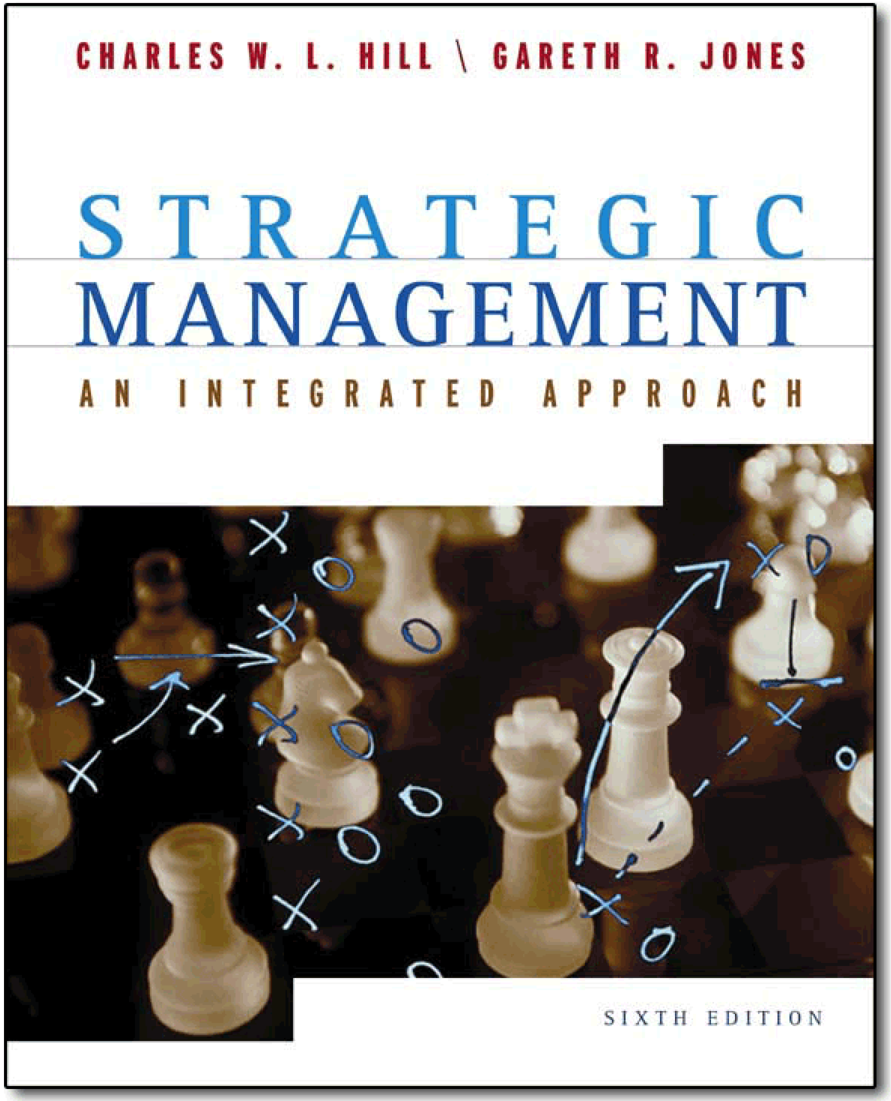
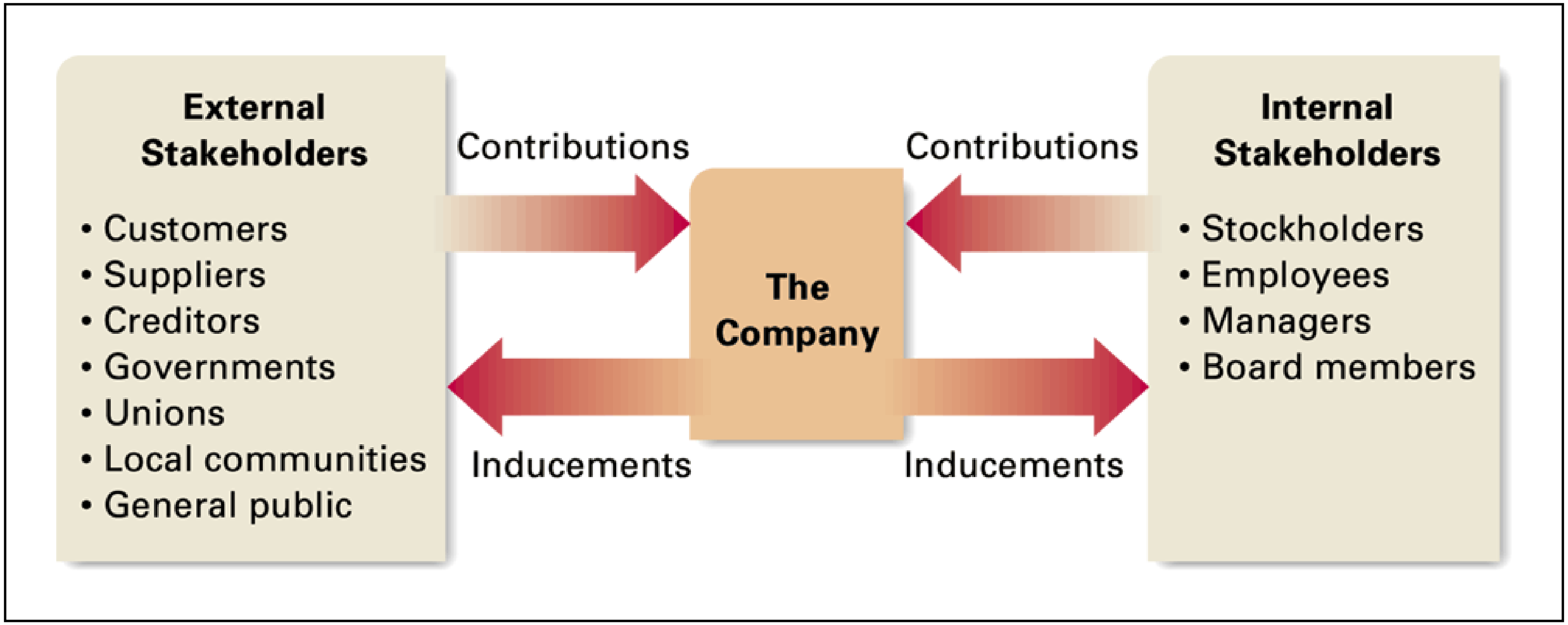


11

Corporate Performance, Governance, and Business Ethics

Stakeholders and the Enterprise



Stakeholder Impact Analysis

- Identify the stakeholders most critical to survival
  – Identify stakeholders.
  – Identify stakeholders' interests and concerns.
  – As a result, identify what claims stakeholders are likely to make on the organization.
  – Identify the stakeholders who are most important to the organization's perspective.
  – Identify the resulting strategic challenges.
- Usually the most important:
  – Customers, employees, stockholders

The Unique Role of Stockholders

- Legal owners
- Providers of risk capital, a major source of capital
  – No guarantee that stockholders will recoup their investment or earn a decent return
- Maximizing return to stockholders
- Employees as stockholders

Profitability and Stakeholder Claims

- Stockholders' returns
  - Dividend payments
  - Capital appreciation in market value of a share
- Maximizing *long-run* ROIC
  - Within limits set by law
  - In a manner consistent with societal expectations

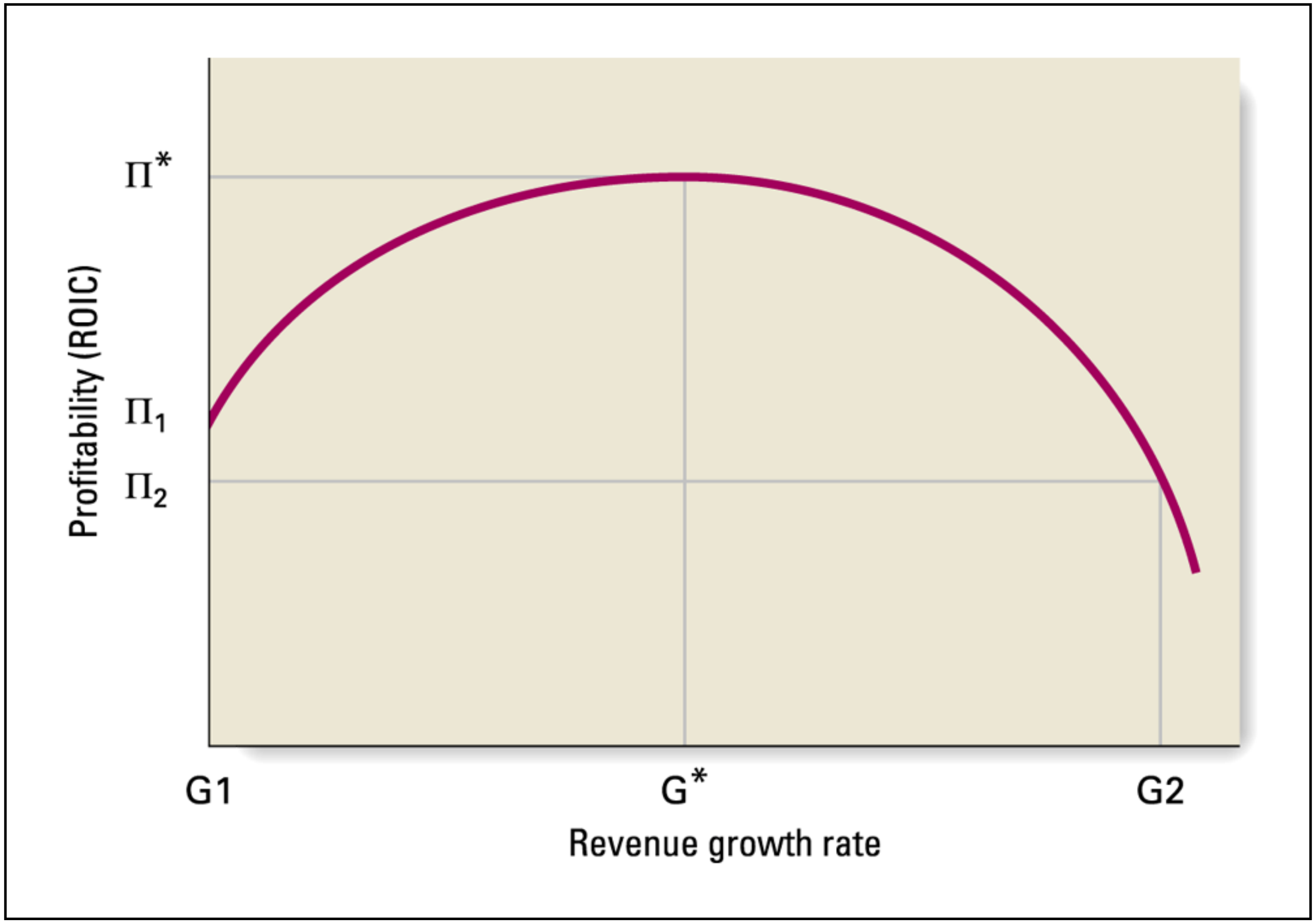
Agency Theory

- Problems can arise in a business relationship when one person delegates decision making authority to another
- Principal-agent relationships
  - Agency relationship: when one party delegates decision-making authority to another
  - Principal: person delegating authority
  - Agent: person to whom authority is delegated

The Agency Problem

- Agents and principals may have different goals
- Agents may pursue goals that are not in the best interests of their principals
  - Information asymmetry: Agents almost always have more information
- Difficult for principals to measure performance
- Trust
  - On-the-job consumption
  - Empire building

The Tradeoff Between Profitability and Revenue Growth Rates



The Challenge for Principals

- Shape the behavior of agents so that they act in accordance with goals set by principals
- Reduce information asymmetry
- Develop mechanisms for removing agents who do not act in accordance with goals of principals

Governance Mechanisms

- The board of directors
  - Elected by stockholders
  - Legally accountable
  - Monitors corporate strategy decisions
  - Authority to hire, fire, and compensate
  - Ensures accuracy of audited financial statements
  - Inside directors
  - Outside directors

Governance Mechanisms (cont'd)

- Stock-based compensation
  - Pay-for-performance
  - Stock options
    - The right to buy company shares at a predetermined price at some point in the future

How Options Skew the Bottom Line

Company	Reduction in Net Profit If Options Had Been Expensed
AOL Time Warner	75 percent
Viacom	66 percent
NVIDIA	40 percent
MedImmune	31 percent
Lucent	30 percent
Pharmacia	28 percent
Cisco Systems	26 percent
Boise Cascade	17 percent

Source: D. Henry and M. Conlin, "Too Much of a Good Incentive?" *Business Week*, March 4, 2002, pp. 38–39.

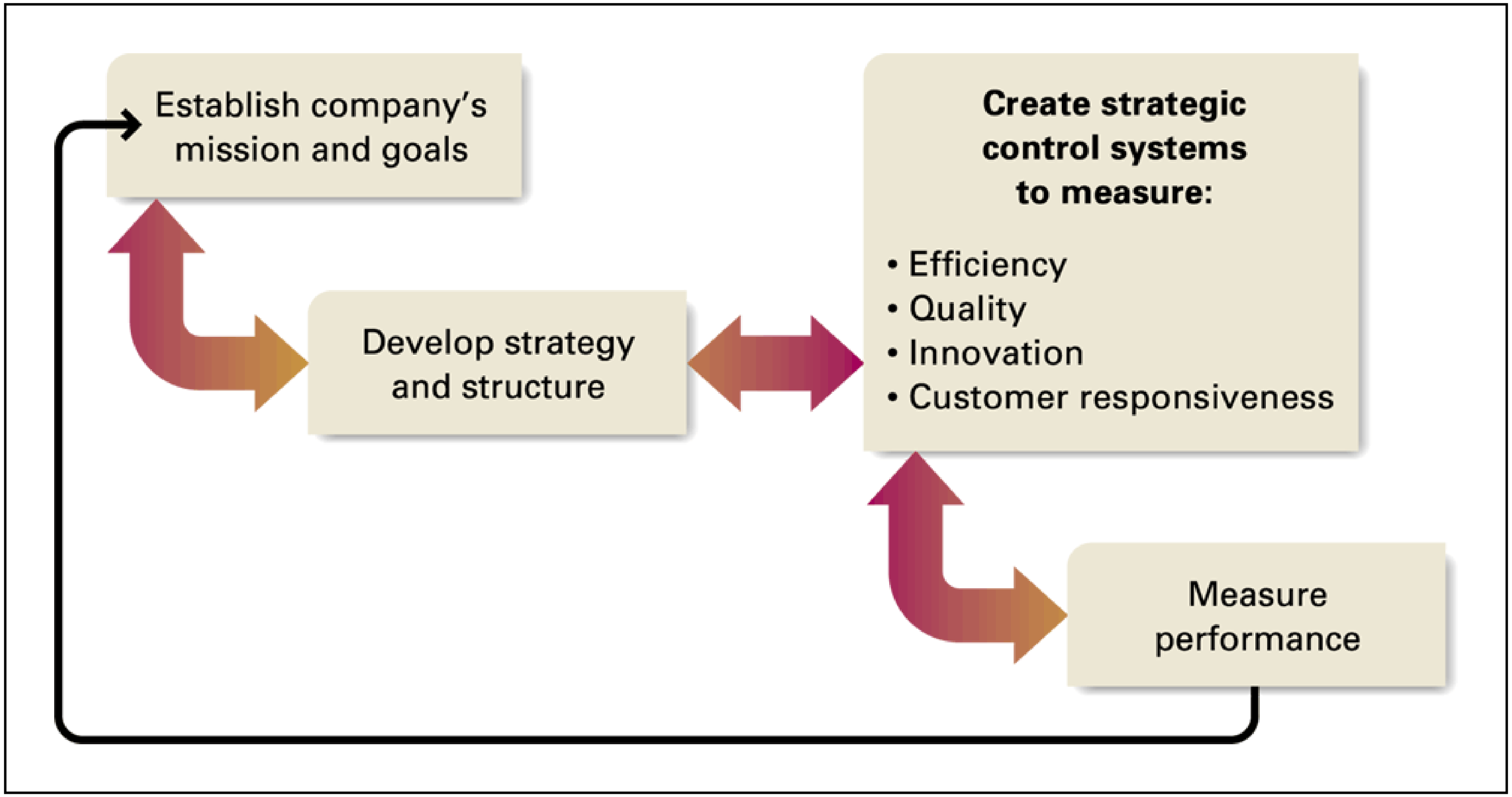
Governance Mechanisms (cont'd)

- Financial statements and auditors
  - SEC
  - GAAP
- The takeover constraint
  - Corporate raiders
    - Greenmail

Governance Mechanisms Inside a Company

- Strategic control systems
  - To establish standards against which performance can be measured
  - To create systems for measuring and monitoring performance regularly
  - To compare actual performance against targets
  - To evaluate results and take corrective actions

A Balanced Scorecard Approach



Governance Mechanisms Inside a Company (cont’d)

- Employee incentives
  - Employee stock ownership plans
  - Stock options
  - Compensation tied to attainment of superior efficiency, quality, innovation, and responsiveness to customers

Ethics and Strategy

- Ethical decision
  - One that typical stakeholders would find acceptable because it aids stakeholders, the organization, or society
- Unethical decision
  - One that a manager would prefer to disguise or hide because it enables a company or individual to gain at the expense of society or other stakeholders

The Purpose of Business Ethics

- To give people the tools for dealing with moral complexity in business
- Business decisions have an ethical component
- Ethical implications must be weighed before acting

Shaping the Ethical Climate of an Organization

- Top managers must use their leadership position to incorporate an ethical dimension into the values they stress
- Ethical values must be incorporated into the company’s mission statement
- Ethical values must be acted on

Comparing Utilitarian, Moral Rights, and Justice

Model	Managerial Implications	Problems for Managers
Utilitarian model: An ethical decision is one that produces the greatest good for the greatest number of people.	Managers should compare and contrast alternative courses of action based on the benefits and costs of these alternatives for different organizational stake-holder groups. They should choose the course of action that provides the most benefits to stakeholders. For example, managers should locate a new manufacturing plant at the place that will most benefit its stakeholders.	How do managers decide on the relative importance of each stakeholder group? How are managers to measure the benefits and harms to each stakeholder group precisely? For example, how do managers choose among the interests of stockholders, workers, and customers?

Comparing Utilitarian, Moral Rights, and Justice

Model	Managerial Implications	Problems for Managers
Moral rights model: An ethical decision is one that best maintains and protects the fundamental rights and privileges of the people affected by it. For example, ethical decisions protect people's rights to freedom, life and safety, privacy, free speech, and freedom of conscience.	Managers should compare and contrast alternative courses of action based on the effect of these alternatives on stakeholders' rights. They should choose the course of action that best protects stakeholders' rights. For example, decisions that would involve significant harm to the safety or health of employees or customers are unethical.	If a decision will protect the rights of some stakeholders and hurt the rights of others, how do managers choose which stakeholder rights to protect? For example, in deciding whether it is ethical to snoop on an employee, does an employee's right to privacy outweigh an organization's right to protect its property or the safety of other employees?

Comparing Utilitarian, Moral Rights, and Justice

Model	Managerial Implications	Problems for Managers
Justice model: An ethical decision is one that distributes benefits and harm among stakeholders in a fair, equitable, or impartial way.	Managers should compare and contrast alternative courses of action based on the degree to which the action will promote a fair distribution of outcomes. For example, employees who are similar in their level of skill, performance, or responsibility should receive the same kind of pay. The allocation of outcomes should not be based on arbitrary differences such as gender, race, or religion.	Managers must learn not to discriminate among people because of observable differences in their appearance or behavior. Managers must also learn how to use fair procedures to determine how to distribute outcomes to organizational members. For example, managers must not give people they like bigger raises than they give to people they do not like or bend the rules to help their favorites.

Thinking Through Ethical Problems

- Does my decision fall within the accepted values or standards that typically apply in the organizational environment?
- Am I willing to see the decision communicated publicly to all stakeholders affected by it?
- Would the people with whom I have a significant personal relationship approve of the decision?

Thinking Through Ethical Problems (cont'd)

- Step 1: Identify which stakeholders the decision would affect and in what ways
- Step 2: Judge the ethics of the proposed strategic decision given the information from Step 1
- Step 3: Establish moral intent (resolve to place moral concerns ahead of other concerns)
- Step 4: Engage in ethical behavior