Introduction to Business Administration

<u>Unit 2: Corporate Social Responsibility</u>

Introduction

Business ethics: ”Following a set of principles when conducting business”

Social responsibility: ”The firm’s recognition of how its business decisions can affect society”

Responsible to whom? ■ Customers ■ Employees ■ Stockholders ■ Creditors ■ Environment ■ Community

Firms should increase firm value without violating ethics and social responsibilities

Responsibility to customers

Responsible production practices

■ Ensure customer safety

■ Instructions and warning labels

Responsible sales practices

■ Avoid overly aggressive sales strategies and deceptive advertising

■ Particularly a concern when employees can benefit from commissions

Ensure good customers treatment

1 Code of responsibilities: Guidelines for ethics, values…

2 Monitor complaints (reactive): Receive customer complaints and react accordingly 3 Customer feedback (proactive): For example, running customer satisfaction surveys

<u>What if firms do not behave responsibly?</u>

The role of **consumerism** (consumer groups):

■ Collective demand by consumers that businesses satisfy their needs

The role of **government regulations**:

■ Product safety: Regulations to ensure safety (food, drugs, toys...)

■ Advertising: Laws against deceptive advertising –> Sometimes hard to implement

■ Industry competition: Promote competition, regulate monopolies, prevent collusion

■ Deregulation: More lenient market laws –> Generally makes it easier for firms to enter the market and leads to increased competition

Responsibility to employees

Ensure safety

■ Monitor production process: Check machinery and equipment, provide safety materials (glasses, gloves...), emphasize safety precautions (training, instructions...)

■ Provide a safe working environment: Necessary cost, prevents injuries, raises morale and productivity of employees

Ensure proper treatment by other employees

■ Managing diversity and avoiding sexual harassment

■ Raise awareness (seminars), integrate, promote...

Ensure equal opportunity

■ Recruiting bias: Not allowed in many countries –> unconscious bias –> monitor hiring process –> encourage anonymous CVs...

■ Affirmative action: Actions intended to increase opportunities for minorities and women

Code of responsibility:

■ Describe firm's policies regarding treatment of employees and hiring procedure

■ Use as a guidance for appropriate interactions with and between employees

■ Sometimes can lead to competitive disadvantages

Grievance policy:

■ Give the chance for employees to express their discontent

■ Gather and resolve employees' complaints to alleviate cases of mistreatment

■ Costly if too many complaints, not all complaints are equally valid

Conflicts with employee layoffs:

■ Layoffs may be necessary to reduce costs...

■ But mass layoffs generate controversy and harm firm's image

■ No easy solution, perhaps reducing hours or helping laid-off employees find another job

Employees' satisfaction

■ Job satisfaction increases productivity, reduces absenteeism and employee turnover

■ Happy workers –> More productivity –> Happy firm

■ Happy workers –> Better job (service quality, customer treatment) –> Happy customers

Responsibility to stockholders

Firms are responsible for satisfying their owners and stockholders (shareholders)... but employees (including managers) may be tempted to satisfy their own interests (conflict of interests). Compensation tied to firm performance (bonuses, stock options...) may solve this, but it can create other conflicts:

1 CEOs have the incentive to over-report firm performance or hide information

■ Cases of CEOs selling their shares before bad info was disclosed

■ Investors have become more suspicious of firm's financial reports

2 Owners / shareholders are concerned about excessive CEO compensation

■ CEO compensation has increased substantially over recent decades

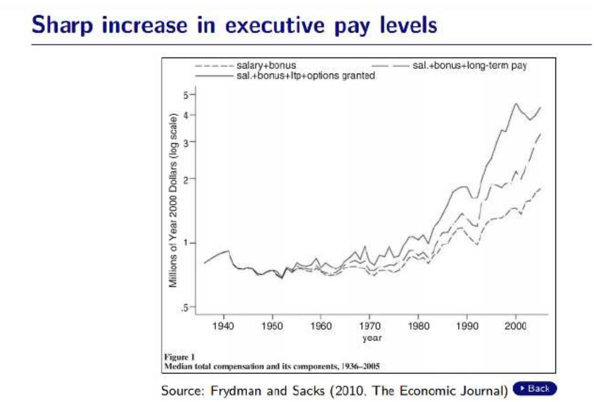

Figure 1
Median total compensation and its components, 1936–2005

Source: Frydman and Sacks (2010, The Economic Journal)

<u>How can shareholders ensure responsibility?</u>

1 There are laws to ensure accurate information and prosecute managers for wrong financial reporting

2 Shareholder activism:

■ Active efforts by stockholders to supervise and influence management decisions

■ Institutional investors: Financial institutions that purchase large amounts of stock (more bargaining power)

Responsibility to creditors

Firms are responsible for meeting their financial obligations to their creditors

■ If the firm does not pay creditors back, it may be forced into bankruptcy

■ If a firm is experiencing financial problems –> should inform its creditors

■ Creditors might extend payment deadlines and offer financial advice Firms may be tempted to violate responsibility to creditors

■ Firms could mislead creditors through over-optimistic financial reports

■ Misled creditors may extend loans believing the firm will be able to pay back eventually

Responsibility to environment

Firms are responsible for the potential harm that their production processes and products may cause to the environment

Preventing air pollution

■ Firms: modifying production processes (less CO_2 emissions)

■ Governments: enforcing guidelines to limit emission levels

Preventing land pollution

■ Firms: revised production and packaging processes to reduce the amount of waste

■ Firms: store toxic waste and deliver it to specified sites

■ Firms: recycle plastic and limit their use of damaging materials

Conflict of interests

■ Environmental care is costly for firms (residual management, process redesign, fees...)

■ Results in lower profits, higher prices, lower stock prices...

■ Firms can only spend so much money in environmental care, as they need to satisfy customers and shareholders

■ Firms do not always agree with guidelines imposed by governments

Responsibility to the community

Firms can help the community by sponsoring local events or donating to local charities. For multinational corporations, the community is the international environment –> international donations

Conflict: Maximizing firm value vs maximizing CSR

■ Costs involved in maximizing responsibility to the community will be passed to customers through higher prices

■ Support to charity and sponsorship can help society and improve the firm's image.

■ Especially If the charitable cause is closely related to the firm's activity