



Experience. Results. Value.

Shareholder Value, Sustainability, Organizational Ethics, and Internal Audit

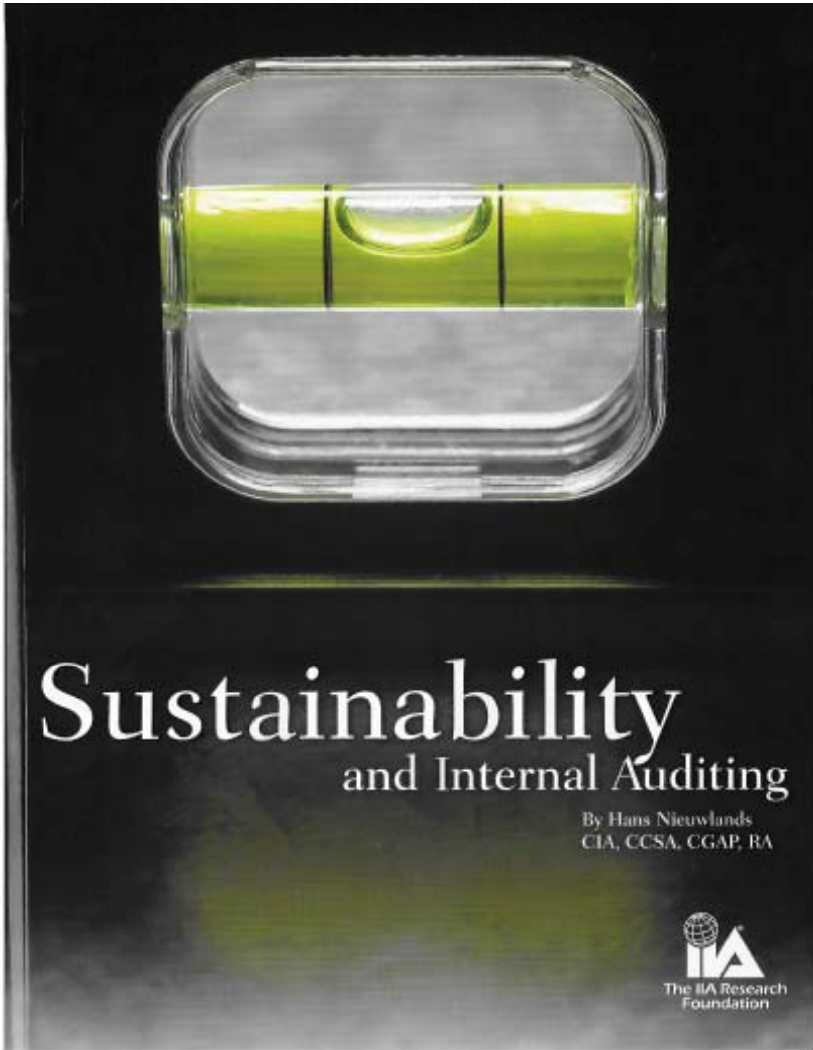
Dr. Daniel K. Saint
November 10, 2009

Session Overview



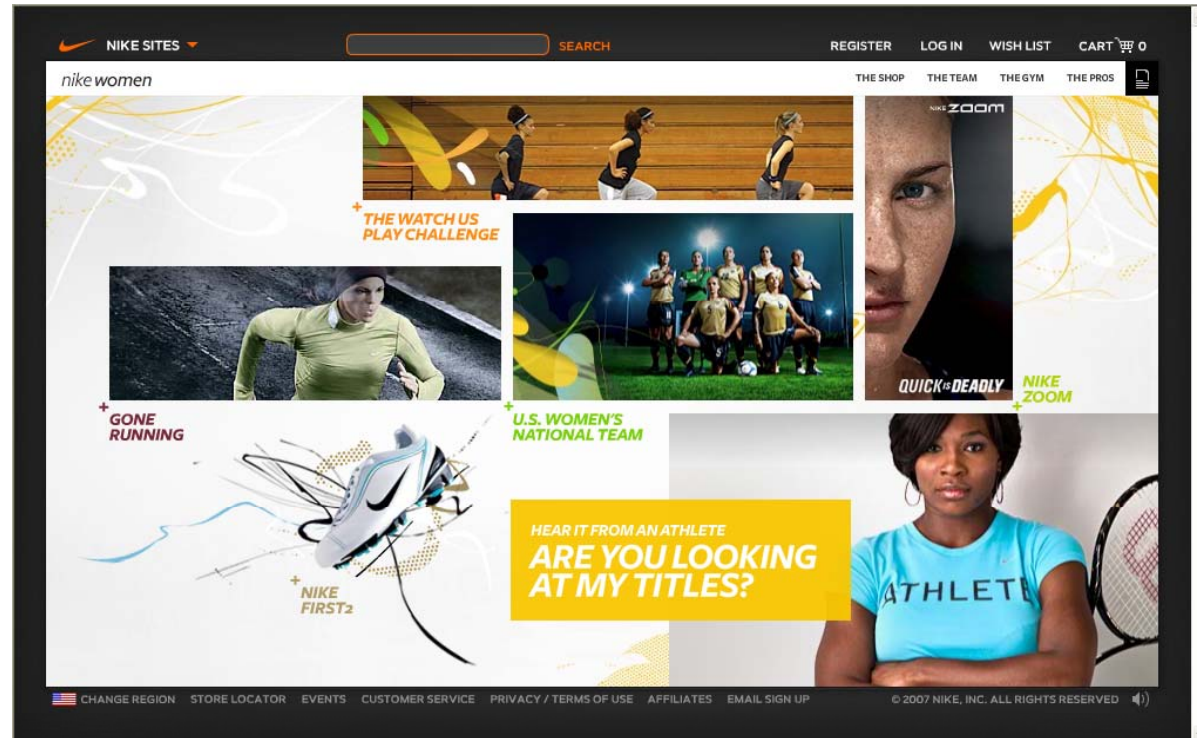
Experience. Results. Value.

- Introduction to Sustainability
- Corporate Purpose
- Manaus Case Study
- Carroll's Four Responsibilities Exercise
- Ethical Models for Decision Making
- Conclusion



“I ask what the person thinks about sustainability? If they do not know what I am talking about, the interview doesn’t go any further.”

Darcy Winslow
General Manager
Women’s Sports
Nike



Sustainability and Corporate Social Responsibility (CSR)



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- “Sustainable development is meeting the needs of the present without compromising the ability of future generations to meet their own needs” (The World Commission on Environment and Development, 1987).
- Triple Bottom Line—new accounting model measuring
 - Environmental stewardship,
 - Social responsibility, and
 - Economic prosperity.
- Elements of Sustainability
 - People— Labor Practices, Human Rights, Society, Product Safety
 - Planet—Materials, Energy, Water, Biodiversity, Emissions, Products
 - Profit

Modern Artifacts



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- Wall Street Journal Advertisements
 - Approximately \$3 million spent on “green” ads last month



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As McKinsey research indicates, executives around the world increasingly recognize that the creation of long-term shareholder value depends on a corporation's ability to understand and respond to increasingly intense demands from society.¹ No surprise, then, that the topic of socially responsible investing has been gaining ground as investors seek to incorporate concepts like sustainability and responsible corporate behavior into their assessments of a company's long-term value.

Investing in **sustainability**

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Four Characteristics of Companies in Trouble



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- Pressure to maintain numbers goals and performance
- Fear and silence
- Youth and inexperience of the management team
- A culture of social responsibility

(Jennings, *Internal Auditor*, 2003)



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Corporate Purpose: Shareholder Value and Stakeholder Theory

**Our assumptions of
corporate purpose
determine what socially
responsible behavior is**

Corporate Purpose



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- Our views on corporate purpose set the foundation of modern financial theory and reflect the fundamental assumptions of modern economic theory
- Finance and accounting as language—theory of social constructionism

Corporate Purpose



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- ***The purpose of the firm is to maximize shareholder value*** (shareholder value theory)
- This is one of the most important and topical issues of the day because of the influence of business on society and increasing demands of society on business

Shareholder Value Theory



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- The language and relationship of shareholder value is systematically embedded in business schools
- Primary theory of MBA finance texts

“Stock price maximization is the most important goal of the firm.” (Brigham et al., 1999)

Theory and Practice of CSR



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- Corporate social responsibility, stakeholder theory and firm performance are interrelated issues.
(Harrison & Freeman, 1999)
- ***Stakeholder theory*** has “emerged as the dominant paradigm of corporate social responsibility.”
(McWilliams & Siegel, 2001)
- Intended antithesis of shareholder value maximization as purpose of the firm

Theory—Purpose of Firm



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Stakeholder Theory

To commercially serve broader societal interests “...no priority of one set of interests and benefits over another.”

(Donaldson & Preston, 1995)

Shareholder Theory

To maximize shareholder wealth “...the interest of shareholders remains second to none.”

(Levitt, 2000)

Theory—Dimensions



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Stakeholder Model

Shareholder Model

- **Definition of CSR**
- **Corporate Behavior**
- **Marketplace Role**
- **Government Role**
- **Management Role**
- **Investment Capital**



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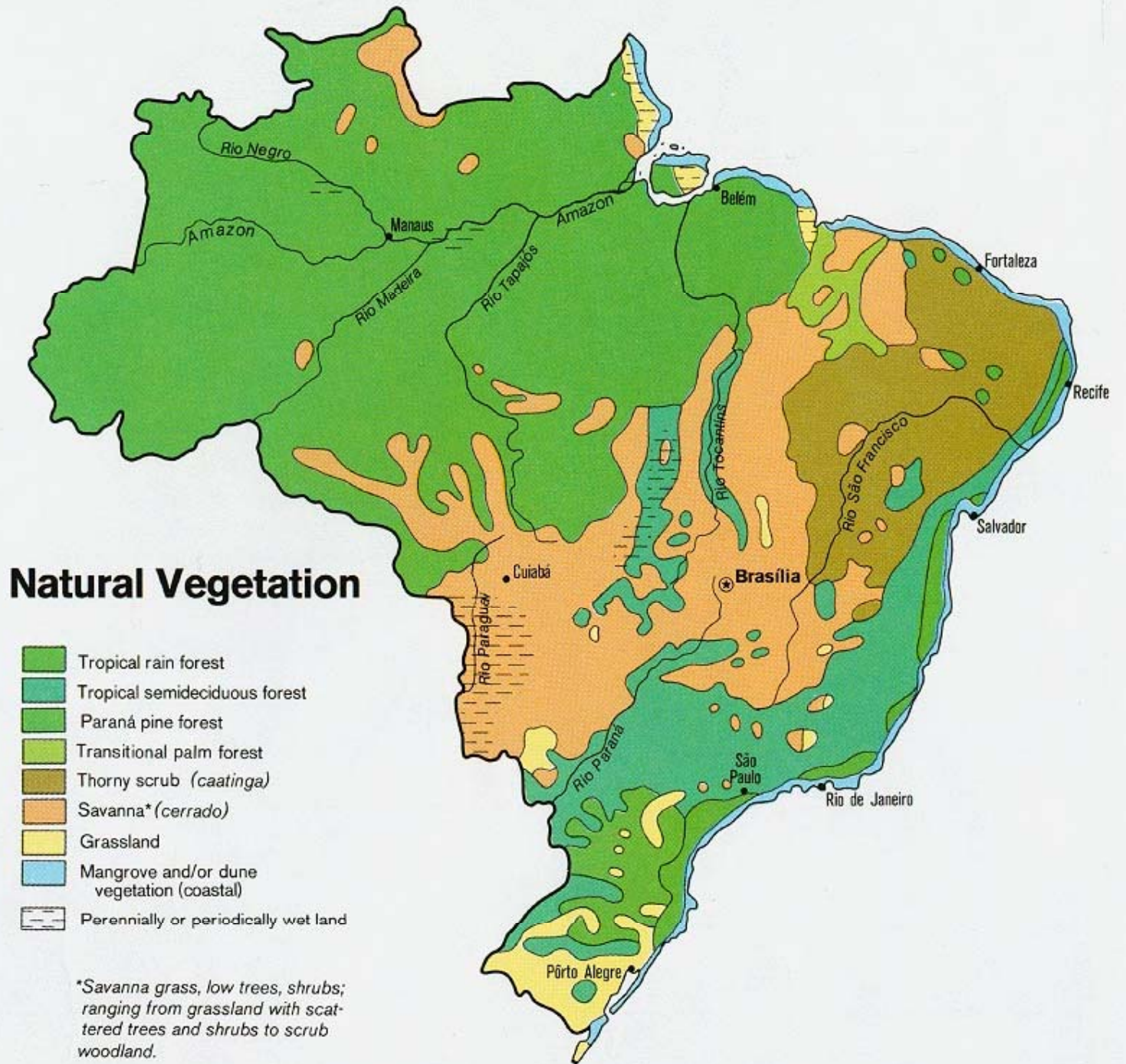
Manaus

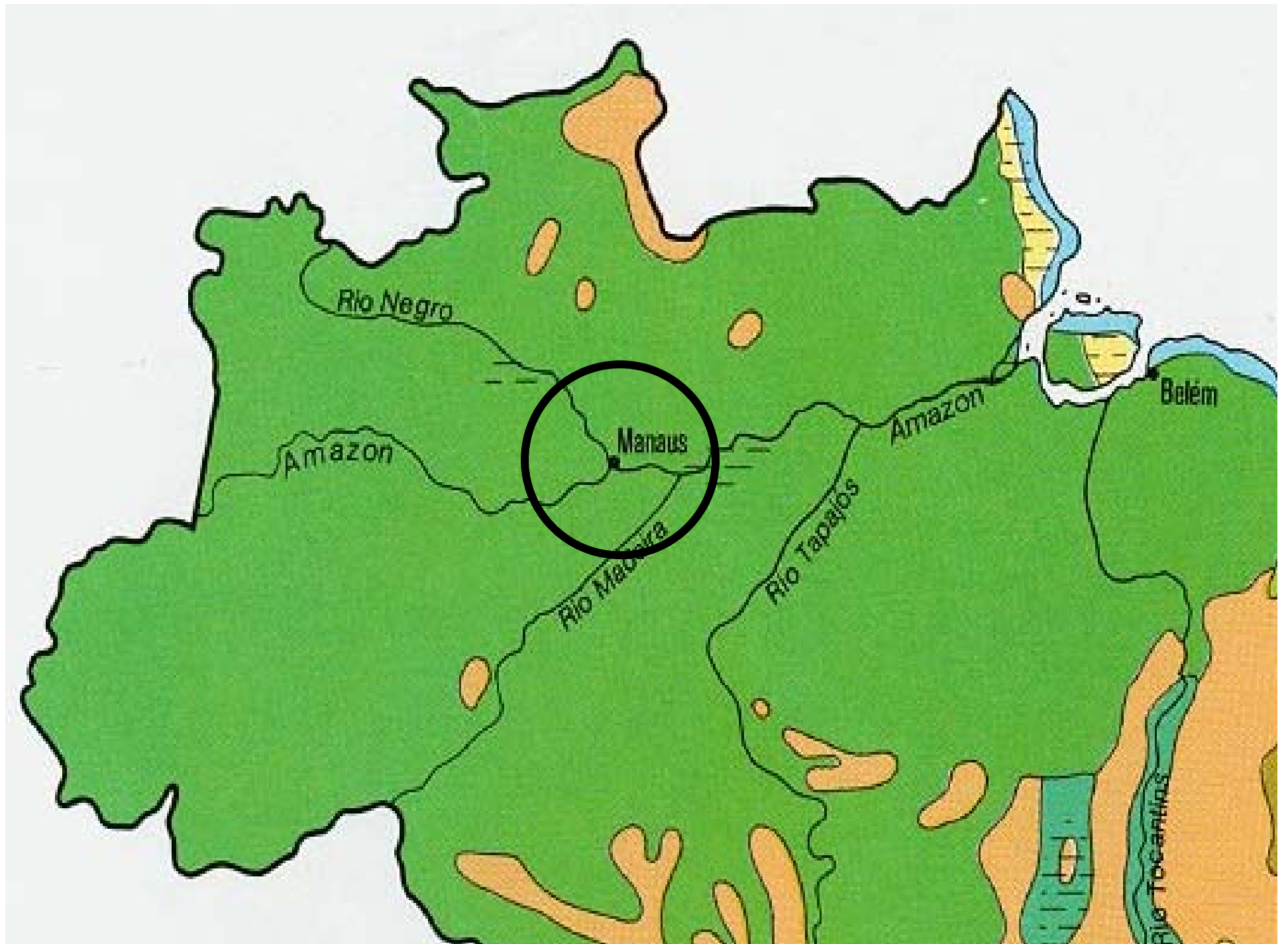
Case Study

Based on a real story from a local company

The details have been significantly
modified for learning purposes

B R A Z I L





Manaus Case Study - Background



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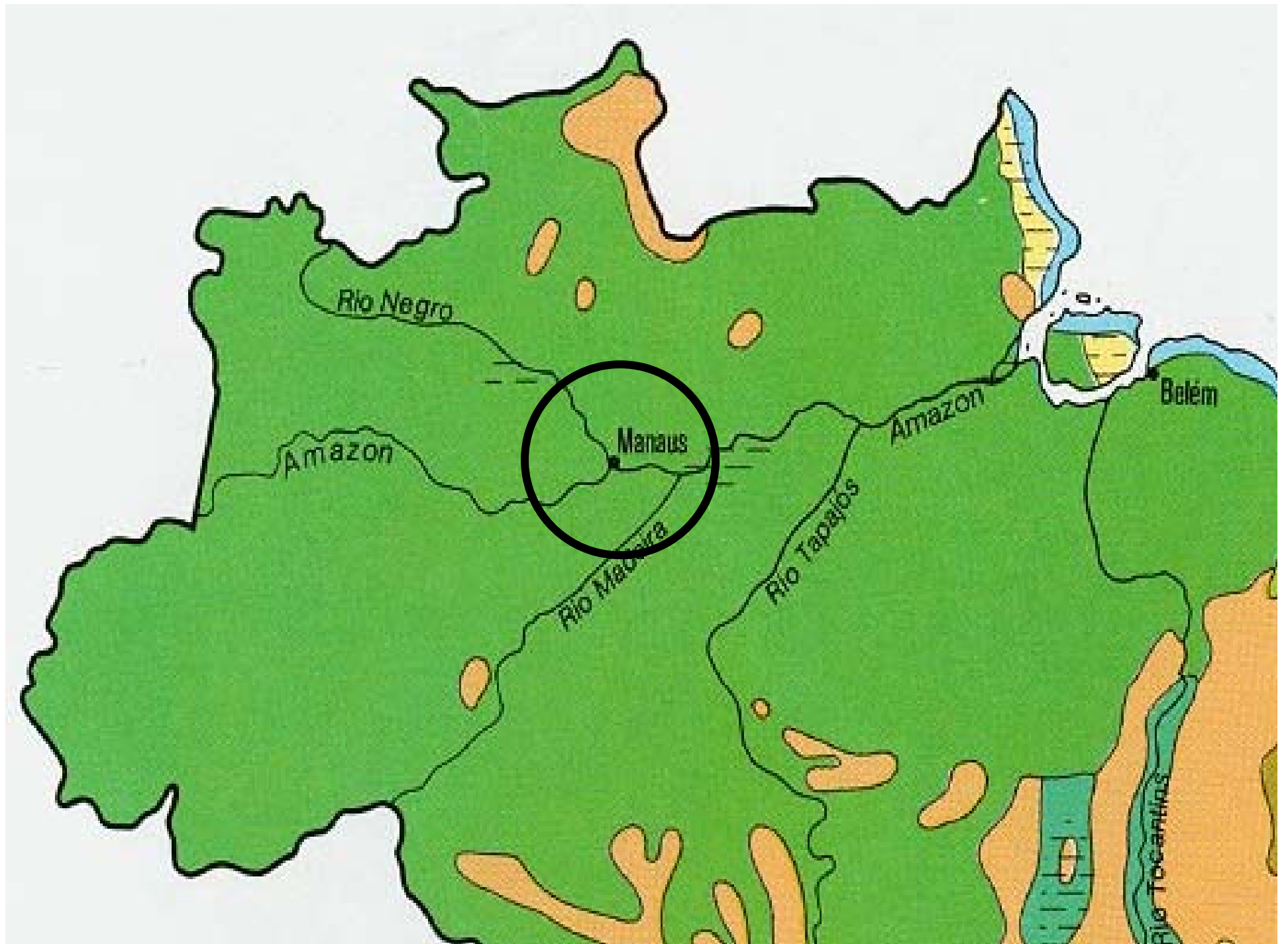
- You have been asked your professional perspective on a potential business venture. An international investment company is considering an investment into Brazil.
- Proposal:
 - Build an automotive manufacturing plant in Manaus
 - Local joint venture
 - Production to serve only the Brazilian market
- Due to local government incentives, alternative seen as most beneficial way to enter Brazil—lowest investment, highest margin alternative.

Manaus Case – Assumptions (hypothetical)



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- No import taxes compared with high tariffs for other market entry alternatives.
- No air, ground or water pollution constraints for at least first ten years. No enforceable safety standards or consequences for workforce and consumers injuries.
- Enforced policy of discrimination— women are allowed to do only the jobs not appropriate for men such as the tedious work of installing the wire in the wiring harnesses by hand. Their work areas must be segregated from the men's areas.



Manaus Case Study- Dialogue



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- With no constraints on pollution, the engineering experts calculate a significantly higher ROI if the new plant ignores environmental considerations.
 - Should the company take advantage of the local regulations? What are some points to consider?

Manaus Case Study- Dialogue



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- While the government directs a policy of discrimination towards a certain class, HR experts calculate no financial impact to do so.
 - Should this have an effect on decision making? Should this be a deal breaker?

**Should
Consider
Environment
and/or HR?**

YES

**Should
Consider
Environment
and/or HR?**

NO

Case Review



Experience. Results. Value.

- In this brief case, we have considered the impact on several stakeholders of the venture: consumers, the local community, employees, and the environment.
- We concluded that business is not concerned merely with profit, but it also takes seriously its responsibilities for avoiding pollution, avoiding discrimination, providing fair employment and ensuring employee and consumer safety.
- **We concluded that a business does have a social responsibility.**

[Continue](#)

Case Review



Experience. Results. Value.

- In this brief case, we have considered the impact on several stakeholders of the venture: consumers, the local community, employees, and the environment.
- We concluded that business is concerned merely with profit; it has no responsibility for avoiding pollution, avoiding discrimination, providing fair employment and ensuring employee and consumer safety.
- **We concluded that a business does not have a social responsibility.**

Carroll's Four Responsibilities



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- Business has four major responsibilities:
 - Discretionary,
 - Ethical,
 - Economical, and
 - Legal
- Of those four, business:
 - Must do one,
 - Has to do one,
 - Should do one, and
 - Can do one

Note for following Slides:

Not necessarily presented in order

No wrong answers

Carroll's Four R's— Matching Exercise



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Legal

Must Do

Ethical

Have to Do

Economic

Should Do

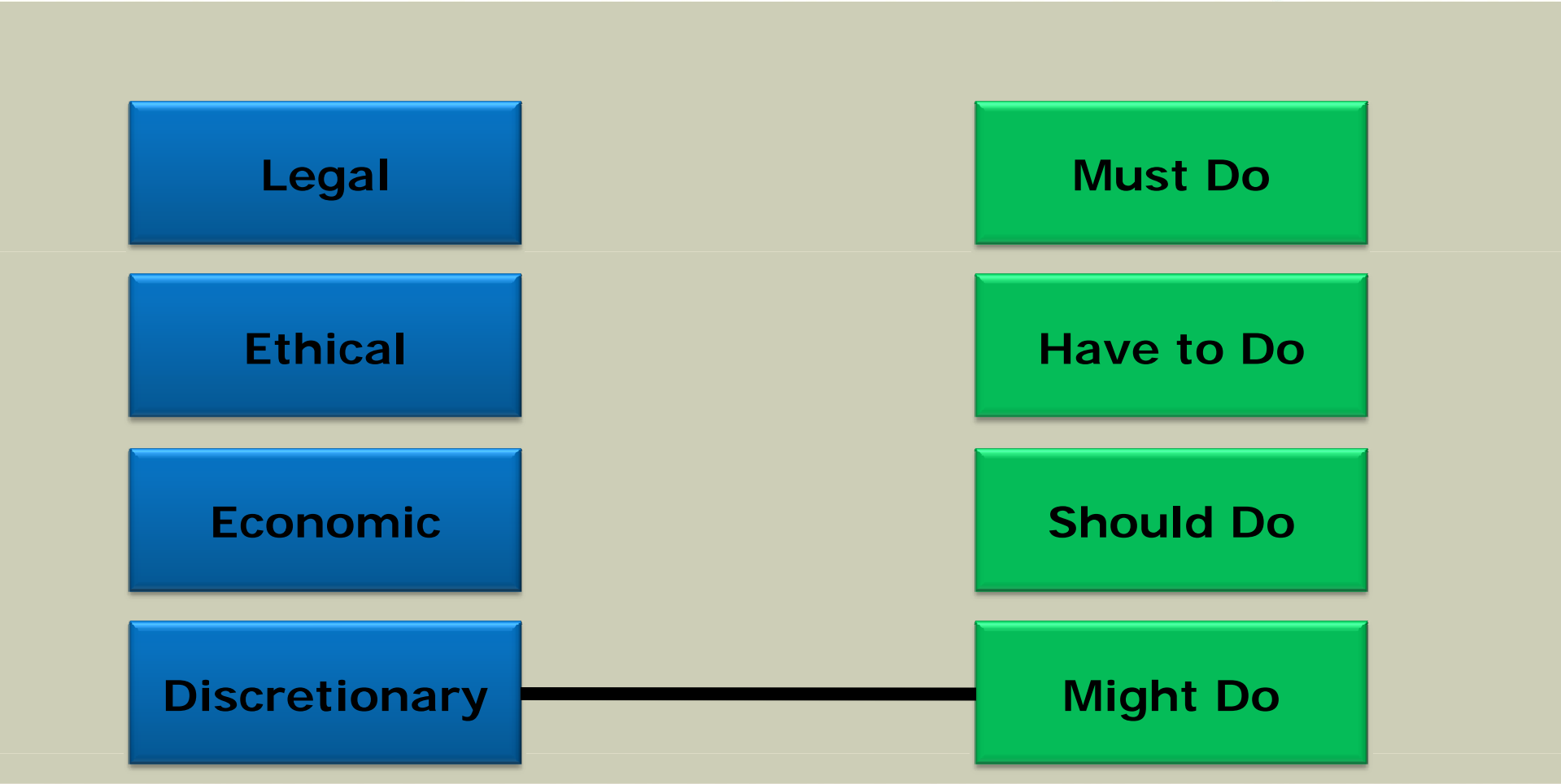
Discretionary

Might Do

Carroll's Four R's— Matching Exercise



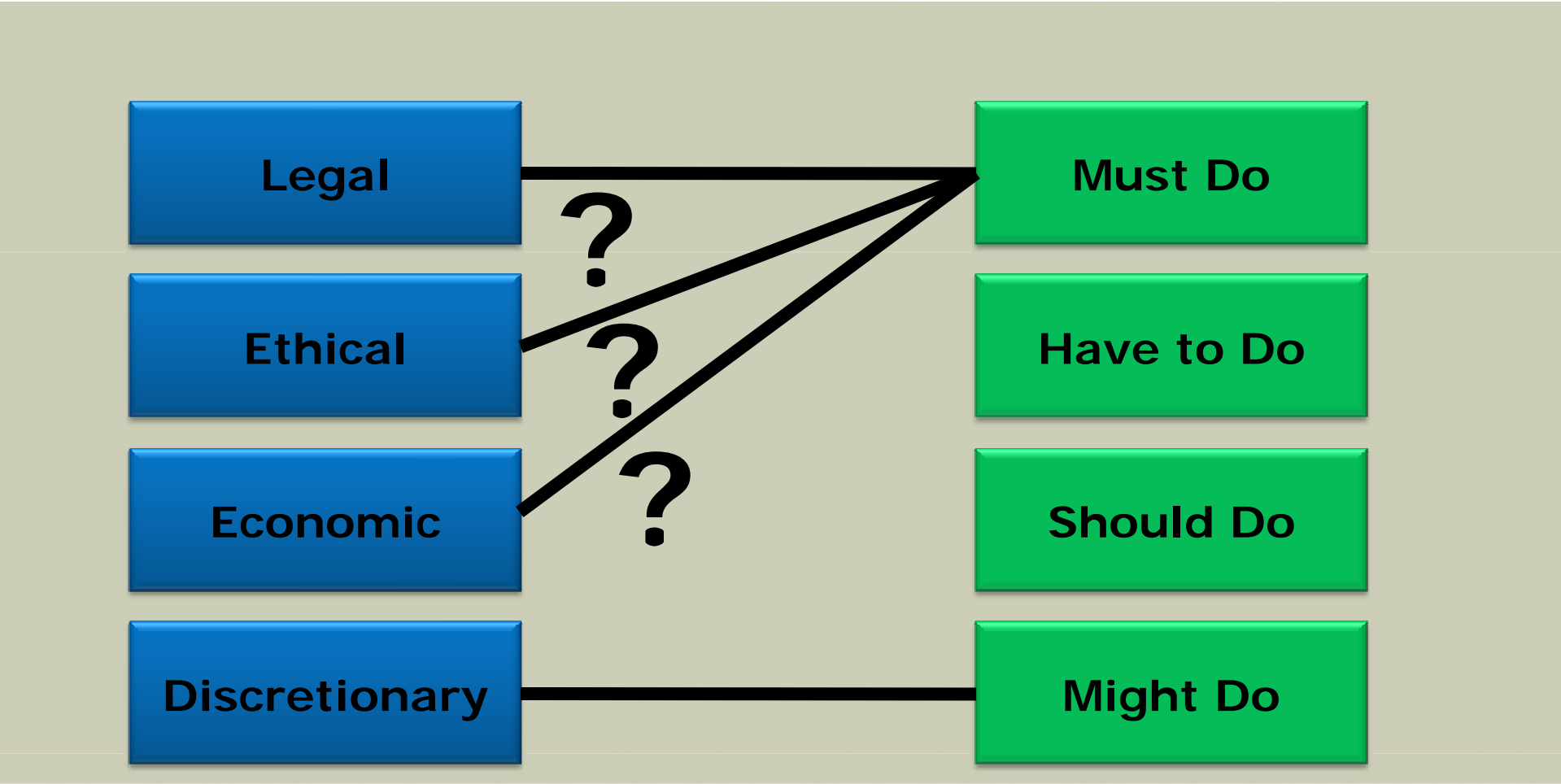
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Carroll's Four R's— Matching Exercise



Experience. Results. Value.



Carroll's Four R's— Matching Exercise



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Discussion

Legal

Must Do

Ethical

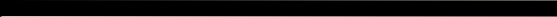
Have to Do

Economic

Should Do

Discretionary

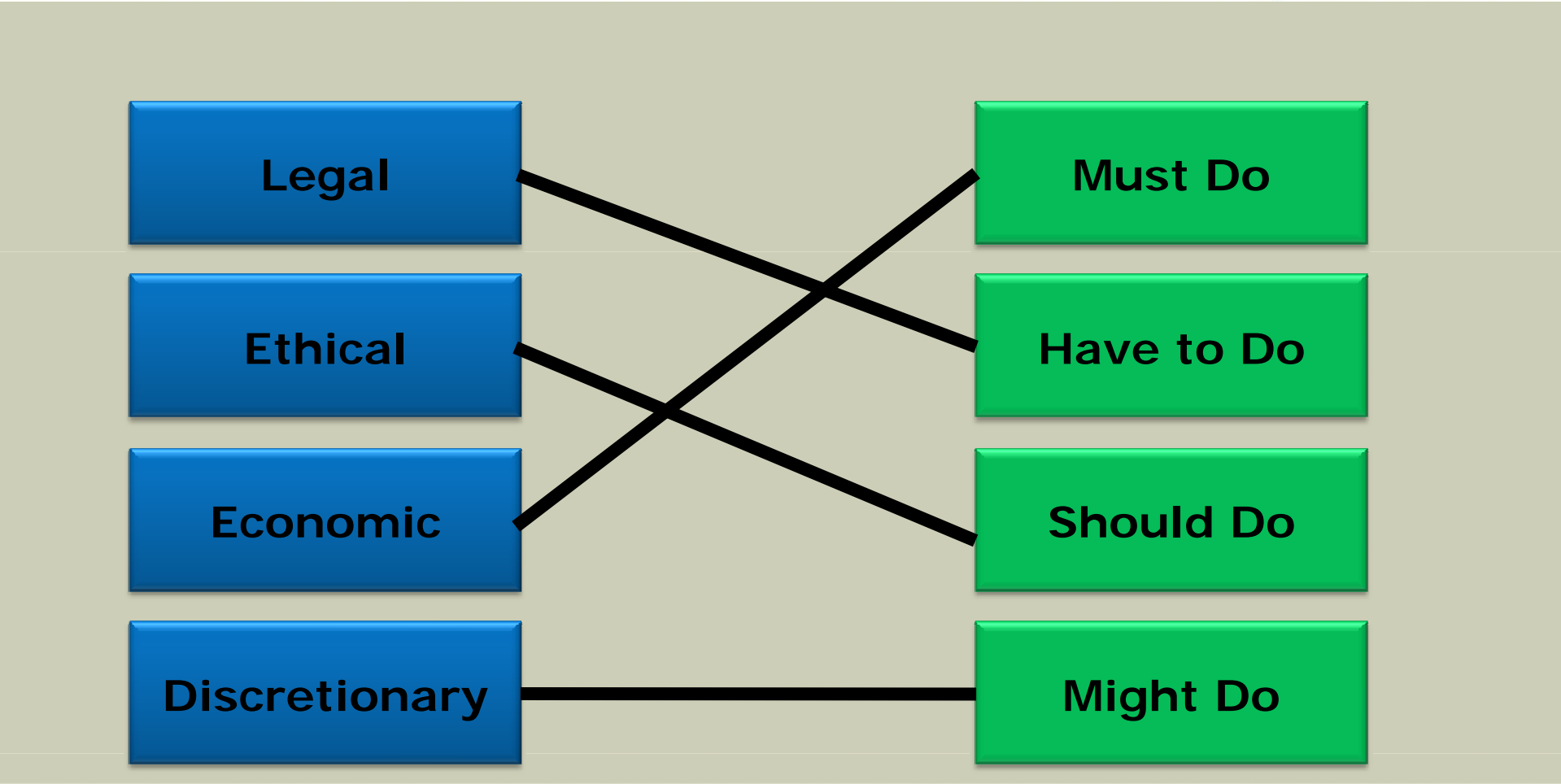
Might Do



Carroll's Four R's— Matching Exercise



Experience. Results. Value.



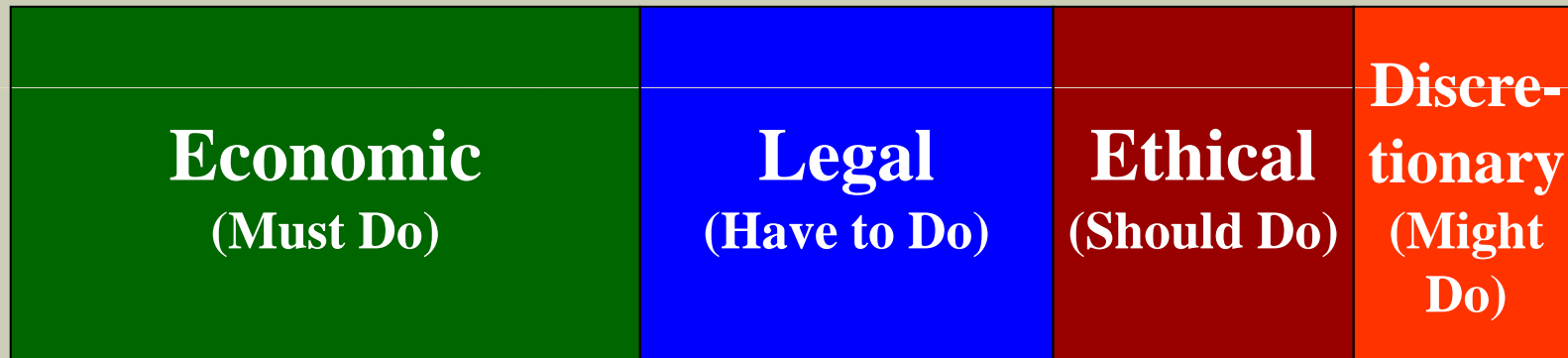
Carroll's Four Responsibilities



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Responsibilities of Business

Social Responsibilities



Source: Adapted from Carroll, A. B. (1979). A three-dimensional conceptual model of corporate performance. *Academy of Management Review*, (October 1979), p. 499.

As presented in MBA course text *Strategic Management and Business Policy* (Wheelen & Hunger 2002)

Carroll's Four R's— Discussion



Experience. Results. Value.

- Background—academic response in opposition to Friedman justifying stakeholder theory

Shareholder Value and Economic Theory



Experience. Results. Value.

- Business has no social responsibilities.
- Business has no responsibility for providing employment, eliminating discrimination, avoiding pollution, ensuring consumer safety or any other popular misconceptions regarding corporate social responsibility.
- Business is concerned merely with making a profit.

Milton Friedman

Shareholder Value and Economic Theory



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When I hear...about the social responsibilities of business... that business is not concerned "merely" with profit but also with promoting desirable "social" ends; that business has a "social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of...reformers...they are...unwitting puppets of the intellectual forces that undermine the basis of a free society.... (Friedman, 1970)

Return to Manaus Case Review



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- We concluded earlier that:

**Should
Consider
Environment
and HR?**

YES

**Should
Consider
Environment
and HR?**

NO

Carroll's Four R's— Discussion



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- What does this model imply?

Responsibilities of Business

Social Responsibilities



- What are the consequences of optional ethical behavior?



**CFO of the year...CFO
Magazine in 1998, 1999, 2000**

Scott Sullivan, Worldcom

Andrew Fastow, Enron

Mark Swartz, Tyco

Award Sponsor: Arthur Andersen

***Business Week's* CEO of the Year for 2001...**



Dennis Kozlowski

Convicted

**Tyco CEO of \$6,000 shower curtain
infamy later indicted for securities
fraud and “looting \$600 million from
shareholders”**



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Royal Dutch Shell Chairman Sir Philip Watts

**Knighthed in the 2003 in recognition of
his services to business and to the
World Business Council for Sustainable
Development...**



**2004 announced \$70
billion overstatement of
assets...**

**“...executives felt
compelled to increase oil
reserves...managed
reserves to satisfy
investors.”**

**Early last week, three days before he was ousted,
Sir Philip was meeting with investors, assuring
them he was not leaving, and sharing the theme of
the annual meeting in May at which he was
planning to speak about the problem of AIDS in
Africa.**

(NY Times, 2004)



Ranked #1 on *Business Ethics Magazine* 100 Best Corporate Citizens List in 2004...

Fannie Mae

A few months later, in a “damning report,” the SEC ordered Fannie Mae to revise its earnings downward by \$9 billion in an accounting scandal that led to the ousting of several top managers including the CEO.

Up to date...

- January 2008: \$7 billion in losses as a result of "rogue trades" at French bank Société Générale.
- March 2008: Swiss investment bank Credit Suisse announced \$2.65 billion of write downs after discovering "intentional mismarkings.
- 2008: Lehman Brothers, Merrill Lynch, Bear Stearns, AIG, Fannie Mae and Freddie Mac
- 2009: European banks reveal their exposure to ex-Nasdaq chairman Bernard Madoff's alleged \$50 billion Ponzi scheme

Closer to Home



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- How many SEC investigations can you think of here in Michigan?

Models



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Open Discussion of Ethical Models for Decision Making

Cavanaugh Model



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- Gather the relevant facts
- Determine the ethical issues
- Relate to the most appropriate norms
 - Utility
 - Caring
 - Rights
 - Justice
- Apply the norms and make the judgment

An Ethical Decision-Making Model



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- Clarify
- Decide
- Implement
- Monitor and Modify

(Source: Josephson Institute of Ethics. "Five Steps of Principled Reasoning," 1999)

Personal Example



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- True story involving teaching and Carroll's model:

Responsibilities of Business

Social Responsibilities



Conclusion



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- Open Discussion
- Thoughts
- Questions



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