corrupt countries tend to be in high-conflict regions, especially in Africa. Clearly poverty is an issue, although corruption and bribery occur at all income levels. Higher levels of corruption and bribery can also lead to or result from destabilized political environments, which can create problems for foreign investors as well as local companies. Transparency International publishes not only a Corruption Perceptions Index but also a Bribe Payers Index, which identifies which of the top 28 countries in the world are likely to have companies that pay bribes to do business abroad. In a recent survey, they reported that companies from Russia, China, Mexico, Indonesia, and the United Arab Emirates were most likely to pay bribes, either to foreign government officials or to other private sector companies.[26] However, it is hard to follow trends in this index since it is not published on an annual basis like the CPI.

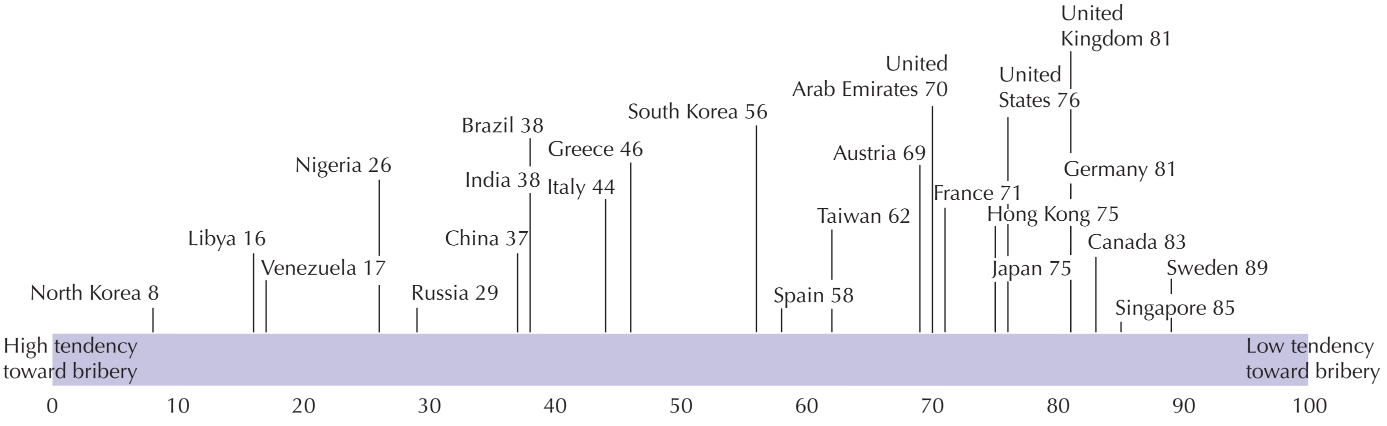
CORRUPTION WITH A GLOBAL TWIST

Corruption is a widespread phenomenon. Sometimes it occurs within a country involving local politicians and companies or between companies and individuals outside the political system. It can also involve countries with a low CPI as well as those with a high CPI. In addition, corruption can also involve foreign actors. One example is the Car Wash scandal involving Petrobras, the Brazilian national oil company, which resulted in the disclosure

FIGURE 5.3 Where Bribes Are (and Are Not) Business as Usual

Transparency International asked country experts, nonresidents, and residents about the overall extent of corruption (frequency and/or size of bribes) in the public and private sectors. The scale runs from 0 to 100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. The figures include a sample of countries.

Source: Based on Transparency International, "TI Corruption Perceptions Index" (2018), transparency.org/cpi201 (accessed February 22, 2019).



of at least $3 billion in bribes, kickbacks, and money laundering, involving payments to company executives, the ruling Brazilian Worker's Party, and more than 50 sitting politicians and numerous companies trying to secure lucrative contracts with Petrobras. The speaker of Brazil's lower house of Congress and a powerful senator close to Brazil's president were also implicated.[27] On the international side, British Engineering group Rolls-Royce was also accused of paying bribes to Petrobras to secure contracts.[28] Other foreign engineering companies are also being investigated for overinflating services and funneling bribes to Petrobras officials and political parties. The Petrobras corruption scandal is one of nine such scandals targeted by Transparency International for a campaign called "Unmask the Corrupt." Petrobras was forced to pay $2.95 billion in restitution.

THE CONSEQUENCES OF CORRUPTION

Corruption affects company performance and local economies. Higher levels of corruption, for instance, correlate strongly with lower national growth rates and lower levels of per capita income.[29] Corruption can also erode the authority of governments that condone it. Over the years, bribery-based scandals have led to the downfall of numerous heads of state, with many government officials and business executives being imprisoned, fined, or forced to resign. President Dilma Rousseff of Brazil was impeached in 2016, and her predecessor, Luiz Inacio Lula da Silva, was sentenced to 13 years in prison over the Car Wash and other bribery scandals. Moreover, disclosures of corruption not only damage the reputations of companies and whole countries, they also compromise the legitimacy of MNEs in the eyes of local and global communities when they become involved in the scandals.[30] Finally, corruption is expensive, inflating a company's costs and bloating its prices. Nevertheless, it persists as one of the most challenging concerns in international business and politics in the world today.

WHAT'S BEING DONE ABOUT CORRUPTION?

Many efforts are underway to slow the pace of bribery as an international business practice at international and national levels. International efforts to combat bribery include those established by the OECD (Organization for Economic Cooperation and Development), the ICC (International Chamber of Commerce), and the United Nations through UNCAC (United Nations Convention against Corruption). The problem is that none of the conventions have the force of law behind them. They can identify key issues in corruption and shine the spotlight on offenders, but legal action under the control of national governments must be taken for the fight against corruption to be effective.

The OECD comprises 36 mostly high-income countries from around the world. Its Anti-Bribery Convention, signed in 1997, establishes legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides recommendations to the countries that adopted the 2009 Anti-Bribery Recommendation. Prior to the signing of the convention, only one country had made foreign bribery a crime, and most others treated foreign bribe payments as legitimate tax-deductible expenses. Of course, the member countries have to implement the recommendations into national law in order for them to have any weight. In addition, the countries have to do a better job of enforcement.[31] For example, a 2015 study by Transparency International found active enforcement in only 4 of the signatory countries, moderate enforcement in 6, and limited, little, or no enforcement in 29 countries.[32] However, the OECD is continuing to strengthen its recommendations, launching in December 2018 a review of the 2009 Recommendation for Further Combating Bribery of Foreign Public Officials in International Business. The review is projected to be completed in 2020.[33]

The European Union The European Commission confirmed its support for strong anticorruption measures within the EU in a 2007 communication to the European Council, Parliament, and Economic and Social Committee. This included the adoption of the UN's official definition of corruption and support for many of the policies contained within international agreements. The communication also sanctions the work of the Commission's office of antifraud (OLAF), which conducts the affairs of the EU relevant to corporate and individual corruption, as well as an internal auditing service that monitors the activities of all of the Commission's departments. The EU does not have specific anticorruption legislation, but it encourages member nations to adopt high standards and follow them. In its most recent Anti-Corruption Report, the EU noted that corruption costs the EU 120 billion euro per year, and that efforts to combat corruption are very uneven across the EU[34]—thus the importance of national legislation.

The Foreign Corrupt Practices Act is U.S. legislation that makes bribery illegal. It applies to domestic or foreign operations and to company employees as well as their agents overseas.

National Initiative: The United States Many countries have established their own anti-corruption initiatives, utilizing international best practices. One example is the United States. There are several ways the United States has gotten involved in foreign corruption. For example, the **Foreign Corrupt Practices Act (FCPA)** outlaws bribery payments by U.S. firms to foreign officials, political parties, party officials, and political candidates. The coverage of the FCPA was extended in 1998 to include bribery by foreign firms operating in any U.S. territory. The FCPA applies not only to companies registered in the United States but also to any foreign company quoted on any U.S. stock exchange.

Although it is legal to make payments to officials to expedite otherwise legitimate transactions (officially called *facilitating payments* but sometimes referred to as *speed money* or *grease money*), payments can't be made to officials who aren't directly responsible for the transactions in question. In 1988, an amendment to the FCPA actually excluded facilitating payments from the definition of *bribery.* Now, for example, payment to a customs official to clear legitimate merchandise is legal, whereas paying a government minister to influence a customs official is not.

Both the U.S. Securities and Exchange Commission and the U.S. Justice Department also play roles in the fight against global corruption even when it doesn't affect government officials. For example, an estimated $150 million bribery scandal involving FIFA, the Swiss-based governing body of football (or soccer in the United States), was brought to light by the U.S. Justice Department because of income tax evasion in the United States by some of the parties, and because of the use of the U.S. financial system to facilitate the flow of funds. Even U.S.-based Nike was brought into the picture because of possible bribes paid to the Brazilian soccer federation. However, the allegations against Nike would not be prosecuted under the FCPA since it didn't involve a foreign government. The scandal became truly global, and the powerful head of FIFA was forced to resign.[35]

Sarbanes–Oxley legislation in the United States is helpful in combating corruption through more effective corporate governance, financial disclosure, and public accounting oversight.

Another major legislative effort in the United States is the Sarbanes–Oxley Act (SOX), which was passed in 2002 as a response to an epidemic of well-known corporate scandals. SOX toughened standards with regard to corporate governance, financial disclosure, strong internal controls, and oversight of accounting and auditing practices. With its passage, the Justice Department began to use the FCPA more aggressively to combat bribery.

ETHICS AND THE ENVIRONMENT

5-7 Summarize what the roles are of governments and companies in resolving environmental issues

Companies that extract natural resources, generate air or water waste, or manufacture products such as autos that generate pollution need to be concerned with their environmental impact.

In this section, we refer to the environment more narrowly in the context of pollution, both air and water, and global warming. All three are important for company policy and strategy. Companies can create water pollution through disposal of industrial waste into water systems as well as the inefficient use of water, which results more in water shortage than in water pollution. There is a link between air pollution and global warming, but the dominant greenhouse gas (GHG) that causes global warming is carbon dioxide, whereas air pollution is more affected by ozone (also a GHG), sulfur dioxide, nitrogen oxide, and particulates. In terms of air quality, India, Pakistan, Bangladesh, and China are the worst, and 7 of the world's 10 worst polluted cities are in India.[36] Even though the advanced industrial countries have seen a reduction in air pollution due to industrial decline and clean air policies, there are still major issues. The European Union estimates that more than 400,000 Europeans die prematurely each year due to air pollution and that health-related issues from air pollution cost 3–7 percent of GDP.[37] Even as the world struggles with global warming, it still has to fight against air pollution.

As we saw in our opening case, the clothing giants have come to see eco-responsibility as a matter of protecting not only the future of the environment but also their own future. Companies contribute to environmental damage in a variety of ways. Some, for example, contaminate the air, soil, or water during manufacturing, or make products such as automobiles or electricity that release fossil-fuel contaminants into the atmosphere.

In extracting natural resources, other companies also have a direct and unmistakable effect on the environment. But even in these cases the issue isn't necessarily clear-cut. Granted, although some resources (such as minerals, gas, and oil) may not be renewable, others (such as timber) are, and some observers even suggest that resources can never really become scarce. Why? Because as they become less available, prices go up and technology or substitutes compensate.

WHAT IS "SUSTAINABILITY"?

Sustainability involves meeting the needs of the present without compromising the ability of future generations to meet their own needs while taking into account what is best for the people and the environment.

Sustainability means meeting the needs of the present without compromising the ability of future generations to meet their own needs. In this section, we use sustainability from the perspective of environmental sustainability. Proponents of the concept argue that sustainability considers what's best for both people and the environment. It is important that companies that affect the environment establish policies for responsible behavior toward the earth—a responsibility that has both cultural and legal ramifications.

Sustainability is no longer just good business practice. New businesses are emerging that are combining the idea of environmental responsibility and profitability.

But is it possible that sustainability is not only a good business practice, but also good business? GE has demonstrated that it makes good business sense to adopt a strong policy of sustainability, but it also has vast resources at its disposal. However, even born-global companies can adopt a sustainable strategy and generate export revenues at the same time.

GLOBAL WARMING AND THE PARIS AGREEMENT ON CLIMATE CHANGE

Global warming results from the release of greenhouse gases that trap heat in the atmosphere rather than allowing it to escape.

At the core of the United Nations Framework Convention on Climate Change talks, held in Paris in December 2015, is the concept that global climate change results from an increase in carbon dioxide and other gases that act like the roof of a greenhouse, trapping heat that would normally radiate into space, and thereby warming the planet. If carbon dioxide emissions aren't reduced and controlled, rising temperatures could have catastrophic consequences, including melting the polar ice cap, flooding coastal regions, shifting storm patterns, reducing farm output, causing drought, and even killing off plant and animal species.[38]

However, the Paris Agreement, which entered into force in November 2016, changed everything. One hundred eighty-seven countries agreed to keep the increase in the global average temperature to 2°C above pre-industrial levels and try to achieve 1.5°C. The countries also agreed to try to shoot for a target of zero net GHG emissions by the second half of the century.[39] That would involve moving away from fossil fuels for electricity and

The Paris Climate Agreement involving 187 countries targeted policies to reduce GHG emissions in order to keep the global average temperature to 2°C above pre-industrial levels.

transportation, the two primary creators of GHG emissions, and moving more toward sustainable energy, such as solar and wind. To achieve this ambitious and improbable goal, all countries, including the emerging markets, intended to set national goals called "intended nationally determined contributions or INDCs." In addition, the developed countries agreed to provide $100 billion per year by 2020 to developing countries to help them adapt to climate change. The Paris Agreement discussed how to not only stabilize atmospheric concentration of GHG emissions, but also to avoid dangerous anthropogenic (human) interference with the climate. A big target of the latter concern is reducing deforestation and forest degradation in countries like Indonesia and Brazil. The problem is that shrinking forests contribute to GHG emissions, and their disappearance also eliminates a major natural way to sop up and store carbon dioxide.[40] The United States, one of the major sources of GHG emissions, signed the agreement in 2015 by executive order of the President of the United States. However, after a new election in 2017, the United States announced it would cease all participation in the Paris Agreement. According to the Agreement, the United States cannot withdraw until four years have passed since it originally signed the agreement; therefore, the earliest effective withdrawal date would be November 4, 2020.

The success of the Paris Agreement to slow global warming has to come from two sources—the public sector and the private sector. The problem with the public sector is that countries still rely heavily on fossil fuels for energy. Even Germany, which is trying desperately to eliminate the use of coal, still relies on it for 37 percent of its energy needs, even as renewable energy has risen from 6 percent of Germany's energy supply to 33 percent in 2018.[41] Reliance on renewable energy is a positive move, but experts point out that we are far from being able to eliminate the use of fossil fuels. Thus, GHG emissions will still be a problem in the foreseeable future. The fall in oil prices since mid-2015 will require significant government subsidies to shift the supply of energy to solar and wind energy. The second source is the private sector. Part of the private sector solution is to reduce the level of GHG emissions through improvements in technology as well as developing products, such as automobiles, that use electricity. Unfortunately, power plants generate electricity, and the world still relies on power plants that use fossil fuels. Stakeholders are pushing companies to reduce their carbon footprint, but a major challenge will be enticing companies to invest heavily in the development of alternative sources of energy without government subsidies to fund growth and money from outside investors. If investors don't see a viable return from investing in alternative energy, they decide not to invest in the renewable energy sector. A good example of this is when PG&E, the California utility, went bankrupt as the stock price plunged in response to concerns over potential liabilities resulting from PG&E's equipment problems contributing to the California wildfires in 2018. Even though PG&E received high marks from the investing community because of their increased usage of renewable energy and a strong reputation in Environmental, Social and Governance (ESG) metrics, investors didn't pay enough attention to risks.[42]

Finally, MNEs have the task of adapting to different standards in different countries. A European-based MNE with operations in, say, the United States, Germany, and China, and a U.S.-based MNE with plants in the same countries are faced with a smorgasbord of regulatory environments. On the one hand, the *legal* approach to responsible corporate behavior says an MNE should settle for adopting local environmental standards in accord with local laws. The *ethical* approach, on the other hand, urges companies to go beyond the law to do whatever is necessary and economically feasible to reduce GHG emissions, given that they still have multiple stakeholders to satisfy.

ETHICAL DILEMMAS OF LABOR CONDITIONS

5-8 Demonstrate how global labor issues need to be addressed by MNEs to their stakeholders

A major challenge facing MNEs today is the labor conditions of foreign workers, whether in their own offshore operations or their outsourced supply chains. They're especially critical in retail, clothing, footwear, electronics, and agriculture—industries in which MNEs typically outsource huge portions of production to independent companies abroad.

POINT

Should MNEs Accept Full Responsibility for the Unethical Behavior of Their Employees?

YES However, it is hard to know where the corruption begins and who knows what. On September 18, 2015, the U.S. Environmental Protection Agency announced that it was going to order German auto company, Volkswagen AG, one of the world's leading auto manufacturers and the largest in Europe, to recall over 500,000 vehicles in the United States because they were equipped with software that allowed them to evade emissions standards for reducing smog during testing. The software would recognize when a car was being tested and turn up emissions controls. Then when the car wasn't being tested, the software turned down the emissions controls, which resulted in better driving performance and fuel economy. It was estimated that in normal driving conditions, cars would emit up to 40 times the amount of pollutants allowed by U.S. government regulations. VW announced that the software designed to trick or "defeat" the emissions tests had been installed in millions of vehicles.[43] Eventually, this spread to certain models in Audi and Porsche, two other VW brands. How could this have happened? There were several very interesting dimensions to the case—different regulatory environments in Europe and the United States; VW's desire to increase its market share in the United States, especially in diesel cars; and the efforts of the regulators and VW itself to find out who knew what was going on.

One of the real ironies is that in its 2014 Sustainability Report, VW claimed that it was selling environmentally friendly products and meeting the guidelines for emissions of carbon dioxide, nitrogen oxide, and other pollutants. It also said it was in compliance with the Global Reporting Initiative (G4), the UN Global Compact, and the German Sustainability Code. PricewaterhouseCoopers, one of the leading global public accounting firms, certified that the Sustainability Report was accurate. Not only did VW claim that it was operating according to high standards, but it also had a program to make sure its employees understood what the company stood for.

Different legal and regulatory systems also contributed to differences between U.S. and German stakeholders. Given that VW is a German Company and therefore under the regulatory environment of the European Union, it claimed that even though it was violating U.S. regulatory guidelines, it was not violating European regulatory guidelines. Is it possible that the software was not illegal in Europe, even though it was in the United States? There are not only different standards in the United States and EU, but there are also different testing procedures. In the United States, California has

COUNTERPOINT

Should MNEs Accept Full Responsibility for the Unethical Behavior of Their Employees?

NO VW obviously must take responsibility for installing the "defeat" software into some of the diesel models it was selling worldwide, but who was responsible for this happening? Wolfgang Hatz, the head of engines and transmissions for VW, was one of the key people in this scandal. He was also one of the first employees suspended by VW when the crisis broke in September 2015. One of his first concerns at VW was to figure out how to develop a diesel engine that would meet the stringent antipollution requirements set by the State of California. He was hired from the same position at Audi, one of VW's brands, which also includes Porsche. Hatz loved fast cars, and he realized that to meet emission requirements VW would have to introduce more diesels into the United States. But how could they develop a car that would still be alluring and peppy, something that American drivers wanted? Diesels have better fuel economy and lower GHG emissions, but they also have higher smog-forming pollutants. One strategy being considered at VW was to build an alliance with Mercedes-Benz and BMW to develop new technologies, but Mr. Hatz and others at VW decided they wanted to develop a less expensive alternative. However, it was clear that this would not meet the emissions requirements. Rather than scale back their strategy to increase the sales of diesels in the U.S. market, someone decided to cheat.

But who was behind the scheme to introduce the "defeat" software? An internal whistle-blower at VW was responsible for uncovering exaggerated carbon dioxide and fuel economy claims, but the U.S. EPA uncovered the "defeat" software strategy for pollutants in the United States. VW decided to offer amnesty to anyone at VW who could shed any light on this subject. The first person sent to prison for the scandal was a VW engineer who also implicated other VW executives. By 2016, five former executives were indicted, and in May 2018, VW's former CEO was indicted for giving approval for the use of the "defeat" software strategy.[45]

Offering amnesty for information is relatively rare in these cases, but a similar thing happened in 2008 when the Siemens bribery scandal broke. In this case, it was determined that Siemens diverted funds filed under bogus consulting contracts into a network of "black accounts" for bribing officials in countries like Italy, Greece, Argentina, and Saudi Arabia. One thing that came out of the investigation is that Siemens had created a culture of corruption. Although the VW example doesn't involve bribery, it obviously involved corrupt behavior in the sense that somebody felt comfortable breaking regulatory guidelines in the United States and Europe in order to enhance sales. As noted by Hans-Dieter Potsch, VW's a stringent antipollution regulatory environment, and VW realized it had to find a way to be successful there if it wanted to increase the sale of its diesel engines. Also, U.S. regulators conduct their own tests to see if auto manufacturers' claims are accurate, whereas European regulators leave the testing and verification to the manufacturers themselves.[44] In order to keep from losing its U.S. customers, VW offered payments to customers who had bought cars with the diesel engines that had the "defeat" software installed. Of course, the legal environment in the United States that allows for class-action suits probably had something to do with that. Class-action lawsuits are relatively unknown in Europe, and payments were not offered to European customers, especially since VW didn't feel it was violating any law in Europe.

chairman, "There was a tolerance for breaking the rules. It proves not to have been a onetime error, but rather a chain of errors that were allowed to happen."[46] As a result of the scandal, VW paid over $20 billion in fines and penalties. Given what we know about VW's supposed commitment to a high level of corporate behavior, why didn't someone step forward and say "no!"

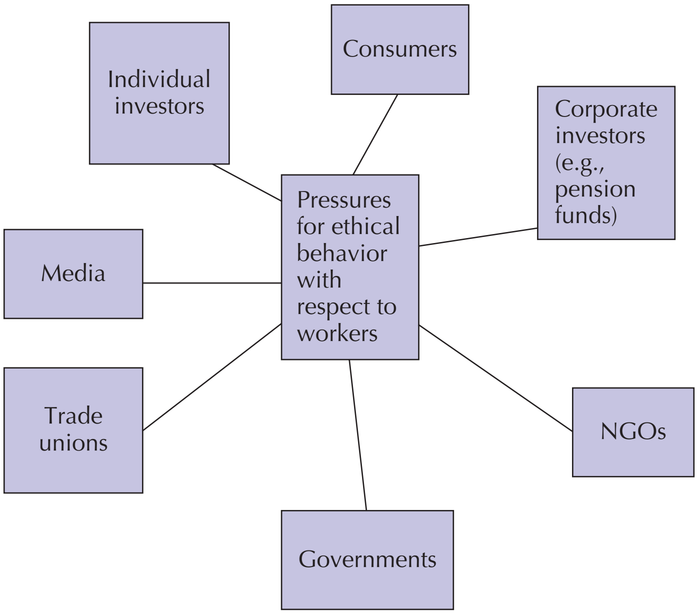
QUESTION

If you were an engineer working on the project to develop the software that would allow VW to avoid providing regulators and consumers accurate data about GHG and pollution emissions, would you have said "no"? Explain why or why not.

Major labor issues that MNEs get involved in through FDI or purchasing from independent manufacturers in developing countries are fair wages, child labor, slave labor, working conditions, working hours, and freedom of association.

The concerns over the ethical treatment of labor deal directly with a company but also indirectly through its suppliers. Increased pressure is being placed on companies to adopt policies to protect workers as well as to disclose to shareholders the policies and their effectiveness. Figure 5.4 highlights the multiple pressures external stakeholders place on companies to encourage them to adopt responsible worker-related practices in their overseas operations. The issues that raise concerns are identified by a variety of organizations, principally the U.N.-based International Labor Organization, the U.N. Global Compact, and others that use many of their benchmarks, such as the Ethical Trading Initiative and the California Transparency in Supply Chains Act of 2010. A more specific listing of worker issues was developed by the Ethical Trading Initiative (ETI), a British-based organization that focuses on MNEs' employment practices and whose standards are consistent with those adopted by the UN-based International Labor Organization. Its members include representatives from GAP Inc., Inditex, H&M, Marks & Spencer, The Body Shop International, and other companies, as well as from trade union organizations, NGOs, and governments. The objective of ETI is to

FIGURE 5.4 Sources of Worker-Related Pressures in the Global Supply Chain



get companies to adopt ethical employment policies and then monitor compliance with their overseas suppliers. ETI's trading initiative base code identifies the following issues:

1. Employment is freely chosen.
2. Freedom of association.
3. Working conditions are safe and hygienic.
4. Child labor shall not be used.
5. Living wages are paid.
6. Working hours are not excessive.
7. No discrimination is practiced.
8. Regular employment is provided.
9. No harsh or inhumane treatment is allowed.[47]

Although all issues identified by each of these organizations are important, there are several sources of concern, including forced labor, modern slavery, human trafficking, and child labor.

Let's start by considering a couple of very brief cases that deal with child labor:

- There are two arguments for the use of children in the Indian carpet industry: (1) they're better suited than adults to perform certain tasks, and (2) if they weren't employed, they'd be even worse off. In fact, children in India are often put to work because parents don't earn enough to support families; if parents can't pay off debts, their children are often *indentured* to creditors.
- In the 1990s, the impoverished Asian nation of Bangladesh was pressured to stop employing thousands of child workers or face U.S. trade sanctions. In this case, the plight of the children did in fact go from bad to worse. Between 5,000 and 7,000 young girls, for example, went from factory work to prostitution.[48]

According to the International Labor Organization (ILO), 218 million children between the ages of 5 and 17 are in employment.[49] The ILO has very specific guidelines describing what it considers child labor to be and what the worst forms of child labor are. In particular, the worst forms involve slavery and prostitution—illicit activities that are a danger to the health, safety, and morals of a child. ILO guidelines state that children who are at least 12–14 years old may be employed in "light" work that's not harmful to their health, is less than 14 hours a week, and doesn't interfere with school. All children under the age of 18 should be protected against the most abusive labor conditions.[50]

The concerns over slavery and human trafficking involve more than just child labor. They are defined by the ILO as "all work or service which is exacted from one person under threat of a penalty and for which the person has not offered himself voluntarily."[51] This tends to occur more in the supply chain for an MNE than it would directly for their own facilities abroad. It could also occur with contract manufacturers.

WHAT MNES CAN AND CAN'T DO

In spite of these difficulties, MNEs are not powerless when it comes to labor-related matters in overseas facilities. When the Swedish retailer IKEA ran into trouble in India for buying carpets from local companies that relied heavily on extensive child labor, it identified and tackled two different problems rather than try to force suppliers to stop exploiting the children. First, it helped working mothers increase family earning power so they could escape the clutches of the loan sharks to whom they were putting up their children as collateral. Second, it set up "bridge schools" to enable working children to enter mainstream education channels within a year.[52]

Some companies avoid operating in countries where child labor is employed, whereas others try to establish responsible policies in those same countries.

Frequently, MNEs operating in countries with very different labor policies succumb to the pressure to simply leave the market. Usually, this turns out to be a shortsighted decision. Research shows, for instance, that companies like IKEA have substantially improved the conditions of workers in overseas facilities.[53]

CORPORATE CODES OF ETHICS: HOW SHOULD A COMPANY BEHAVE?

5-9 Restate how codes of conduct can help MNEs respond to concerns by stakeholders over responsible corporate behavior

MOTIVATIONS FOR CORPORATE RESPONSIBILITY

Companies need to act responsibly because unethical and irresponsible behavior

- could result in legal sanctions,
- could result in consumer boycotts,
- could lower employee morale,
- could cost sales because of bad publicity.

Companies generally experience four strong motivations for acting responsibly:

1. Unethical and irresponsible behavior can result in *legal headaches,* especially in such areas as financial mismanagement, bribery, and product safety.
2. Such behavior could also result in *consumer action* such as a boycott.
3. Unethical behavior can affect *employee morale.* Conversely, responsible behavior can have a positive influence on a workforce, both at corporate headquarters and in overseas facilities.
4. You never know when *bad publicity* is going to cost you sales. Perhaps this concern is one reason why many global apparel and clothing companies responded so quickly to criticism about unfair employment practices in developing countries.

DEVELOPING A CODE OF CONDUCT

A major component in a company's strategy for ethical and socially responsible behavior is a code of conduct.

A **code of conduct** is a major component of most companies' strategies for ethical and socially responsible behavior. In the context of international operations, it can take the form of two perspectives: external and internal. Codes of conduct are useful insofar as they give companies some general guidance on how to operate. The practical challenge for the company is familiarizing itself with the codes of many different organizations and using them to fashion its own *internal code of conduct.*

Codes of conduct involve four dimensions:

- Setting a global policy that must be complied with wherever the company operates,
- Communicating the code to employees, suppliers, and subcontractors,
- Ensuring that policies are carried out,
- Reporting results to external stakeholders.

What makes a good internal code of conduct? Here are four criteria:

1. *It sets global policies with which everyone working anywhere for the company must comply.* A good example is the code promulgated by the Finnish cell-phone company Nokia, which discusses how its code was set, who approved it, how it is communicated to its employees, and what its foundation values are.
2. *It communicates company policies not only to all employees but to all suppliers and subcontractors as well.*
3. *It ensures that the policies laid out in the code are carried out.* This usually occurs through training programs where employees sign off on their compliance and sometimes through internal audits.
4. *It reports the results to external stakeholders.* This usually occurs in a company's annual report to shareholders, but GE uses social media to communicate with external stakeholders, a common practice of most MNEs. In addition, a major contributor to enhanced transparency is the Global Reporting Initiative (or GRI), which has issued G4 sustainability reporting guidelines that identify several different areas related to the environment, society, and the economy.[54]

LOOKING TO THE FUTURE Dealing with Ethical Dilemmas in the Global Economy

As you prepare to work globally, it is essential that you understand the environmental, social, and governance structure (often known as ESG) of the company you work for. This chapter has continued the discussion from Chapter 1 on the effects of globalization, but with more focus on the ethical issues and how companies can be more responsible as they operate abroad. Chapter 1 identified three scenarios on the future of globalization:

- Further globalization is inevitable.
- International business will grow primarily along regional rather than global lines.
- Forces working against further globalization and international business will slow down the growth of both.

Regardless of what happens, the more companies expand abroad, the greater the likelihood they will have

(*continued*)

hard decisions to make on how they should operate in a socially responsible manner. As discussed by Bartlett and Beamish,[55] MNEs can operate in four major ways. They can be exploitative, which is the model of the past. However, some MNEs still operate exploitatively in poorer countries that do not have the strength to stand up for what they think is best. Second, they can operate on a transactional basis where they engage in doing deals and respecting the law. The challenge is that they may have to choose between local law and the law of the country where their corporate headquarters is domiciled. Third, they can be responsive in the sense of trying to make a difference in the countries where they operate. This is clearly the direction that most large MNEs find themselves going. Many of them have signed on to the UN Global compact and try to make a difference in human rights, labor standards, the environment, and anticorruption. Finally, they can be transformative in terms of taking the lead in generating broad change. This is far more difficult and requires a joint partnership with NGOs and local governments, often responding to the wishes of their stakeholders.

It is clear that social media will have a greater impact on socially responsible behavior in the future. Historically, we have always thought that one of the keys to transparency is an independent press willing to investigate and report on wrongdoings. But now social media, such as Facebook, Twitter, YouTube, and so on, have added an important new dimension to transparency. Neither companies nor governments can hide in the shadows, so it is critical for socially responsible companies to be transparent, and a solid social media strategy is an important dimension of their transparency.

CASE

Anglo American PLC in South Africa: How Can You Make a Difference in the Fight Against HIV/AIDS?[56]

By now it should be obvious that, regardless of where it chooses to do business, an MNE is going to face quite a variety of threats and disruptions to its plans and operations, ranging from bureaucratic corruption and political instability to terrorism and war. In 2019, Anglo American PLC, one of the world's largest mining companies, found itself involved in a global campaign to eradicate the HIV/AIDS epidemic in South Africa.

In 2002, Anglo American made a landmark decision to provide free antiretroviral therapy (ART) to HIV-infected employees there, and expanded these efforts in 2008 to include treatment for the dependents of their employees. Now the U.K.-based company is asking itself, "Where do we go from here?"

AIDS in South Africa

How bad must a disease be to be accorded the status of an "epidemic"? When Anglo American was first confronted with the issues of HIV/AIDS, sub-Saharan Africa was home to just over 10 percent of the world's population and 60 percent of all people infected with HIV, the virus that causes AIDS. South Africa had the highest number of people living with HIV/AIDS and one of the world's highest rates of HIV infection and mortality from AIDS-related diseases. Even in 2017, approximately 75 percent of all people living with HIV live in sub-Saharan Africa.

Thus, over the past decade the spread of HIV/AIDS has had a profound impact on the people of South Africa and their economy. Life expectancy is 56.1 years compared to, say, 76.8 years in Poland, a country with a similar population size and per capita GDP. AIDS has also devastated the country's economy. Between 1992 and 2002, South Africa lost $7 billion annually—around 2 percent of GDP—as a result of AIDS-related worker deaths.

Anglo American Operations in South Africa

Anglo American PLC is a diversified mining conglomerate operating worldwide with 69,000 employees who produce diamonds, precious metals (platinum), base metals (copper, nickel, zinc, and phosphates), and bulk metals (such as iron and coal). Founded in 1917 as the Anglo American Corporation of South Africa, it is a multinational firm headquartered in London with mining operations worldwide.

Anglo American and ART

With such a huge investment in South Africa, Anglo American has been hit hard by the HIV/AIDS epidemic. Having recognized the threat as far back as the early 1990s, Anglo was one of the first corporations to develop a comprehensive, proactive strategy to combat the ravages of the disease on its workforce.

Originally, the program consisted of prevention initiatives aimed at education and awareness, the distribution of condoms, financial and skill-related training to alleviate poverty, and a survey system to monitor the prevalence of the infection. Eventually, these policies were expanded to include voluntary counseling, testing, and care-and-wellness programs, and the services of all programs were extended to cover not only the families of employees but also the populations of surrounding communities.

Children all over Africa demonstrate against AIDS, including these children in Fitche, Ethiopia, on the 20th World AIDS Day event on January 13, 2008.

Source: Clive Chilvers/Shutterstock

By adopting these strategies so early, Anglo American became a de facto leader in the private-sector fight against HIV/AIDS in Africa. Many other MNEs soon followed Anglo's example. However, the majority of companies operating in South Africa still hesitated, which is why Anglo's 2002 announcement that it would provide ART to its South African workforce (at company expense) was met with wide approval by organizations such as the World Health Organization and the Global Business Council on HIV/AIDS.

The Costs of Operating in an Epidemic

The incentive for Anglo American's ART program largely came from the failure of its AIDS-prevention efforts to make much headway in stemming the spread of the disease. By 2001, the prevalence of HIV-positive workers had risen to an average of 21 percent across all operations—a figure that was climbing steadily at a rate of 2 percent annually. It was estimated that HIV/AIDS was adding as much as $5 to the cost of producing one ounce of gold, thereby tacking on $11 million a year to the company's production costs. Then there was the $7 million it was spending annually to combat such AIDS-related illnesses as tuberculosis (which was five times as prevalent as it had been just a decade earlier).

Finally, in addition to losses in productivity, the company had to bear the costs entailed by high levels of absenteeism, the constant retraining of replacement workers, and burgeoning payouts in health, hospitalization, and death benefits. Studies conducted at the time indicated not only that the costs of AIDS could reach as much as 7.2 percent of the company's total wage bill but also that the costs of leaving employees untreated would be even higher than the cost of providing ART.

Nine years after it rolled out its ART program, Anglo found itself struggling to please various stakeholders and determine whether all of its efforts are making a difference in the underlying problem or merely masking its effects. By the end of 2009, for instance, although 27 percent of the HIV-infected workforce was receiving ART, the company still struggled with high rates of non-adherence and dropout from treatment regimens.

Anglo also faces the problem of spiraling costs for the program itself. Even though the prices of most of the necessary drugs have been decreasing, the cost of distributing them remains high, and the treatment regimen costs the company an estimated $4,000 per year per employee—quite expensive, especially compared to the wages and benefits that Anglo typically offers mineworkers. (Average monthly wages in the South African mining industry are about 5,100 rand, or US$830.) Meanwhile, as Anglo officials continued to remind investors that treating workers ultimately serves the bottom line, estimates projected a total cost to the company of $1 billion or more over 10 years.

On the upside, cost per patient should decrease as the number of workers participating in the program increases. Unfortunately, one of the biggest challenges facing Anglo is encouraging participation among a migrant and largely uneducated workforce laboring under harsh conditions in an unstable environment. In South Africa, HIV/AIDS still carries a severe stigma, and many South Africans refuse to be tested or to admit they've been infected for fear of discrimination by managers, fellow employees, and even society at large. Moreover, many of those who agreed to participate have been confused by rumors and misinformation, leading them to assume that they could stop using condoms once they were on the drugs—a situation, of course, that only exacerbated the prevalence of unsafe behavior.

In addition, harsh working conditions often make it hard for workers to take medications on time or to deal with certain side-effects. Finally, migrant workers—about four-fifths of the total workforce—who come from isolated villages hundreds of miles away are 2.5 times more likely to contract the disease, which they take with them back to their villages.

Constituencies, Critics, and Progress

Anglo American also faces the problem of pressure from various stakeholders. Anglo has countered many of these criticisms, insisting that it's beyond the resources and capacity of a single company to combat the overall problem, and it has called for more involvement on the part of the South African government. Instead of cooperation, however, the company initially encountered outright opposition from political leaders.

In addition, dealing with pharmaceutical companies has proved a tricky proposition. On the one hand, Anglo has a deal with GlaxoSmithKline allowing it to purchase ART drugs at a tenth of the market price in the industrialized world (the same that GSK charges not-for-profit organizations). At the same time, however, other pharmaceutical companies have been hesitant and unreliable at best, promising price cuts and then reneging over fears of violating intellectual property rights. In spite of that, new and more effective drugs are now available to treat HIV/AIDS.

Given the many challenges Anglo has faced, not to mention the opposition from some stakeholders, some have suggested that the company would be better off simply pulling back on its HIV/AIDS treatment program. In the long run, however, Anglo must consider the continued pressure it will get from ethically minded shareholders as well as its own sense of moral responsibility.

There are also indications that the future may not be as bleak as it initially appeared. In 2017, due to an aggressive global campaign to deal with HIV/AIDs, 59 percent of the people living with HIV worldwide were receiving ART, and AIDS-related deaths had dropped by more than 51 percent since the peak in 2004. For its part, Anglo American's efforts resulted in 86 percent of its employees and dependents receiving free ART therapy, testing, and treatment. UNAIDS is leading the charge to eliminate AIDS as a public health threat by 2030, a strategy endorsed by Anglo American. UNAIDS has announced a 90-90-90 strategy: By 2020, 90 percent of all people living with HIV will know their status; 90 percent of all people diagnosed with HIV infection will receive sustained ART; and 90 percent of all people receiving ART will have viral suppression.

However, the introduction and spread of COVID-19 in 2020 has added a new complexity to the challenges faced by Anglo American, as over 7.000 people have died in South Africa from the pandemic, and nearly 500,000 people have been diagnosed with the virus. Although the AIDS virus has created problems with employees and their families, the COVID-19 pandemic has had a far greater impact on Anglo American's operations because of the devastating effects on the global economic and the demand for their products. It is amazing how two different viruses can have such an huge impact on the global operations of an MNE and their employees worldwide.

QUESTIONS

5-3 Because such a large percentage of its workforce consists of migrant workers who are more likely to acquire and spread HIV/AIDS, should Anglo adopt the policy of not hiring migrant workers? Should the South African government close the doors to migrant workers?

5-4 What role do pharmaceutical companies play in responding to the HIV/AIDS epidemic in South Africa? Given that HIV/AIDS drugs can be exported from India at a lower cost than from the pharmaceutical companies themselves, should Anglo just import the drugs to be used for their employees?