THIRD EDITION

MANAGEMENT

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MANAGEMENT

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MANAGEMENT

Third Edition

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Preface

What Makes This Book Unique?

One of our fundamental objectives as an author team was to create a textbook for students and instructors that was both relevant and rigorous. Despite the number of good textbooks on the market, many of them tend to lean in one of two directions: Some textbooks do a good job of presenting material and integrating research, but students struggle to make the connection between theory and practice. Other textbooks do a good job of relating the material to the real world, but they are not always based on the most current research. Our experience in teaching students, talking with other instructors, and working with practicing managers has led us to develop a textbook that is both relevant and strongly based on current research literature. This combination meets the needs of students for developing skills and having a good working knowledge of management.

As an author team we are fortunate to have, collectively, more than 100 years of in-depth experience directly conducting research, reviewing articles, and studying management literature—particularly in the international sphere—and working with colleagues from a variety of different countries and cultures. The breadth and depth of our experience has helped us identify the key theories, concepts, and empirical findings that inform the practice of management in both domestic and global contexts.

We have also had a great number of opportunities over the years to teach many students, work with a large number of managers, and consult with various companies, all focused on the practice of management. Like our research, these experiences have taken place in a variety of locations around the world. We have worked with managers from every part of the globe. We believe this experience has helped us understand the challenges that students of management face in tying theory to practice. As a consequence, we have worked hard to relate the findings from current research to the implications they hold for practicing managers.

Why a New Edition?

The dual objectives of relevance and rigor were the basis of the first two editions of *Management,* and they continue to be the basis for this third edition. However, as a team, we are great admirers and try to be good examples of the principle of continuous improvement. Toward this end, in this new edition we have made several changes that we believe enhance the book. Additionally, the recent changes in the economic environment and enhanced global interdependencies necessitated changes in many of the cases and examples that are used liberally throughout the book. Following is a summary of the major revisions made in this edition:

- We have updated the information on management concepts based on the most current research. In doing so, a number of new references were inserted into each chapter. In several chapters, 20 to more than 30 new references were used (many published in 2009 and 2010).
- Each chapter contains several "Managerial Challenge" segments (mini-cases showing application of the managerial concepts explained in the chapter). Approximately 50 percent of these are new. The others were reviewed and revised where appropriate to ensure currency and continued accuracy.
- All "Managerial Challenges from the Front Line" (chapter-opening managerial profiles with the "Rest of the Story" at the end of the chapter) were updated, and three new managerial profiles were inserted (Chapters 3, 4, and 15).
- All in-text examples were checked for currency and accuracy, and many examples are new or updated.

- All end-of-chapter cases were updated except for two new ones that replaced existing cases (Chapters 11 and 14).
- All in-chapter exhibits were checked for continued relevance and currency. Several were updated and a few new ones were inserted (for example, in Chapters 9, 10, and 11).
- There were a number of small, but nontrivial, changes to the content designed to ensure that the content is "cutting-edge" in the literature and both rigorous and relevant.

We continue to emphasize the connection between relevance and rigor for students and instructors. For example, we again use the feature that appeared first in the second edition, titled Managerial Challenges from the Front Line. It includes a focused example of a managerial challenge faced by a real person. Several of these people are recent college graduates, and others are more experienced managers. The feature helps students understand and relate the chapter content to managerial practice. We also provide a "Rest of the Story" feature at the end of the chapter that briefly describes how the manager resolved the challenge. A few of the people profiled in them and their stories are new; all others have been updated.

Because many undergraduates have not yet had extensive practical experience working in organizations, they are not always able to benefit from the personal insight and awareness that experience can provide. Yet, as we also know, much of a manager's approach to various managerial activities, such as decision making or communicating, are influenced by his or her own tendencies, orientations, and the like. As a consequence, we continue to have a "Self-Assessment" feature at the end of each chapter to help students evaluate and understand their capabilities (especially related to the material covered in the chapter).

This third edition retains our intent to be comprehensive but concise, with 15 chapters. We also continue to include an appendix titled "The History of Managerial Thought and Practice" for students who desire to learn more about the historical development of the management field. Overall, we believe this third edition provides students with a solid and stimulating understanding of the scope and challenges of the function of management in organizations.

Supplements to This Book

This third edition of *Management* has been designed specifically to support the instructor teaching the course and to be user friendly for students. The following support materials have been developed to accompany the third edition:

Instructor Supplements

At the Instructor Resource Center, www.pearsonhighered.com/irc, instructors can access a variety of print, digital, and presentation resources available with this text in downloadable format. Registration is simple and gives you immediate access to new titles and new editions. As a registered faculty member, you can download resource files and receive immediate access to and instructions for installing course management content on your campus server. In case you ever need assistance, our dedicated technical support team is ready to help with the media supplements that accompany this text. Visit http://247.pearsoned.com for toll-free user support phone numbers and answers to frequently asked questions.

The following supplements are available for download to adopting instructors:

- Instructor's Manual
- Test Item File
- TestGen (test-generating program)
- PowerPoint Slides

VIDEOS ON DVD Video segments that illustrate the most pertinent topics in management today and highlight relevant issues that demonstrate how people lead, manage, and work effectively. Contact your Pearson representative for the DVD.

Student Supplements

COURSESMART eTEXTBOOK CourseSmart is an exciting new choice for students looking to save money. As an alternative to purchasing the print textbook, students can purchase an electronic version of the same content. With a CourseSmart etextbook, students can search the text, make

notes online, print out reading assignments that incorporate lecture notes, and bookmark important passages for later review. For more information or to purchase access to the CourseSmart eTextbook, visit www.coursesmart.com.

mymanagementlab (www.mymanagementlab.com) is an easy-to-use online tool that personalizes course content and provides robust assessment and reporting to measure individual and class performance. All of the resources that students need for course success are in one place—flexible and easily adapted for your students' course experience. Some of the resources include an eText version of all chapters, quizzes, video clips, simulations, assessments, and PowerPoint presentations that engage your students while helping them study independently.

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We extend special thanks for the excellent feedback from reviewers, users, and focus group participants (designated as "FG") for the third and previous editions of this textbook. These include:

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Part One

Managing Ethically and Globally

Chapter 1 The Nature of Management
Chapter 2 Social Responsibility and Managerial Ethics
Chapter 3 International Management and Globalization

1

The Nature of Management

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

Define the term *management*.

Explain the major challenges that managers must address.

Describe how historical research on management has contributed to the current practice of management.

Identify and discuss the primary managerial functions.

Explain the three general roles involved in managerial work and the specific roles within each.

Explore and describe the three dimensions of managerial jobs.

Discuss the primary skills required to be an effective manager.

Managerial Challenges from the Front Line

Photo Courtesy of Blaine Halvorson, Junk Food Clothing

Name: Blaine Halvorson

Position: Chief Creative Officer (CCO), Junk Food

Alma mater: Montana State University (BA in Fine Arts/Graphic Design)

Outside work activities: Leisure time, travel, and painting (mainly pop art)

First job out of school: Designed clothes for rock bands and MTV while in college; post-college, worked for a short time at a Los Angeles apparel company followed by Planet Golf, where he oversaw the Japanese distribution of the company's products.

Hero: Jean-Michel Basquiat—I think that he is an amazing artist.

Motto to live by: Everyone should take a leap of faith once in their lives and see if they can do something great.

What drives me: The desire for accomplishment and to take something to the next level.

Management style: Not following a straight line—thinking outside of the box and having tremendous drive.

Graphic designer Blaine Halvorson, along with his business partner Natalie Grof, are the founders of the multimillion-dollar clothing-design business Junk Food, Inc. They worked together at Planet Golf prior to starting their own company. They built the company from a two-person business operating out of an apartment into the world's largest licensing T-shirt manufacturer.

Halvorson experienced early success designing clothes, showing that he had talent and that there was a market for his ideas. He attended trade shows and received a lot of positive press. Then, he started receiving large orders for his designs, but did not have the capacity to mass-produce his products. He realized that he had to learn more about managing a business. His subsequent learnings helped him make Junk Food a success a few years later.

While working at Planet Golf, Halvorson developed a business on the side that was the forerunner of Junk Food. After an investor bought Planet Golf, Halvorson sent him a new design and his idea for a different T-shirt line .

The owner of Planet Golf became an angel investor in Junk Food (a silent partner who provided money while Halvorson and Grof managed the company). The basic idea for the company was to provide a different product that customers valued. Halvorson and Grof built the brand name by using popular icons. Until then, licensing was used only for mass market merchandise, not "designer clothes," especially T-shirts. Starting with names like Twister, Candy Land, and My Little Pony, Halvorson and Grof moved to other licensees, such as Sesame Street, Rolling Stones, DC Comics, and Looney Tunes. They developed a strong following for the Junk Food brand, with even the products becoming collectibles because of the Junk Food brand label. Most recently, the Junk Food brand has moved into sports and entertainment, with licenses with the NFL, the NBA, and Disney. Junk Food's products are now sold globally, in Australia, Japan, Mexico, and many European countries, with a strong focus on Germany and Asian countries.

To do what Halvorson did—that is, build a successful company—requires the willingness to take risks and a desire to create something on your own. It also requires sacrifice, investing substantial amounts of time and effort to make the business work. What's more, it takes significant management skills. For example, Halvorson had to attract, hire, and manage a high-quality team to make Junk Food a success. It also requires perseverance and knowing the market. He learned how to mass-produce products and manage the business's cash flow, among other challenges. Halvorson describes the process as "moving in 50 different directions simultaneously and trying to solve 10 problems at the same time."

Even in the recent economic recession, Junk Food sales increased and the company grew. Because of severe price competition, however, the company moved more of its production overseas (products made in the United States have decreased from 80 percent to 10 percent). Still, as a known and respected brand, Junk Food has increased market share. For example, Gap now co-brands products with the company. Halvorson obviously learned well and has become not only a successful entrepreneur but also a highly effective manager.

As described in the opening profile, Blaine Halvorson has built a highly successful company. He did so by developing an idea for a different type of clothing design that customers valued. While Halvorson is a creative and excellent designer, his success was due to much more. For example, early in his career, he showed his talent for developing creative clothing designs that the market desired. However, he also learned how to build and manage a business. Halvorson had to learn how to organize the company to design, manufacture, and distribute Junk Food's products. He had to hire and manage people to complete these tasks. And finally, he had to ensure that the company used resources efficiently to make a profit and ensure that the business was successful.

The profile on Halvorson shows that management is a challenging and necessary part of a successful business. It also depicts management as exciting and yet requiring a lot of hard work and dedication. In this chapter, we introduce the concept of management and show how it is done. We explore the challenges that managers face on a regular basis and the skills they must have to successfully handle them.

Now, we turn to a set of basic questions that are the focus for the remainder of Chapter 1: (1) What is management? (2) What are the primary challenges that managers face? (3) What do managers do? (4) What skills do managers need?

What Is Management?

To begin, we examine the concepts that form the base of this book.

management
the process of assembling and using sets of resources in a goal-directed manner to accomplish tasks in an organizational setting

Management is an activity or process. More specifically, **management** is the process of assembling and using sets of resources in a goal-directed manner to accomplish tasks in an organization. This definition can be subdivided into its key parts:

1. Management is a process: It involves a series of activities and operations, such as planning, deciding, and evaluating.
2. Management involves assembling and using sets of resources: It is a process that brings together, and puts into use, a variety of resources: human, financial, material, and informational.
3. Management involves acting in a goal-directed manner to accomplish tasks: It is an activity with a purpose and direction. The purpose or direction may be that of the individual, the organization or, usually, a combination of the two. It includes one's efforts to complete activities successfully and to achieve particular levels of desired results.
4. Management involves activities carried out in an **organization:** It is a process undertaken in an organization by people with different functions intentionally structured and coordinated to achieve common purposes.

organization
an interconnected set of individuals and groups who attempt to accomplish common goals through differentiated functions and their coordination

In addition to being "a process" or set of activities, management can also have several other meanings. The term sometimes designates a particular part of the organization: the set of individuals who carry out management activities. Thus, some may use the phrase "the *management* of IBM decided…" or "the *management* of University Hospital developed a new personnel policy.…" Often, when the term is used this way, it does not necessarily refer to all members of management but rather to those who occupy the highest-level positions within the organization (top management).

Another similar use of the term is to distinguish a category of people (that is, "management") from those who are members of collective bargaining units ("union" members or, more informally, "labor") or those who are not involved in specific managerial activities, whether or not they are union members ("nonmanagement employees" or "rank-and-file employees"). The term *member* refers to any person (any employee) in an organization without regard to that individual's role in the organization. In this book, we use the term *manager* to refer to anyone who has designated responsibilities for carrying out managerial activities, and *managing* to refer to the process of completing those activities.

However, *management* is too complex a concept for one definition to capture accurately. Next, we explain several of the challenges that managers must address.

Managerial Challenges

Managers face a number of challenges on a regular basis. The nature of the environment in which managers operate requires that they manage change effectively. Managers are responsible for managing resources—financial, human, and otherwise. To ensure that their organization is competitive and survives in a rapidly changing environment, they must manage strategically. Because of the major changes occurring rapidly in the business world today, managers must be entrepreneurial and innovative. Essentially, they must continuously find ways to create more value for customers than do competitors. Managers' activities take place within organizations. Although managers are the primary "drivers" of their organizations, organizations place boundaries on what managers can and cannot do. We examine each of these challenges next.

Managing Change

Managing change is the most persistent, pervasive, and powerful challenge with which all managers have to deal, regardless of the nature of their organization or its location. No matter how new or experienced managers are, they will be confronted with both the need for change and the opportunity to create change.[1] Not making any changes is unlikely to be an option. As a Greek philosopher once wrote many centuries ago, "Change alone is unchanging," and that statement remains appropriate today.[2]

Managing change is no simple task, especially because most people naturally resist change. Thus, managers must find ways to gain employees' acceptance of change in order to implement it effectively. To gain acceptance, it is useful for managers to create "small wins." For example, the manager might implement the change in one smaller area and make it successful. This success then makes the change legitimate in the eyes of the employees.[3] Two major causes of change that managers must address are new technology and globalization.

TECHNOLOGY No managers in today's world can ignore the impact of technology and the way it affects their jobs and firms. Technology developments often force managers to make changes—whether they want to or not. The Internet is a case in point. The Internet has had far-reaching effects on how managers do their jobs.

The introduction of a new technology often leads to the development of new products and new processes for accomplishing tasks. The Internet has created many opportunities to market products differently, to reach distant markets, and to communicate internally and externally in more effective ways. And, some of the technologies developed to use the Internet in more and effective ways have led to the development of complementary technologies and products, such as Apple's iPod and iPad. Therefore, the Internet has provided many opportunities for managers. Yet, managers must identify these opportunities and find ways to exploit them. If they do not, their competitors are likely to do so and take market share from them. Essentially, the development of new technologies has increased the speed of change, the flow of information, the competitive reach into international markets, and the amount of competition in all markets.

The continued development of new technologies and information about them has emphasized the importance of knowledge and increased the importance of human capital (the holder of the knowledge).[4] It has helped many small- and medium-sized firms enter and compete in international markets, thereby enhancing globalization.[5]

GLOBALIZATION Globalization is the development and observation of the increasing international and cross-national nature of everything from politics to business. Managers must maintain an awareness of what happens in the rest of the world because events in other countries affect their organizations. Global events will almost certainly affect managers' goals and decisions, and how they must coordinate and lead the work of other people.[6]

The opening of many world markets (for example, China), free trade agreements such as GATT, the General Agreement on Tariffs and Trade, and NAFTA, the North American Free Trade Agreement, growing economies around the world, and increases in technology that facilitate global partnerships and competition all contribute greatly to increasing globalization.[7]

Opening of markets to foreign firms coupled with economic development increases market opportunities but simultaneously leads to greater global competition. In order to compete effectively in global markets, firms have sought increasingly to outsource activities to people and firms in lower-cost countries like India and China.[8] Such actions were taken by the Junk Food Company as explained by Halvorson in the opening profile. And, the firm outsourced its manufacturing activities to overseas companies to reduce their costs, allowing Junk Food to successfully compete on price. Of course, global supply chains can also be risky because they are subject to more potential disruptions, such as host country government export and import controls and other regulations, terrorist actions, and more.[9]

Globalization promotes greater involvement in international markets. Thus, firms moving into international markets increasingly need to learn about other cultures and the institutional environments in these markets.[10] Some firms have facilitated this learning process by developing multicultural management teams. These teams have managers who speak different languages and have knowledge about the markets and environments in different regions of the world in which the firms operate.[11] Because of the complexities of operating in multiple countries and regions, some firms focus their international operations in one or a few specific regions of the world. In this way, they can develop the knowledge of the culture, markets, and institutions to operate there effectively.[12]

The changes and the complexities in the global economic environment are evident in the recent rankings of the world's most innovative companies. In the first ten years of the twenty-first century, the United States lost 2.6 million manufacturing jobs to China. In addition to the development of low technology manufacturing capabilities, several Asian countries were building the capacity to produce more sophisticated and higher technology products. Companies in these countries have also been developing their innovation capabilities. As a result, by 2010, 15 of the top 50 most innovative companies were based in Asia and a majority of the firms in the top 25 were based outside the United States. This ranking foretells of a major restructure of the global economy.[13] Entering into international markets has become a critically important growth strategy for major firms worldwide.[14] (Chapter 3 discusses, in further detail, globalization and how firms manage in a global environment.)

Wal-Mart's early entries into foreign markets such as Mexico and Japan were marked by errors suggesting the challenges of operating in foreign markets even for a highly successful and powerful company. But Wal-Mart's management team learned from these mistakes and has since built its international operations into a $100 billion business. Wal-Mart's success can be seen in its China unit. The company hires Chinese managers and sources much of its merchandise locally; still, managers have Wal-Mart values and are passionate about the company. It is expected that Wal-Mart will face additional challenges entering new foreign markets. For example, some analysts question its plans to enter the Russian market because of significant corruption. However, with Wal-Mart's financial and political power along with its managerial skills developed from operating in other foreign markets, many believe that the firm is likely to succeed.

Managing Resources

A major part of a manager's job is managing the organization's resources. The manager must ensure the efficient use of resources but also use the resources in ways that maximize achieving the organization's goals. Among the resources important to managers are financial capital, human capital, physical resources (such as buildings and equipment), and technology. Managers build and manage a portfolio of resources.[15] To build the portfolio, they must acquire and develop the resources needed to complete the organization's tasks. For example, managers need to recruit and select the best-possible employees, then continually develop their knowledge and skills.[16] As employees are developed, their value to the organization increases. This implies that managers need to be effective evaluators of people's skills in order to select the best candidates and identify the skills to be developed. Managers must also design and implement the means to promote learning in the organization.[17]

After building a portfolio of resources, managers must then allocate and coordinate these resources to accomplish the organization's tasks.[18] Managers are also responsible for developing and implementing a strategy to use the organization's capabilities to accomplish its goals.[19] A major dimension of coordination is interpersonal relationships, with other managers and with

A MANAGER'S CHALLENGE

GLOBALIZATION

Wal-Mart's Global Strategy

Wal-Mart is the largest company in the world, with slightly more than $400 billion in annual sales. It serves more than 200 million customers with over 8,000 retail units. The company has 2.1 million employees and because of joint ventures and acquisitions, it operates under 53 different names in 15 countries. There is little doubt that Wal-Mart is a major force in the global economy and has many more foreign markets to conquer with its current global strategy. Although Wal-Mart has been highly successful in the U.S. domestic market, its first forays into foreign markets were marked by mistakes and a few failures. For example, Wal-Mart's first major retail store in Mexico had a huge parking lot, similar to stores in the United States, but most customers arrived and departed by buses. And, it also had some early product failures. For example, Wal-Mart tried to sell golf balls in Mexico even though most of its customers are low-income and could not afford to play golf. Wal-Mart has had to learn about and adapt to local culture: in Japan, for example, low prices are equated with low-quality goods and few customers buy large quantities because of very small living quarters. Wal-Mart also had to close operations in Korea and Germany, two major economies.

Yet, the company has learned from early mistakes and has been more successful in its later entries into foreign markets. As an example, Wal-Mart has 260 retail outlets and almost 90,000 employees in China. All of its stores in China are operated by Chinese general managers. According to Ed Chan, Wal-Mart's China CEO, all of the management team are passionate about Wal-Mart's values, Wal-Mart in China, and about China as well. Wal-Mart sources many of its products locally within China as well, helping to keep costs low.

Wal-Mart was successful relative to most retailers during the recent recession. Overall, it experienced sales growth, and its international division was a major contributor because U.S. sales declined. Approximately 25 percent of Wal-Mart's annual sales come from its international business. In fact, if its $100 billion international business were a stand-alone company, it would be among the top five retailers in the world. Wal-Mart has plans to increase this unit by entering more markets with major operations such as India and Russia. In addition, the company plans to greatly reduce its costs by moving to global sourcing directly from the manufacturers, where possible. This move alone is expected to save the company billions of dollars. For goods unavailable in this way, it has signed a major agreement with Li & Fung to serve as a direct source for major merchandise needs. Li & Fung will focus primarily on emerging markets for the goods. Through these efforts, Wal-Mart CEO David Duke expects the company to maintain its momentum as the global economy continues to improve.

Sources: K. Talley & K. O'Keeffe, "Wal-Mart, Li & Fung Sign Sourcing Deal," *Wall Street Journal,* January 29, 2010, http://www.wsj.com; Company Web site, "Wal-Mart Leverages Global Scale to Lower Costs of Goods, Accelerate Speed to Market, Improve Quality of Products," http://www.walmart.com, accessed January 28, 2010; J. Krishna, "Bharti Wal-Mart Sets up Farm Produce Sourcing Center," *Wall Street Journal,* January 20, 2010, http://www.wsj.com; N. Majahan-Bansal, "Wal-Mart's Strategy Through the World," *Business*, October 20, 2009, http://www.business.in.com; M. Boyle, "Wal-Mart's Painful Lessons," *BusinessWeek,* October 13, 2009, http://www.businessweek.com; "China's Retail Revolution: An Interview with Wal-Mart's Ed Chan," *McKinsey Quarterly*, October 2009, http://www.mckinseyquarterly.com; S. Rosenbloom, "Wal-Mart Outlines Plans to Keep Its Momentum," *New York Times*, June 6, 2009, http://www.nytimes.com; "Case Study: Wal-Mart Stumbles in Its Global Expansion Strategy," in D. M. DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities,* http://knoll.google.com.

employees. Managers' interpersonal and communication skills are paramount in this process. We conclude that managers largely get things done with and through people in the organization. As a result, how they manage human capital is critical to their success.

Anne Mulcahy, chairman and former CEO of Xerox, is largely credited with turning around that company's performance. But Mulcahy claims Xerox employees were responsible for the turnaround. She stated that ". . . attracting them, motivating them, keeping them—making Xerox an employer of choice—is critical to our drive back to greatness."[20] These comments suggest that staffing the organization with the best human capital possible and further developing the knowledge and skills of employees is critical for the success.[21] This conclusion emphasizes the importance of managing the organization's resources (especially the people) to its ability to compete and survive in an increasingly competitive environment.[22]

Executives at Xerox know that the company is more than just its machines. Xerox's CEO, Anne Mulcahy, has emphasized that the firm's human capital (people) are critical to the company's success in the highly competitive photocopier market.

PhotoDisc/Getty Images

Managing Strategically

Managerial challenges create an incredibly complex, dynamic, and competitive landscape in which most managers must operate. To survive and perform well in such an environment, managers throughout the organization need to manage strategically.[23] Managers at the top of the organization—CEOs like Steve Jobs at Apple—establish goals and formulate a strategy for achieving those goals. To accomplish the goals, the company must effectively implement the strategy, which requires managers at all levels of the organization to set and accomplish goals that contribute to the organization's ultimate performance.

The increasing globalization and the enhanced use of technology have contributed to greater changes emphasizing the importance of knowledge to organizational success.[24] The importance placed on the intellectual capital of the organization requires managers to use their portfolio of resources effectively.[25] Of primary importance are intangible resources such as the employees and the firm's reputation. Managers are responsible for building an organization's capabilities and then leveraging them through a strategy designed to give it an advantage over its competitors.[26] They usually do this by creating more value for their customers than their competitors do.[27]

Managers are responsible for forming the strategies of the major units within the organization as well. Because people in the organization have to implement the strategy, managers must focus heavily on the human factor. As they implement their strategies, they will encounter conflicting conditions. Often this means managing multiple situations simultaneously and remaining flexible to adapt to changing conditions. In fact, when Unilever experienced problems and changed its strategy in 2005, it also found it lacked the ability to implement and execute the strategy. Therefore, to improve its performance, the company developed and implemented a process called Strategy in Action (SIA). It follows a sequence of activities to which the firm refers as think, plan, deliver and review. The managers begin by developing and testing an excellent strategy followed by planning for its implementation by management teams through the organization. Management teams mobilize to accomplish the goals established in the implementation plan, followed by a review of the results and planning for improvement. This process is based on the principle of Japanese *hoshin kanri,* or policy deployment.[28]

Additionally, achieving an organization's goals requires that managers commit themselves to always being alert to how they can improve and strengthen strategies in advancing

the organization's vision. Finally, the dynamic competitive landscape entails substantial change. To adapt to this change, managers should be innovative and entrepreneurial, continuously searching for new opportunities.

Managing Entrepreneurially

Managers should regularly search for new opportunities in the current marketplace or identify ideas that could create new markets.[29] Entrepreneurship involves identifying new opportunities and exploiting them.[30] Thus, managers must be entrepreneurial. Entrepreneurial activity is not limited to new, small firms, however. Managers in large firms also must be entrepreneurial and strive to create new businesses.[31] Developing new businesses requires that the lead person, and perhaps others, take entrepreneurial actions. Given the amount of change and innovation encountered in most industries and countries, businesses cannot survive without being entrepreneurial.[32]

To be entrepreneurial, managers must develop an entrepreneurial mind-set. An entrepreneurial mind-set is a way of thinking about businesses that emphasizes actions to take advantage of uncertainty.[33] With an entrepreneurial mind-set, managers can sense opportunities and take actions to exploit them. Uncertainty in the environment tends to level the "playing field" for organizations of all sizes. Whether an organization is rich or poor in resources, uncertainty enables them to identify and exploit opportunities to achieve competitive advantage. This is how Google, in its early days, beat larger, more powerful competitors. To develop an entrepreneurial mind-set, managers must first be alert to new ideas and use them to create value for customers.[34]

Both large and small firms and new and established firms can be entrepreneurial. For reasons described earlier, they not only can be, they must be to survive. Polaroid Corporation was once an entrepreneurial company and a market leader in instant photography. But the original Polaroid organization no longer exists: it lost its entrepreneurial nature and saw market share evaporate with the introduction of digital photography technology. The firm that bought the rights to the Polaroid name struggled and went out of business, selling the assets to an entrepreneur who intends to use them to sell specialty film to artists and the few remaining owners of Polaroid cameras. As a whole, small and new firms tend to be more entrepreneurial but often lack the ability to sustain this advantage. On the other hand, large, established firms are good at using their size to gain an advantage and sustaining their positions as long as new, rival products don't enter the market. However, larger firms have a more difficult time being entrepreneurial.[35]

Polaroid, once an entrepreneurial company, and a former market leader, no longer exists because it lost its substantial market share to digital photography technology.

Patrick Strattner\Jupiter Images

Historical Approaches to Management

While many think that management is a very new concept, it is not. Even ancient civilizations encountered managerial challenges and found ways to cope with them. More than 1,000 years ago, Chinese leaders searched for an effective means of governing a large organization (government) and expressed the importance of open communications and consideration of people's needs. Additionally, Chinese leaders discussed the value of specialized labor, hiring and promotions based on merit, and the need to clearly describe jobs.[36] The modern field of strategic management owes its origins to military history and an ancient Chinese warrior, Sun Tsu, and his book, *The Art of War*.[37]

Long ago, management was already being practiced in many parts of the world. The pyramids, for example, were designed and built in Egypt thousands of years ago. Completing these "wonders of the world" required a significant amount of planning, organization, and management of labor. Likewise, 2,000 years ago, the Roman Empire required effective management to build major monuments and an extensive network of roads and viaducts. Additionally, the development and growth of the Catholic church throughout the world required a significant amount of planning, organizing, and directing people's efforts and activities.

The origins of what is often referred to as "modern management" are found in the Industrial Revolution, which began in England in the mid-eighteenth century and later spread to the United States and other regions of the world. While many have contributed to the development of management thought and practices, American engineer Frederick W. Taylor (1856–1915) is often credited as the "father of modern management." Taylor's work on linking workers' incentives to their performance provided an important base for motivation theory applied to the workplace. He argued that pay was only part of the reward and that employees should be provided regularly with feedback on their performance. His primary legacy is the principles of scientific management that form the base for many of the different functions, roles, and activities of managers explored in this book.[38] Research suggests that scientific management was a sophisticated theoretical approach that contributed to other fields as well as institutional economics.[39]

Many other people have contributed to modern management theory and practice over the course of the last two centuries. Among them are Frank and Lillian Gilbreth, who developed the beginnings of time and motion studies to determine the most efficient manner in which to complete tasks. Alfred P. Sloan (former CEO of General Motors) and Chester Barnard (an executive of AT&T) both contributed to our knowledge of how to build an efficient and effective organization. While Sloan focused on the formal aspects of organizing, such as the functions and divisions, Barnard emphasized the social characteristics of organizing, such as cooperation, building common purpose, and the importance of communication.

Mary Parker Follett and Douglas McGregor focused on the importance and value of leadership in organizations. Follett espoused principles related to the importance of integration and treating employees as partners. Similarly, McGregor is best known for promoting "Theory Y" leadership practices with positive assumptions about human nature in which positive leadership can bring forth greater efforts and levels of achievement from employees. And Abraham Maslow and Frederick Herzberg made major contributions to our knowledge of motivation that continue to be present in managerial practices today. Maslow is best known for his "hierarchy of needs" theory and Herzberg for proposing the independence of motivators and hygiene factors. Both of these individuals' ideas led to the concept of job enrichment used to design tasks that more effectively motivate employees and use more of their skills.[40]

A more detailed discussion of the history of management thought and practice is presented in the Appendix. The ideas of these management pioneers are evident in the discussion of what managers do in the following sections.

What Do Managers Do?

In the opening profile about Blaine Halvorson, we learn that management has many dimensions. Halvorson's first attempt to design and sell clothes was successful because he created a product the market desired. Yet, he was unable to satisfy that demand. He did not know how to develop and manage an organization. His description of what he did in developing and managing Junk Food to be a successful company shows a number of managerial tasks that he had to complete, which include many of the functions described in this section.

There are several ways to examine managers' jobs aside from observing what managers do. Over the years, several systems have been developed to classify (1) managerial functions, (2) the roles in which managers operate, and (3) the characteristics and dimensions of managerial jobs. These typologies can provide useful ways to examine the varied nature of managerial jobs and responsibilities. In effect, they provide a road map for understanding what management is.

One way to think about the question "What do managers do?" is to analyze their work according to the different functions that they perform. The first such classification system dates back at least 80 years and, after more than eight decades, this system remains widely used by management scholars and writers.[41] A variation of this traditional typology forms the basis for the general sequencing of the chapters in this book (as well as most other textbooks on the subject of management). The four principal managerial functions most applicable to modern organizations are planning, organizing, directing, and controlling.

Planning

Planning involves estimating future conditions and circumstances and, based on these estimations, making decisions about the work of the manager and for all employees for whom she or he is responsible. This function involves at least three distinct levels or types:

planning
estimating future conditions and circumstances and making decisions about appropriate courses of action

1. Strategic planning, which addresses strategic actions designed to achieve the organization's long-range goals:[42]
2. Tactical planning, which translates strategic plans into actions designed to achieve specific and shorter-term goals and objectives;[43] and
3. Operational planning, which identifies the actions needed to accomplish the goals of particular units of the organization or particular product lines in their respective markets.[44]

Planning is important in large and small organizations and in new and established companies. It may be even more important in new and small businesses because they rarely have a surplus of resources available to overcome major mistakes.[45] Firms that do not plan are frequently unprepared for the unexpected. When unexpected events occur, the firms' performance suffers, and they may have to take extraordinary actions.[46] Thus, planning is a highly important managerial function.[47]

Organizing

To conduct managerial work, resources must be integrated systematically, and this function is called **organizing.** It involves identifying the appropriate structure of relationships among positions, and the people occupying them, and linking that structure to the overall strategic direction of the organization.[48] Because today's world is full of uncertainties and ambiguities, organizing is a critical function of managers. At its most basic level, the purpose of this managerial function is the attempt to bring order to the organization. Without it, chaos would ensue.

organizing
systematically integrating resources to accomplish tasks

Most people think of the organization structure as represented by an organization chart. An organization chart informs others about some portions of the formal structure; yet, organizing involves much more. For example, decisions about what units should be represented on the firm's project teams are a part of organizing.[49] The degree of autonomy granted to these units is a managerial organizing decision. Often firms producing modular products also have autonomous modular organization units.[50] Such units are becoming more common when integrating units from acquired businesses and when establishing international subsidiaries.[51] As a result, the organizing function of management is complex and challenging.

Home Depot had a decentralized organizational structure prior to Bob Nardelli becoming CEO. The firm's store managers had a great deal of autonomy to select products and offer services that satisfied local customers. And, the company achieved significant success using this structure. However, because Nardelli felt the decentralized structure was costly and inefficient, he implemented a centralized structure along with a strong monitoring and control system (for example, a centralized inventory control system). While the new structure was more efficient, it also eroded the entrepreneurial spirit and customer satisfaction suffered. As a result, Home Depot lost market share to competitors and its financial performance declined. These outcomes suggest that organizational structure matters a great deal. This case example also suggests the importance of leadership in developing and implementing changes. Leadership is an important dimension of directing; the next topic to be examined.

Directing

This function has typically had a number of different labels over the years. **Directing** is the process of attempting to influence other people to attain the organization's objectives. It heavily involves leading and motivating those for whom the manager is responsible, interacting with them effectively in group and team situations, and communicating in ways that acknowledge and support their efforts to accomplish tasks and achieve organizational goals. Directing has several dimensions, including leadership, motivation, communication, and managing groups or teams.

directing
the process of attempting to influence other people to attain an organization's objectives

A MANAGER'S CHALLENGE

CHANGE

The Failure of Home Depot's Organizational Structure Changes

Home Depot was known for its entrepreneurial approach and customer service. To promote an entrepreneurial spirit and strong customer service, the company was highly decentralized, with much autonomy given to each store in serving its local community and customers. Flexibility of action was valued even at the department level within a store. As a result, Home Depot grew to be large and highly successful. Its sales grew to $45 billion in 2000 from its beginnings in 1979, earning it the title of the fastest-growing retailer in U.S. history.

In 2000 Home Depot hired a new CEO: former GE executive Bob Nardelli. Nardelli was alarmed at what he considered a lack of control and the need to reduce costs. Thus, he implemented an aggressive plan to institute controls that effectively centralized many merchandise and supply decisions. He bought self-checkout equipment and inventory control systems. The investment of almost $1 billion in new technology allowed top managers to measure better the activities at the store level and local managers were then held accountable for their numbers. Yet, while these centralized controls helped to manage the costs, morale of the many managers and employees suffered.

The management model implemented was more of a military style with a hierarchical approach to decision making, emphasizing control and efficiency—a stark contrast to the decentralized decision making and entrepreneurial culture that existed before Nardelli became CEO. In the previous environment, leaders tried to serve as mentors and coaches, enhancing morale. Store managers and unit and department managers within the stores operated in a reasonably autonomous manner and with an entrepreneurial spirit. Nardelli's approach represented a dramatic change dictated from the top.

While Nardelli's changes created greater discipline and more structure, they also led to unexpected consequences. People were unhappy with their loss of autonomy and flexibility. They disliked their inability to be entrepreneurial. Because everything was controlled according to the numbers, managers managed to the numbers. Some felt the new culture was based on fear. Morale among store managers and employees declined significantly and turnover occurred. Home Depot's customer service also declined and competitors such as Lowes attained a foothold, taking market share away from Home Depot. As a result, Home Depot's stock market performance suffered. Finally, partly because of these problems and in a dispute with the board of directors, Bob Nardelli resigned.

Charlie Neibergall/AP Wide World Photos

CEO, Frank Blake, (Bob Nardelli's successor) refocused the business on its original structure with a more entrepreneurial spirit. Customer satisfaction once again increased, helping the firm remain financially fit.

The new CEO, Frank Blake, managed to stop the skid by closing Home Depot's specialty stores, refocusing on its prime business and eliminating expansion, especially during the recent economic recession. While the reduction in capital spending and operating costs from store closings helped Home Depot remain financially fit. Home Depot also reemphasized customer satisfaction. But, Lowes, its primary competitor is not standing still either. It has entered the Mexico and UK markets. Time will tell if these are profitable moves.

Sources: M. A. Hitt, C. Miller, and A. Collela, *Organizational Behavior* (Hoboken: John Wiley & Sons, 2011); M. Marcus, "Home Depot Rallies as Wall Street Weakens," *Forbes,* February 8, 2010, http://www.forbes.com; J. McGregor, "Smart Cost-cutting: How Home Depot Built It In," *BusinessWeek,* August 4, 2009, http://www.businessweek.com; L. Uchitelle, "Home Depot Girds for Continued Weakness," *New York Times,* May 19, 2009, http://www.nytimes.com; J. Creswell and M. Barbaro, "Home Depot Ousts Chief," *International Herald Tribune,* January 2007, http://www.iht.com.

Leaders must develop effective relationships with employees, and their actions should result in fair outcomes, often referred to as *justice.*[52] Leaders try to develop positive psychological capital in their employees, which in turn has several positive outcomes such as higher productivity and a lower probability of leaving the organization.[53] Leaders can have a significant impact on an organization's outcomes—for example, on its innovation and performance.[54] Thus, managers' leadership actions are important. Managers use leadership actions to manage change (to transform organizations and units).[55] A critical function for managers as leaders is to motivate their employees to be highly productive. To do so requires that the managers understand the individuals they manage and use the tools at their disposal to create individualized rewards tied to employees' performance.[56] Many managers focus their activities on directing teams in the current organizational environment. Thus, as leaders, they must find ways to direct the team while simultaneously motivating individuals, empowering both the team and its individual members.[57] For these reasons, directing is a challenging responsibility for managers.

Controlling

The word **controlling** sometimes has a negative connotation. Yet, *control* is a necessary and important managerial function. The essence of this function is to regulate the work of those for whom a manager is responsible.[58] Managers can accomplish control in several different ways, including setting standards of performance for employees in advance, monitoring ongoing (real-time) performance and, especially, assessing the performance of employees on completed tasks.[59] The results of these evaluations are then fed back into the manager's planning process. However, controlling employee behavior is a difficult task. If managers do not take great care in this process, they can elicit some unexpected and undesirable behaviors.[60] Therefore, managers must apply controls carefully and effectively.[61] Although they might want to avoid controls that are too tight for their employees, managers must also be careful to avoid overly loose controls. The absence of effective controls can lead to negative outcomes, such as the Enron affair and the more recent problems in several major financial services firms, such as Lehman Brothers and Goldman Sachs. Thus, managers must achieve a *balanced* set of controls.

controlling
regulating the work of those for whom a manager is responsible

It is important to consider these four managerial functions as parts of a reciprocal and recurring process, as illustrated in Exhibit 1.1.

Managerial Roles

Some years ago, the Canadian scholar Henry Mintzberg proposed another approach to understanding managerial work.[62] Mintzberg based his classification system on research regarding how managers spend their time at work, primarily with regard to the roles they play. This way of viewing managers' work activities complements the functional approach; it provides additional understanding and insights on what managers do.

Mintzberg's typology of managerial roles has three major categories—interpersonal, informational, and decisional—each of which contains specific roles. Together, there are 10 such roles in this typology, as shown in Exhibit 1.2 and described in the following sections.

Deb M. explains several interpersonal roles that she fulfilled in her managerial job (see A Week in the Managerial Life of Deb M.). Among those are the leader role and the liaison role explored next.

EXHIBIT 1.1

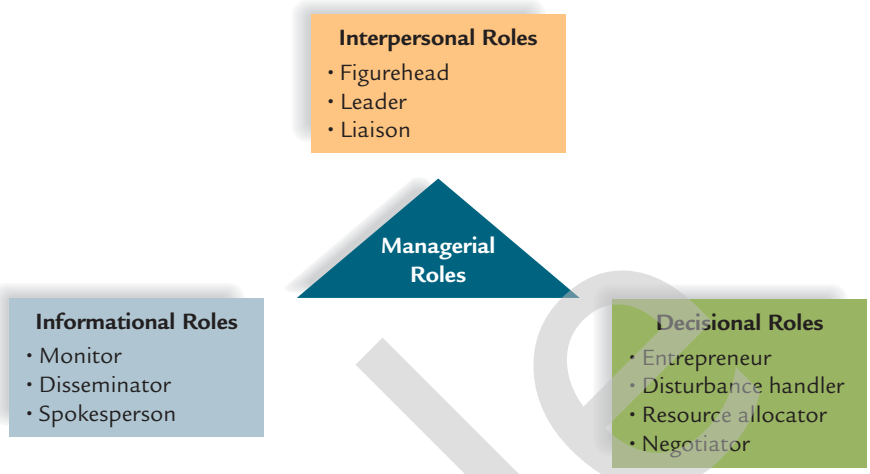
Managerial Functions

INTERPERSONAL ROLES Interpersonal roles are composed of three types of behavior and are derived directly from the manager's formal authority granted by the organization. They are:

1. ***The Figurehead Role*** This set of behaviors emphasizes ceremonial activities, such as attending a social function, welcoming a visiting dignitary, or presiding at a farewell reception for a departing employee. A familiar term

EXHIBIT 1.2

Types of Managerial Roles



for this role of representing the organization, borrowed from the military, is "showing the flag." Over time, this behavior is important and is a necessary component of a manager's job. For example, the dean of a business school often finds it necessary to participate in figurehead activities such as commencement ceremonies, which are important for the long-term benefit of the school.

2. ***The Leader Role*** This role involves influencing or directing others. It is the set of responsibilities people typically associate with a manager's job, as the organization gives the manager formal authority over the work of others. To the extent that managers are able to translate this authority into actual influence, they are exercising leadership behavior. A manager demonstrates leadership behavior when, for example, a newly appointed project team leader gathers her team and discusses the vision and goals for the team and how to accomplish them.[63]
3. ***The Liaison Role*** This role emphasizes a manager's contacts with those outside the formal chain of command. These contacts include not only other managers within the organization but also such external individuals as customers, suppliers, government officials, and managers from other organizations. It also emphasizes lateral interactions, as contrasted with vertical interpersonal interactions of a manager, and it highlights the fact that an important part of a manager's job is to serve as an integrator for his or her own unit and other units or groups.[64] The liaison role applies to the situation where a marketing manager interacts with key customers to learn about their reactions to new product ideas.

INFORMATIONAL ROLES This set of roles builds on the interpersonal relationships that a manager establishes, and it underscores the importance of the network of contacts a manager builds and maintains.[65] There are three specific informational roles:

1. ***The Monitor Role*** This type of behavior involves extensive information seeking in which managers engage to remain aware of crucial developments that may affect their units and their own work. Such monitoring typically deals with spoken and written information regarding "soft" as well as "hard" facts. An example of this role would be a manager attending an industry conference who spends considerable time in informal lobby and cocktail lounge conversations in order to gather data on current developments in the industry.
2. ***The Disseminator Role*** A manager not only receives information but also sends it. This often includes information that the receiver wants but otherwise has no easy access to without the help of the manager. A supervisor who learns about the firm's reorganization plans affecting his or her department and conveys that information to subordinates is acting in a disseminator role. For example, Deb played a disseminator

A week in the managerial life of DEB M.

Deb M. is the director of organizational effectiveness for a Canadian oil and gas company.

Question: Describe the type and range of managerial activities in which you were involved this past week.

Last week, 70 percent of my time was spent in meetings with others. That's a bit high but not totally unusual.

One of the meetings, I organized and led. Actually, it was a two-day work meeting with HR peers in other parts of the company. We were working on coordinating our HR activities, such as recruiting and performance management, across the company. We have four separate operating units, and each has its own HR department to some extent.

One of the other meetings involved making a presentation to our corporate senior management team regarding our compensation strategy. I was explaining how changes we proposed to make would help us better attract and retain employees with key skills.

I also had a meeting with my boss to review resource needs for my team in order to manage increasing workloads. I spent several hours interviewing job candidates for a new hire to join my team.

I also conducted an orientation session with a number of our managers to explain our new job evaluation system. The rest of the time was spent working on several efforts to better integrate and harmonize certain HR practices, such as pay, across the company. This involved both working with my subordinates as well as working on my own.

Question: What do you like best about your job as a manager?

One of the things I like best about my job is that I have the opportunity to influence the decisions and actions that will have a significant impact on the success of the company. Much of our success depends on the people we attract and select into the company and the performance current employees contribute. My job in HR and the work of my subordinates contribute directly to the quality of people we have and how well they perform.

Question: In the past year or so, what is the biggest change to which you have had to respond?

We are going through a lot of changes right now. We have changed our strategy and our structure, but most of these changes were planned. The unexpected changes have involved individuals who have either deviated from the agreed-to plan and/or have not shared key pieces of information that would have caused us to plan differently. In the first case, I've had to rely on my interpersonal skills to try and get the person back on track. In the second case, I've had to incorporate the new information and adjust our plans.

role when she made a presentation on her company's new compensation program to the firm's senior managers.

3. ***The Spokesperson Role*** A manager is frequently called upon to represent the views of the unit for which he or she is responsible. At lower management levels, this typically involves representing the unit to other individuals or groups within the organization. At higher management levels, this typically involves an external component, presenting the organization's activities and concerns to external constituents, such as customers and suppliers.[66] For example, when the manager of the western region meets with other regional managers and presents the views of his region's sales personnel about how well a proposed new sales incentive plan is working, he is functioning in a spokesperson role.

DECISIONAL ROLES The final category in the typology of roles relates to the decision-making requirements of a manager's job. There are four such decisional roles:

1. ***The Entrepreneurial Role*** Managers not only make routine decisions in their jobs but also frequently engage in activities that explore new opportunities or start new projects. Such entrepreneurial behavior within an organization often involves a series of small

decisions that permit ongoing assessment about whether to continue or abandon new ventures.[67] Playing this role often involves some risk, but the sequence of decisions usually limits this risk. Suppose, for example, that a lower-level production manager comes up with an idea for a new organizational sales unit. She then discusses the idea with her colleagues and, based on their reactions, modifies it and presents it to upper-level management. Such a manager is playing an entrepreneurial role that goes beyond her regular responsibilities.

2. ***The Disturbance Handler Role*** Managers initiate actions of their own, but they must also respond to problems or "disturbances." In this role, a manager often acts as a judge, problem solver, or conflict manager. The goal of such actions is to stop small problems from developing into larger ones. If a manager faces a situation in which employees cannot agree about who will do a particularly unpleasant but necessary task, the manager must settle the matter. In doing so, he or she is functioning as a disturbance handler. When Deb M. took action to correct an employee's deviation from the plan, she acted in the disturbance handler role.
3. ***The Resource Allocator Role*** Because resources must be managed efficiently in organizations and slack rarely exists, an important responsibility of managers is deciding how to distribute resources.[68] Allocation decisions have a direct effect on a unit's performance and indirectly communicate information to employees about the relative importance of the firm's activities.[69] The manager of front desk services for a large resort hotel who decides how many and which clerks to assign to each shift is operating in a resource allocator role. Deb M.'s decisions related to her team's resource needs and their allocation represents the resource allocator role.
4. ***The Negotiator Role*** Managers are often called upon to make accommodations with other units or other organizations (depending on the level of the management position). In this decisional situation, managers are responsible for knowing what resources they can or cannot commit to particular negotiated solutions. A manager who serves on a negotiating team to establish a new joint venture with another company functions in the negotiator role.

Decisional roles are particularly important in managerial responsibilities. Managers are expected to make decisions, and many of those decisions have important performance implications. For example, managers have to decide when to develop and take new products to the market, when to develop new ventures, when to hire and lay off employees, and so forth. They are expected to make these decisions efficiently, with due speed but also comprehensively.[70] Frequently, there are no clearly correct paths to follow. Rather, decisions often require that managers exercise reasonable judgment and use their education, training, and experience.[71] And, finally, managers must make decisions that leads the company to engage in ethical practices.[72]

This typology of managerial work roles emphasizes the considerable variety of behaviors required by managers. Certainly, the extent to which any particular role is important varies considerably from one managerial job to another. The front-line supervisor of a group of bank tellers is likely to have a different mix of roles than the bank's executive vice president. Nevertheless, the ten roles help to understand the total set of activities that managers usually have to perform over time.

Managerial Job Dimensions

Analyzing the dimensions of managerial jobs provides additional insight about the work. British researcher Rosemary Stewart developed one particular approach.[73] Stewart proposed that, regardless of its level and type of unit in an organization, three dimensions characterize a managerial job:

- the demands made on it;
- the constraints placed on it; and
- the choices permitted in it.

A week in the managerial life of GREG K.

Greg K. is director of finance and accounting for a large division of a financial services firm.

Question: Describe the type and range of activities you were involved in, as a manager, this past week.

In my managerial job, I'm involved in a variety of activities, ranging from division project meetings to staff meetings to time to work on my own projects. Here is a brief overview of my activities this past week:

Monday: In the morning, I participated in a conference call with various management-level employees to discuss activity at one of our broker-dealers. The remainder of the day largely involved interacting with staff, completing my assignments, and reacting to various inquiries from other departments, divisions, and auditors.

Tuesday: On this morning I participated in a biweekly status call with our third-party administrator for one of our products. Following the conference call, I met with one of my direct reports (accounting manager) for our weekly staff meeting. We discussed the status of various department projects, staffing issues, upcoming projects, and current events affecting the division. Later that day I met with our accounting coordinator to discuss the status of a pricing project on which she was working.

Wednesday: This was a light day for meetings; however, I attended a one-hour training class regarding upcoming new product features that we will be offering. I then worked on several job-related projects.

Thursday: Thursdays are typically busy in the mornings due to two meetings I attend: a biweekly technology meeting and a weekly product meeting. When both of these meetings occur, it typically takes two or three hours of my morning. This Thursday our department head held a monthly staff meeting to discuss general events affecting the department, the division, and the company.

Friday: The morning began with a weekly investment meeting. I represent our division in this meeting, which includes other representatives from all divisions of the company. The remainder of the day was spent working on various normal tasks.

Aside from the meetings that I attend throughout the week, the remainder of my workweek typically includes other interactions with staff and completion of my other assignments (responsibilities as a "working manager"). I typically interact at least daily with our department head (the Chief Finance Officer—CFO). We discuss new requests and projects, staffing, status of current projects, and so forth. I also interact regularly throughout the day with my five direct reports to discuss projects, answer questions, and provide feedback. I also am responsible for approving all of our sales force travel and expense reports and approving sales support requests that come from our sales force.

Question: What do you like best about your job as a manager?

I need to answer this from two vantage points: one from the perspective of my direct assignments and one from a managerial perspective.

Regarding my direct assignments, the most rewarding part of my job is contributing to a division project that directly affects the division with findings and recommendations that are communicated to senior management. Feeling part of the division team is very rewarding.

As a manager, I enjoy problem solving and coaching my direct reports regarding problems they encounter and complex tasks they have to complete. My company offers several management development programs, and one that I found especially useful concerned leadership. I try to apply knowledge that I learned from the class to situations that arise in my job.

Question: In the past year or so, what is the biggest change to which you have had to respond?

From a management perspective, the most challenging change over the past year was terminating two employees (not my direct reports, but I was highly involved in the process) and adjusting accordingly on all facets of the job. I had not previously been involved in a termination, so it was challenging. The process included performance concerns, HR concerns, reallocating resources within the department to ensure that all the assignments were completed, and communication to other employees (a delicate matter).

Analyzing managerial jobs in this way not only provides further understanding of what managers do but also permits direct comparisons of different jobs, for example, how the position of "manager of information systems" compares with that of "marketing vice president" or "plant manager."

Greg K. engaged in a number of activities that reflect each of the three dimensions of managerial jobs.

DEMANDS This dimension of management refers to what the holder of a particular managerial position must do. "Demands" involve two types: activities or duties to carry out and the standards or levels of minimum performance to meet. Demands can come from several sources, such as the organization, the immediate boss, or the organization of work activities. Typical types of demands include such behavior as attending required meetings, adhering to scheduled deadlines, following certain procedures, and the like. No doubt, for example, Ursula Burns has sales and performance targets to meet in her CEO position at Xerox. Greg K. participates in several regular meetings each week, with his boss, his employees, and other department managers.

CONSTRAINTS "Constraints" are factors that limit a manager's response to various demands. One obvious constraint for any manager is the amount of time available for an activity. Other typical constraints include budgets, technology, the attitudes of subordinates, and legal regulations. All managerial jobs have constraints. Managers need to develop a good understanding of how to minimize or overcome constraints.

CHOICES This dimension underscores the fact that despite demands and constraints, managers always have the opportunity to exercise discretion. Thus, a manager regularly makes choices about what to do or not do, how to complete tasks, and which employees will participate in projects, among others. Frankly, discretion is an important part of a managerial job. How managers exercise discretion and the quality of the judgments they make largely determine their effectiveness as managers. In her present and past managerial positions, Ursula Burns has faced a multitude of choices about how to make staffing decisions, how to demonstrate leadership, how to respond to changing market conditions affecting use of technology based products, and the like.

Exhibit 1.3 illustrates these three job dimensions for two different managerial jobs, a project team manager in a manufacturing company and a manager of a medium-sized fast-food restaurant.

EXHIBIT 1.3 Two Managerial Jobs with Different Demands, Constraints, and Choices

	Job A: Project Team Manager	Job B: Fast-Food Restaurant Manager
Demands	• Develop new product with strong market appeal • Hold formal weekly progress meeting with boss • Frequent travel to other company sites	• Maintain attractive appearance of restaurant • Keep employee costs as low as possible • Meet standards for speed of service
Constraints	• 12-month deadline for product development • Project budget limit of $1 million • No choice in selecting team members	• Most employees have limited formal education • Few monetary incentives to reward outstanding performance • Federal and state health and safety regulations
Choices	• The organizational structure of the project team • Sequencing of project tasks • Budget allocations	• Selection of employee to promote to supervisor • Scheduling of shifts and assignments • Local advertising promotions

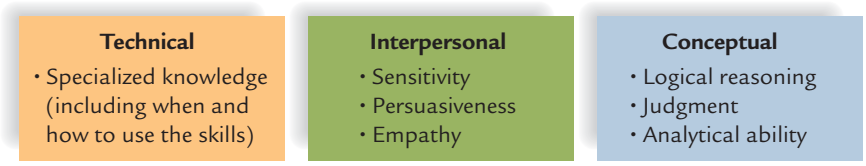


EXHIBIT 1.4

Manager's Skills

Although both are managerial jobs, their demands and constraints are quite different. Some of the choices permitted, however, are similar. The combination of the three dimensions determines the requirements to be a manager.

What Skills Do Managers Need?

Similar to other human activity, managing involves the exercise of skills, that is, highly developed abilities and competencies. Managers develop these skills through a combination of aptitude, education, training, and experience.[74] Three types are critical for managerial tasks, particularly for the leadership component of management: technical, interpersonal, and conceptual (see Exhibit 1.4).

Technical Skills

Technical skills involve having specialized knowledge about procedures, processes, and equipment, and include knowing how and when to use that knowledge. Research shows that these skills are especially important early in managerial careers (see Exhibit 1.5), when leading lower-level employees and gaining their respect is often part of a manager's job. In addition, technical skills seem to be particularly critical in many successful entrepreneurial start-up firms, such as those involving Steve Jobs and Steve Wozniak at Apple Computer or Bill Gates at Microsoft. Technical skills, whether in an entrepreneurial venture or in a larger organization, are frequently necessary but usually are not sufficient for managing effectively.[75] An overreliance on technical skills may actually reduce a manager's effectiveness. For example, the first Apple computer designed and built by Jobs and Wozniak required technical skills to start the fledgling company. However, as Apple grew, their technical skills became relatively less important because they employed technical specialists. However, Jobs and Wozniak were not always readily able to exchange those technical skills for other, equally impressive leadership skills. As a result, the company had to search for other managerial talent, and did so with mixed success. After gaining considerable managerial experience in other business endeavors, Jobs subsequently returned to lead Apple in the late 1990s with the assistance of other able managers. Since his return, Apple has experienced an incredible amount of success. Because of this, *Fortune* magazine recently named Jobs CEO of the Decade.[76]

Interpersonal Skills

Interpersonal skills such as sensitivity, persuasiveness, and empathy are important at all levels of management, although particularly so at lower and middle levels.[77] A longitudinal study of career advancement conducted at AT&T found evidence that such skills, measured early in careers, were

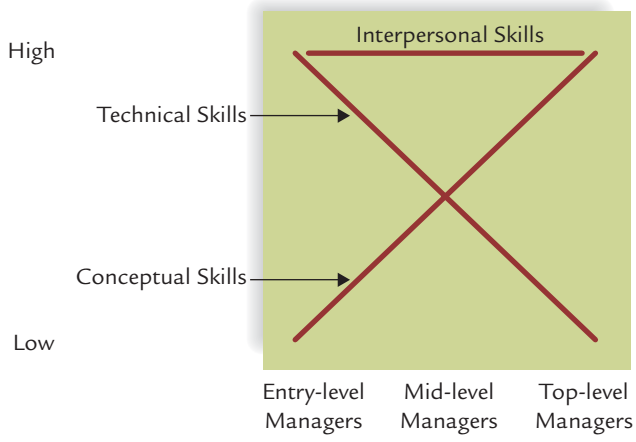


EXHIBIT 1.5

Relative Importance of Managerial Skills at Different Organizational Levels

Marcio Jose Sanchez/AP Wide World Photos

Steve Jobs, Apple Computer designer, returned to Apple in the late 90s and Apple has experienced an incredible amount of success as a result.

important in predicting advancement in managerial ranks 20 years later. However, a lack of these skills may prematurely limit managerial advancement even when other skills exist, but these skills alone are unlikely to guarantee managerial success. Exhibit 1.6 summarizes the findings of one study that investigated reasons why some fast-rising executives eventually plateau in their managerial careers, even when they appeared to start out with acceptable levels of interpersonal skills. As the management researchers suggested, "The charming but not brilliant find that the job gets too big and the problems too complex to get by on interpersonal skills [alone]."[78]

Conceptual Skills

Often called *cognitive ability* or *cognitive complexity,* conceptual skills such as logical reasoning, judgment, and analytical abilities are a relatively strong predictor of managerial effectiveness. These skills are often a major determinant of who reaches the highest management levels in the organization.[79] A clear example of someone who was selected for a CEO job precisely because of his conceptual skills is Jack Welch, former CEO at General Electric. Welch was appointed to GE's top position in 1981 and immediately set out to restructure the organization with the objective of making it more globally competitive. Over time and after several major changes in the organization, he reduced a significant amount of GE's bureaucracy and developed a more flexible organization. He also changed GE's corporate culture to one based on greater employee empowerment.

The Plan of This Book

After examining the nature of management in this chapter, we present the overall structure and plan of the remainder of the book. Following, we identify each part of the book and the chapters within it.

Part 1 provides an introduction to management and critical domains of managerial jobs. These chapters provide you with an introduction to the nature of management (Chapter 1) and its context. Two important contextual dimensions of managerial jobs are ethics and social responsibilities (Chapter 2) and international management and globalization (Chapter 3). Managers must act ethically and be sensitive to the social environment in which their organizations operate.

The rest of the book follows the functions of management. Part 2 examines the functions of planning and organizing. An important decision made by managers is the strategy the organization must follow to achieve a competitive advantage. This aspect is explored in Chapter 4. Chapter 5 discusses the process of planning designed to implement the strategy throughout the organization. Finally, Chapter 6 explains how to organize the firm in order to effectively implement the strategy and operate an efficient organization. This part ends with a discussion of managing human resources and diversity (Chapter 7).

Part 3 consists of five chapters dealing with the crucial managerial responsibility of leading. It begins with a discussion of leadership, a critically important responsibility of managers (Chapter 8). Chapter 9 examines the topic of motivation, to provide an understanding of how managers can influence behavior in an organizational context. Chapter 10 turns to the role of groups and teams and how managers lead and govern teams' processes to guide their performance. Chapter 11 discusses effective managerial communication. The part ends with a discussion of the importance of and how managers make decisions in their jobs (Chapter 12).

Part 4 explores the nature of managerial control activities. Chapter 13 examines basic evaluation and control challenges in organizations. By contrast, Chapter 14 discusses operations controls that managers can use. Finally, Chapter 15 concludes the book by exploring organizational change. It discusses how managers can take a proactive role to facilitate organizational renewal and development within their firms.

EXHIBIT 1.6 Who Succeeds? Who Doesn't?

Potential managerial leaders share traits early on:	Those who don't quite make it:	Those who succeed:
Bright, with outstanding track records	Have been successful, but generally only in one area or type of job.	Have diverse track records, demonstrated ability in many different situations, and a breadth of knowledge of the business or industry.
Have survived stressful situations	Frequently described as moody or volatile. May be able to keep their temper with superiors during crises but are hostile toward peers and subordinates.	Maintain composure in stressful situations, are predictable during crises, are regarded as calm and confident.
Have a few flaws	Cover up problems while trying to fix them. If the problem can't be hidden, they tend to go on the defensive and even blame someone else for it.	Make a few mistakes, but when they do, they admit to them and handle them with poise and grace.
Ambitious and oriented toward problem solving	May attempt to micromanage a position, ignoring future prospects; may staff with the incorrect people or neglect the talents they have; may depend too much on a single mentor, calling their own decision-making ability into question.	While focusing on problem solutions, keep their minds focused on the next position, help develop competent successors, seek advice from many sources.
Good people skills	May be viewed as charming but political or direct and tactless, cold, and arrogant. People don't like to work with them.	Can get along well with different types of people, are outspoken without being offensive, are viewed as direct and diplomatic.

Source: Adapted from M. W. McCall, Jr. and M. M. Lombardo, "Off the Track: Why and How Successful Executives Get Derailed," *Technical Report #21* (Greensboro, NC: Center for Creative Leadership, 1983), pp. 9–11. Copyright © 1983 Center for Creative Leadership. Used with permission.

Managerial Challenges from the Front Line

The Rest of the Story

We know from the opening profile that Blaine Halvorson and his partner Natalie Grof have built their company, Junk Food, into a highly successful organization. Halvorson was creative and took entrepreneurial risks but also learned, from his earlier experience, how to become an effective manager. In 2005, Delta Apparel acquired the company, making Halvorson and Grof wealthy individuals. However, part of the agreement was that Halvorson would remain with Junk Food and continue to build the business. It is his responsibility to continue taking Junk Food to new heights. For a few years Halvorson remained president and CEO, sharing the responsibilities with Grof. Then, he moved into the Chief Creative Officer position with the primary goal of building and expanding the brand. For example, he has been responsible for expanding the Junk Food's global sales and the increased market share achieved during the economic recession. He plans to extend the Junk Food brand to new products and to open Junk Food retail stores in the future.

Summary

- Management is the process of assembling and using sets of resources in a goal-directed manner to accomplish tasks in an organizational setting. It occurs in an organizational context.
- Managers face a number of significant challenges. Managerial challenges include managing change, managing resources, managing strategically, and managing entrepreneurially. Increasing technology and globalization has caused much organizational change, and companies must manage it effectively. Efficient management of resources is only part of the equation. Organizations must develop their resource portfolios and integrate resources to create capabilities that are then leveraged to achieve a competitive advantage. Managers select and implement a strategy designed to provide greater value to customers than do competitors. Finally, managers have to act entrepreneurially, even in large organizations, to identify and exploit opportunities.
- Management is an old concept dating back thousands of years; ancient Chinese rulers used management concepts of organization, specialization of labor, and strategy. The basis of modern management is traditionally thought to be scientific management proscribed by Frederick Taylor during the industrial revolution. However, a number of historical figures contributed to our knowledge of modern management. Other people have contributed to our knowledge of productivity (Frank and Lillian Gilbreth, for example), organization (Alfred Sloan and Chester Barnard), leadership (Mary Parker Follett and Douglas McGregor) and motivation (Abraham Maslow and Frederick Herzberg).
- What managers do can be understood through the functions that they perform. Among them are planning, organizing, directing, and controlling. Planning involves projecting the future conditions and tasks required to be successful in these conditions. Organizing involves identifying the appropriate structure of relationships among positions, and the people occupying them, and linking that structure to the overall strategic direction of the organization. Directing is the process of attempting to influence other people to attain organizational objectives with managerial activities such as leading, motivating, and communicating. Control is a necessary and important managerial function designed to regulate the work of those for whom a manager is responsible.
- A complementary way of viewing managerial work is through the roles they fill. Managerial roles comprise three major categories—interpersonal, informational, and decisional—each of which has specific roles. Interpersonal roles include the figurehead, leader, and liaison. Informational roles include monitor, disseminator, and spokesperson. The four decisional roles are entrepreneurial, disturbance handler, resource allocator, and negotiator.
- Managerial work can also be understood from the dimensions of managerial jobs. The dimensions include the demands and constraints placed on managers and the discretionary choices allowed by the job.
- To effectively perform the functions, fulfill the roles, and deal with the dimensions of the job, managers need several skills. Among these are technical, interpersonal, and conceptual skills. All of the skills are important, but the mix and levels of the skills required to be effective vary by type of managerial job and level in the organization.

Key Terms

controlling 13
directing 11
management 4
organization 4
organizing 11
planning 11

Review Questions

1. How is management defined, and what are its basic elements?
2. What are the four major challenges that managers face, and how do managers deal with them?
3. Who are the primary historical figures who have contributed to modern management, and what are their most important ideas?
4. What are the four primary functions of management and their contents?
5. What are the ten managerial roles and their importance to managerial work?
6. How does each of the three dimensions of managerial jobs contribute to managerial tasks?
7. What are the three primary managerial skills, and how does their importance vary with the type and level of a manager's job?

Assessing Your Capabilities

Managerial Core Values

Rank the following statements as to how important they would be to you as a manager (with 1 being most important and 16 being least important).

_____ Be professional
_____ Cooperate with others in the organization
_____ Make a profit in the short term
_____ Solve problems
_____ Achieve positive results
_____ Deliver quality outcomes
_____ Think in the long term
_____ Satisfy your client
_____ Communicate effectively with others
_____ Offer superior value to constituents
_____ Take risks in order to innovate
_____ Lead to serve others
_____ Motivate employees
_____ Enjoy your work
_____ Reach your goals
_____ Build and maintain relationships with others

There are no correct or incorrect answers, but the ranking suggests the core values that will underlie your actions as a manager. For example, if you give a high rank to cooperating with others, leading to serve others, building relationships, communicating effectively, and motivating employees, you are likely to emphasize a service role. Alternatively, if your highest rankings go to enjoying your work, making a short-term profit, and reaching your goals, your managerial activities are more likely to be opportunistic. Finally, if you highly rank solving problems, achieving positive results, delivering quality outcomes, and offering superior value, your managerial actions are likely to be results-oriented. Share rankings with a few classmates and discuss why they are different for each of you.

Source: Based on J. van Rekom, G. B. M. van Riel, and B. Wierenga, "A Methodology for Assessing Organizational Core Values," *Journal of Management Studies* 43 (2006): 176–201. Copyright © 2006. Used with permission.

Team Exercise

Form teams of three to five people.

The H. J. Heinz Company has made a number of significant changes in its operations since 2002, when it spun off several noncore businesses. Some attribute the changes to Nelson Pelz, a hedge fund manager and activist investor, who acquired over 5 percent of Heinz stock as an activist investor. Others attribute the changes and performance improvement over time to the management of Heinz CEO William Johnson.

Obtain information about the company and the changes it has made over time. The following Web sites might be useful:

www.heinz.com/heinz.aspx

http://www.heinz.com/our-company/investor-relations.aspx

For links to up-to-date information on the Heinz Company, the following Web site may be helpful: http://www.alacrastore.com/company-snapshot/H_J_Heinz_Company-1007855

Analyze the information you obtained and, as a team, answer the following questions.

1. What major challenges have Heinz managers faced over the last five years?
2. What managerial functions are evident in the actions Johnson has taken to improve his company's performance? Please link the actions and functions.
3. What managerial roles are displayed in Johnson's actions? Please relate the actions to specific roles.

Closing Case FedEx's Successful Internationalization

Companies desiring to compete in global markets need to be flexible in how, where, and what they provide customers. As early as 1979, FedEx founder Fred Smith acknowledged that customer needs were constantly changing, and to be successful FedEx would need to implement strategies to help it become mobile and flexible and at the same time ensure strong customer satisfaction. Through a series of buyouts, FedEx implemented successful strategies in Asia. Simultaneously, the firm implemented innovative technologies, creating a seamless experience for international customers using its services.

It was no accident that FedEx became the premier carrier servicing Asia. As early as the 1980s, Smith recognized the growing market in China and knew that Asia would become an economic powerhouse. So, in 1984, FedEx launched operations in China and began the first direct express flight to the mainland in 1996. In 1989, FedEx paid $895 million to buy Tiger International Inc., a struggling hauler with rights to fly into most Asian airports and a management team familiar with the Pacific Rim. Wall Street did not like this decision because of Asia's unpredictability, but FedEx saw the potential in this region. The decision turned out to be highly profitable. FedEx's business in Asian countries has soared, with a dramatic increase in the volume of goods shipped over FedEx's international network and much of the growth coming from Asia. In January 2006, FedEx spent $400 million to buy out its partner in China, Tanjin Datian W Group, giving FedEx full control over Datian's trucking fleet and 89 distribution hubs. It also gave FedEx more control over services in secondary Chinese cities that are becoming more linked to the global economy as manufacturers shift factories further inland as they flee increasing labor costs in coastal regions. FedEx closed its Asian hub in the Philippines in 2008 and built a new $150 million super hub in the heart of Guangzhou, one of China's fastest-growing manufacturing districts. To provide seamless services, FedEx recognized the need to provide all types of services that identify communication needs and in 2004 rebranded all of its companies to make customers aware of the breadth of its services.

Implementing the proper IT system to assist FedEx with the challenges of growing internationally was equally important. FedEx managers realized that an IT system must take into account the idiosyncrasies of different countries, custom authorities, and individual needs. FedEx knew that, to provide detailed and accurate information to customs about customer shipments, it had to automate and electronically track all shipment documentation. So, FedEx installed the technology for customs authorities to review the documentation, in turn, simplifying the customs process and giving them the ability to identify and examine the inbound manifest of shipments quickly and accurately. The IT system also gives customers seamless clearance through customs, plus visibility of their shipments and customs procedures through to a receipt. A customer can go online from anywhere to conduct a transaction or track a shipment. FedEx also administers its own IT operations and develops much of its own technology. In order to achieve this, it has a large team of developers and IT personnel.

These initiatives have helped make FedEx successful, especially in the Asian market. FedEx continues to expand its operations in Asia, opening a freight forwarding office in India in early 2010. In fact, during 2008–2010, it opened 22 freight forwarding offices in international locations such as London, Brussels and Mexico City. Additionally, in 2010, FedEx announced the start of a new international supply chain service called International DirectDistribution. The intent is to provide a single rapid, flexible solution that increases the speed to market and reduces cost. It consolidates multiple packages, bypasses distribution centers, and streamlines customs clearance, thus delivering goods quickly to their final destination. The company's managers realized that in order to be successful, they needed to respond quickly to the changes and new challenges of the "flatter" world. FedEx has been one package ahead of its competitors as a first mover in areas throughout the world.

Questions

1. Why has FedEx been so successful in Asia?
2. Can competitors imitate FedEx's approach in international markets and take market share away from the company? Why or why not?
3. Is the FedEx move to close its hub in the Philippines and build a new one in China a good decision for its Asian operations? Explain.
4. Can you identify the application of the managerial functions of planning, organizing, and controlling in FedEx activities? Explain.

Sources: "FedEx Launches New International Freight Service," *FleetOwner,* January 29, 2010, http://www.fleetowner.com/management/news/fedex-international_freight; H. Chemikoff, "Update 3-FedEx Opens First India Freight Forwarding Offices," Thomson Reuters, February 11, 2010, http://www.reuters.com/assets; J Bourke, "FedEx Opens British Freight Forwarding Offices," *RoadTransport.com,* February 18, 2010, http://www.roadtransport.com/articles; D. Goulden, "Managing IT for a Flat World," *BusinessWeek,* October 2, 2006, http://www.businessweek.com; D. Foust, "FedEx," *BusinessWeek,* April 3, 2006, http://www.businessweek.com; A. Counsell, "Doing More Faster and Better," *Financial Times,* February 14, 2006, http://www.ft.com; C. Shevlin, "Move out of Range to Think out of the Box," *Financial Times*, August 19, 2004, http://www.ft.com; S. Murray, "Putting the House in Order," *Financial Times,* November 8, 2006, http://www.ft.com; "FedEx Completes Acquisition of DTW Group," *BusinessWeek,* February 28, 2007, http://www.businessweek.com; Corporate Web site, "FedEx Reports Solid Revenue and Earnings Growth," http://www.fedex.com/us/investorrelations.com, accessed December 20, 2006.

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2 Social Responsibility and Managerial Ethics

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

Describe why an understanding of basic approaches to ethical decision making and corporate social responsibility is important.

Compare and contrast the efficiency and social responsibility perspectives.

Explain the strategic corporate social responsibility approach.

Explain the basic approaches to ethical decision making.

Explain the aspects of moral intensity.

Describe the actions that can foster a high degree of ethical behavior in an organization.

Half Price Books

Managerial Challenges from the Front Line

Name: Sharon Anderson Wright

Position: CEO, Half Price Books

Outside work activities: Literacy and family literacy efforts; personally committed to Half Price Books' mission of preserving the environment by reusing and recycling.

First job out of school: Began working for Half Price Books at the age of 13, sorting and shelving paperbacks.

Management style: Collaborative

Reportedly, Sharon Anderson Wright likes finding a good deal at a thrift store. This would probably not surprise you, unless you knew that Wright is the head of Half Price Books, the largest used-book company in the country. Half Price Books was a company begun by Wright's mother, Pat Anderson along with her boyfriend, diamond salesman Ken Gjemre, in 1972. They opened their first store in a converted Dallas launderette. Anderson wanted to save trees by recycling unwanted books. "Nobody was recycling books then," says Wright. "They hated seeing all this great stuff thrown away." Over the years Half Price Books has recycled 16 million books and saved over 650,000 trees.

Today, Half Price Books has 2,500 employees and generates over $210 million in annual sales. It has nearly 100 stores in 16 states. (Most of the stores are in Texas.) It buys and sells books, magazines, and recorded material from individuals as well as leftover stock from publishers. The company sponsors literacy programs around the country and donates over 1 million books a year to schools, prisons, and hospitals all over the world. "These books are like manna from heaven to low-income families." Says Michael Hirschhorn, president of the National Alliance of Urban Literacy Coalitions. Besides donating books, the company is dedicated to recycling. Wright also encourages her employees to pursue their own philanthropic activities. "It enriches their lives," she says, "and they enrich ours."

Half Price Books' success has created its own challenges, however. On the one hand, every new store it opens employs people in the community. On the other hand, expansion has meant that the company and its managers have had to invest money in information, finance, and other systems to properly run the business. These investments coupled with rising health care costs have squeezed margins to the point where the company had to decide recently whether to continue paying health care benefits for its part-time employees. The company had always provided both its full-time and part-time employees with the benefits.

You may be wondering, "Why should I care about corporate social responsibility or managerial ethics or whether or not my employees have health care benefits? Aren't these the types of issues philosophers worry about?" To answer this question, you only need to pick up a recent newspaper or business magazine. Everything from Wall Street trading scandals to accounting frauds at AIG, Lehman Brothers, Enron, Parmalat, Satyam, WorldCom, Tyco, and Global Crossing to corporate cover-ups and massive oil spills from British Petroleum's offshore drilling rig explosion in the Gulf of Mexico seem to be in the press daily. For example, Citicorp lost billions in market value when it was revealed that a group of traders in the firm's London office had manipulated the bond market: A small set of traders disrupted the European bond market by placing 188 sell orders simultaneously (approximately $20 billion worth of bonds) on August 2, 2004 in about 18 seconds. This drove the price of bonds, in general, down dramatically. The prices continued to drop even after the Citibank traders stopped selling. Just a few minutes later, the same traders then bought the bonds back at much cheaper prices than they had been sold. This new buying triggered buying by other traders, and prices rose. In the process, Citibank traders made about $20 million in profits in under five minutes. Although the employees did not do anything illegal, their behavior was deemed unethical. In the end, Citicorp paid a $28 million fine to the Financial Service Authority for "failing to conduct its business with due skill, care and diligence, and failing to exercise proper controls over the London bond trading team."[1]

Individual or corporate decisions that are judged to be wrong, either ethically or legally, can not only hurt those directly affected by the decisions but can boomerang to generate

negative publicity, hurt a company's stock price, destroy shareholder value, and, as a consequence, make it difficult for the individual to get future employment or for a firm to recruit high-quality employees. In contrast, good managerial ethics and corporate social responsibility generate significant, positive consequence for employees, customers, shareholders, and communities.

How the Ethics of Individual People Develop

managerial ethics
the study of morality and standards of business conduct

At its heart, **managerial ethics** is concerned with morality and standards of business conduct, especially among individuals. Managerial ethics begins at the top of the organization.[2] For ethical decisions and practices to permeate the firm, top executives must build a culture based on those values. This includes establishing codes of ethics, implementing ethics training for employees, and rewarding ethical behaviors (as we discuss later in this chapter). Moreover, it includes top executives behaving in an ethical manner *themselves.*

Although top managers can have an impact on the ethical (or unethical) behavior that occurs in a firm, much of what influences someone's perspective on what is or is not ethical happens long before he or she begins working. Consider your personal situation: what role have your family, friends, peers, teachers, religion, job experiences, and life experiences played in helping to shape your ethical beliefs? Think about a situation in which someone made an ethical judgment different from your own. Suppose you had been born in a different country, raised by a different family, attended a different school system, experienced different religious influences, had different friends, and held different jobs: would you hold the same ethical values you do now and make the same ethical judgments?

There is little debate that family, friends, peers, teachers, religion, job experiences, and life experiences all play a significant role in the development of an individual's ethical values and judgments.[3] What is debated is which factors play the strongest role because their influence varies from person to person.[4] This debate is unlikely to be resolved soon, nor is its resolution necessary for our purposes. The primary reason for raising the issue is to realize that in order to understand how others make decisions, you need to understand something about their backgrounds.[5]

Simply labeling other ethical judgments as wrong is likely to foster feelings of mistrust (in both directions) and hurt your working relationships. The greater the diversity in the workforce, the greater the need for tolerance and understanding. However, as a manager, tolerance does not mean simply allowing your subordinates to come to whatever ethical decisions they individually deem right. Because individual decisions can have consequences for the organization, managers often need to shape and influence their subordinates' ethical thinking, judgment, and decision making.

Consider the following real case conveyed to us recently. (We have disguised the names at the manager's request.) You are a manager in a publishing company. Your assistant manager has just recruited a new employee, Martha, from a key competitor. Martha worked for your competitor for 11 months after graduating from college. Even though Martha held a junior position at a competing company, her position provided access to key strategic plans. Given her somewhat junior position in the company, she had not been asked to sign, nor had she signed, a "noncompete" clause that would have prevented her from taking a job with a competitor for a specific time period or disclosing the strategic knowledge she had gained while working for the competing company. Your assistant manager has proposed paying Martha a $10,000 signing bonus—something unusual for a junior hire. Martha had performed well enough to earn a $10,000 bonus at the competing company but would be entitled to it only if she stayed on for a full 12 months. Given the time-sensitive nature of some of the information Martha has, you would rather have her join you now. Should you pay the signing bonus? Is it simply a legitimate replacement for the bonus Martha would have earned had she stayed on at your competitor? Or does the signing bonus constitute payment for the competitive intelligence you expect Martha to share once she joins your firm? And if it is, do you have any ethical misgivings about using a signing bonus as a means of securing competitive intelligence? Suppose your competitor pays Martha her end-of-year bonus before she completes a year of service: would that have any bearing on what you would expect her to reveal to you or whether you would still pay the signing bonus? If you were

Martha, would your ethical perspective on the money or revealing competitive intelligence change under these varying scenarios?

How should you make decisions like these? Are there ethical approaches you can look to for guidance? The answer is that there are some basic approaches, and they have been around for a long time—in part, because the challenge of ethical decision making is not something new. Having to make a choice between two competing but arguably valid options is known as an **ethical dilemma.** People have faced ethical dilemmas throughout history.

ethical dilemma
having to make a choice between two competing but arguably valid options

ethical lapse
decision that is contrary to an individual's stated beliefs and policies of the company

In the next section, we will describe these basic approaches for two reasons. The approaches can help you (1) understand how other people approach ethical dilemmas and (2) avoid an **ethical lapse**—that is, a decision that is contrary to one's stated beliefs and company policies.

Again, it is important to keep in mind that the workforce is becoming increasingly diverse. As a result, now more than ever before, you are likely to encounter people who respond to ethical dilemmas differently. Research finds significant differences among managers from different nationalities.[6] For example, one study examined the extent to which salespeople from the United States, Japan, and Korea viewed a set of actions as posing an ethical issue.[7] Koreans in the study did not think it was unethical to ask customers what price a competitor had quoted them, whereas the Americans and Japanese generally did think it was unethical. What do you think? Do you think asking a customer for information on the price submitted by your competitors is ethical or not?

From this same international study, researchers found that Korean salespeople did not think that giving free gifts constituted an ethical issue, while American salespeople did. General Motors shares this "American" view and has a policy that restricts the giving of gifts. For example when golfing with the president of the Philippines and discussing the possibility of a new GM factory in the country, the president of GM's Asia Pacific region was prohibited by company policy from paying for his guest's golf game. Do you think GM's policy is appropriate, or has it gone too far?

Even within a culture, ethical judgments vary. In one recent study, researchers found that individuals in a marketing department were less likely to judge interactions with customers as unethical as compared to peers in other functions such as HR or operations.[8]

Without understanding how or why others come to different conclusions, it is easy to criticize those who hold those beliefs as "wrong." For example, in a recent study, Chinese and Australian auditors working for the same multinational accounting firms reached different decisions about proper ethical conduct because of different cultural assumptions. Chinese auditors looked to their peers whereas Australian auditors looked to themselves for guidance in making ethical decisions. This reference point reflects the cultural group orientation of Chinese and the individual orientation of Australians.[9] If either set of auditors simply judged the other wrong without any sensitivity to how culture might influence ethical decisions, imagine how difficult it might be for them to work together on a global audit team. Research has shown that *ethnocentricity*—the view that your perspective is correct and the views of people in other cultures are inferior—tends to hurt managerial effectiveness. This is especially true in culturally diverse or international contexts.[10] So, it is important for new managers to examine the basic approaches to ethical decision making and recognize that individuals' backgrounds, including cultural values, influence their decisions and behavior.

As we stated, the second reason for examining basic approaches to ethical decision making is to avoid ethical lapses. Ethical lapses are more common than you might think. The pressures emanating from both the external environment and internal company environment often can be overwhelming. This is especially true if managers lack a systematized way of thinking through dilemmas. For example, suppose you were a sales manager about to report your current quarterly sales. You are short of your target. The policy is that you can only report sales for which a contract has been signed. You have a signed letter of intent but not a contract from a customer—a customer who has purchased from you before. The value of the deal will take you over your target and will trigger a bonus for you and the salesperson in charge of this account. The salesperson has told you that if the sale goes through, the customer will sign a contract dated prior to the close of the quarter. You barely missed your sales target last quarter. The company has a strong performance culture. In other words, if you don't perform, you don't have a career with that company. Under pressures like these, can you imagine how it might be possible to make a decision contrary to your stated beliefs?[11]

Basic Approaches to Ethical Decision Making

Several frameworks, or approaches, to making ethical decisions exist. We examine four of the most common: the utilitarian, moral rights, universalism, and justice approaches. An understanding of the basic approaches to ethical decision making will help you as a manager to examine your own personal ethics and work more effectively with employees whose ethical perspectives are different because the approach you use does have an impact on whether you judge something as ethical or unethical.[12]

The Utilitarian Approach

The utilitarian approach focuses on consequences of an action. Simplified, using a **utilitarian approach,** you try to make decisions that result "in the greatest good." For example, assume you are trying to sell grain to a developing nation, and a customs agent demands an extra fee before he will clear your shipment. From a utilitarian perspective, you would try to determine the consequences of the options available to you. For example, you could (1) pay the money, (2) not pay the money and let the grain sit there, or (3) seek intervention from a third party. Which action would result in the greatest good? If there are starving people waiting for the grain, would you argue that the "good" of saving lives outweighs the "bad" of paying an illegal bribe?

utilitarian approach
focuses on the consequences of an action

When characterizing an outcome as "good" or "bad," keep in mind that any two people may see the same outcome differently. In other words, the "goodness" or "badness" of an outcome is often subjective. Factors such as culture, economic circumstances, and religion can all affect those subjective judgments. For example, what if keeping the shipments of grain moving was needed to keep 2,000 people employed? Would you argue that the good of saving 2,000 jobs justified paying off government officials? What if unemployment were high in the region?

The Moral Rights Approach

The **moral rights approach** to ethical decisions focuses on an examination of the moral standing of actions independent of their consequences. According to this approach, some things are just "right" or "wrong," independent of consequences. When two courses of action both have moral standing, the positive and negative consequences of each should determine the more ethical course. Using this approach, you should choose the action that conforms with moral principles and provides positive consequences.

moral rights approach
focuses on examination of the moral standing of actions independent of their consequences

To illustrate: suppose you have an ongoing supplier relationship but no written contract. Is it ethical to cut off the supplier with no warning in order to switch to a different supplier with lower prices? From a moral rights approach, if it is wrong not to honor unwritten commitments to suppliers, it could be argued that it would be unethical to cut the supplier off with no warning. Conversely, if operating without a contract is simply a business convenience, you might easily make the case that changing suppliers is just a matter of business, not ethics.

The managerial challenge here is that the moral standing of most issues is debatable. For example, you might say it is wrong to lie. But is it wrong to make your competitors think you are about to enter one market when you are really about to enter another so as to gain a competitive advantage over them? Is it wrong to say you are not working on a new technology when you actually are in order to divert competitors from investing in the technology and thereby enjoy an advantage when you finally perfect the technology? Some would say that this is exactly what Apple did when Steve Jobs in 2003 said, "I'm not convinced people want to watch movies on a tiny little screen," while Apple was actually hard at work on its fifth-generation iPod that would include video capabilities.[13] In the same interview, Jobs also said he didn't think Apple would do well in the cell phone business: yet at that time, Apple was already at work on its smash hit, the iPhone.

The Universal Approach

Immanuel Kant, perhaps one of the most famous moral philosophers, articulated the best-known ethical imperative, or **universal approach.** Simplified, Kant's moral imperative was "do unto others as you would have them do unto everyone, including yourself." If you follow this

universal approach
choosing a course of action that you believe can apply to all people under all situations

approach, you should choose a course of action that you believe can apply to all people under all situations and that you would also want applied to yourself. At the heart of universalism is the issue of rights. For Kant, the basis of all rights stem from freedom and autonomy. Kant believed that actions that limit the freedom and autonomy of people generally lack moral justification. Now let's return to the customs agent and bribe scenario we just discussed. Based on the universal approach, it might be difficult to justify paying bribes to government officials. To meet the "do unto others as you would have them do unto everyone" criterion, you would have to be willing to let everyone use bribes as a means of getting the ends they desired.

The Justice Approach

justice approach
focuses on how equitably the costs and benefits of actions are distributed

The **justice approach** focuses on the equity of process and outcomes.[14] In general, costs and benefits should be equitably distributed, rules should be impartially applied, and those damaged because of inequity or discrimination should be compensated.

distributive justice
the equitable distribution of rewards and punishment, based on performance

DISTRIBUTIVE JUSTICE Managers ascribing to **distributive justice** distribute rewards and punishments equitably based on performance. This does not mean that everyone gets the same or equal rewards or punishments; rather, they receive equitable rewards and punishments as a function of how much they contribute to or detract from the organization's goals. From this perspective, it would be wrong for a manager to distribute bonuses, promotions, or benefits based on such arbitrary characteristics as age, gender, religion, or race. This is the basic rationale behind the U.S. Civil Rights Act of 1964. Under this law, even if a manager has no intention of discriminating against a particular minority group, if a minority group can demonstrate inequitable results (called *disparate impact*), legal action can be brought against the firm. For example, if 50 percent of a firm's applicants for promotion were women, but 75 percent of those receiving promotions were men, the data could be used to file a claim of discrimination based on the underlying notion of distributive justice.

procedural justice
ensuring that those affected by managerial decisions consent to the decision-making process and that the process is administered impartially

PROCEDURAL JUSTICE Managers ascribing to **procedural justice** make sure that people affected by managerial decisions consent to the decision-making process and that the process is administered impartially.[15] Consent means that people are informed about the process and have the freedom to exit the system if they choose. As with distributive justice, the decision-making process cannot systematically discriminate against people because of arbitrary characteristics, such as age, gender, religion, or race. Recent research involving employees across multiple countries consistently suggests that perceived justice relates positively to desired outcomes such as job performance, trust, job satisfaction, and organizational commitment and negatively relates to outcomes such as turnover and other counterproductive work behavior.[16] Procedural justice is generally studied and interpreted within the context of the organization. However, the findings of a recent study show that factors external to the firm can also have strong effects: In one study, violent crime rates in the community where a plant resided led researchers to correctly predict that workplace aggression in that plant would increase, whereas the plant's procedural justice climate did not.[17]

compensatory justice
if distributive and procedural justice fail, those hurt by the inequitable distribution of rewards are compensated

COMPENSATORY JUSTICE The main thesis of **compensatory justice** is that if distributive justice and procedural justice fail or are not followed as they should be, then those hurt by the inequitable distribution of rewards should be compensated. This compensation often takes the form of money, but it can take other forms. For example, compensatory justice lies at the heart of affirmative action plans. Typically, affirmative action plans ensure that groups that have been systematically disadvantaged in the past, such as women or minorities, are given every opportunity in the future. For example, special training programs could be instituted for women who were passed over for promotions in the past because they were denied access to certain experiences required for promotion.

Recent research has also focused on interpersonal and informational justice. Interpersonal justice focuses on the polite, respectful treatment of people. Informational justice focuses on the timely communication or reasonableness of explanations of organizational actions. Research suggests that employees' perceptions of interpersonal justice and informational justice in the workplace have a positive impact on such outcomes as trust in management, job satisfaction, commitment to the organization, and intent to stay with the organization.[18]

Some of the most recent research suggests that "emergent" justice rules fall outside the traditional categorizations. For example, employees may use such factors as a pleasant working environment and development opportunities in assessing the fairness in an organization or consider a supervisor's accommodating and developmental behavior in assessing the supervisor's fairness. In fact, one recent study of managers found that 76 percent utilized at least one emergent rule in ascribing fairness and only 28 percent used one of the three traditional justice rules.[19] Whatever the justice rules, people cannot be relied on to consistently hold to them. Recent research has also found that people vary by nearly 20 to 30 percent over a period as short as eight weeks.[20]

The Moral Intensity Factor

As this chapter points out, one of the challenges in managers' ethical decision making is that for many issues and consequences, people do not have identical perspectives. They differ in whether they see a situation as involving ethics and in how they would determine their course of action. So the practical question is whether managers can help people come to a common viewpoint on the "moral intensity" of issues.[21] **Moral intensity** is the degree to which people see an issue as an ethical one. Moral intensity has six components, as illustrated in Exhibit 2.1: (1) magnitude of the consequences, (2) social consensus, (3) probability of effect, (4) temporal immediacy, (5) proximity, and (6) concentration of effect.[22] In other words, the overall moral intensity of a situation is the cumulative result of all of these components. As a manager, you can use this framework both to anticipate the moral intensity of an issue and to diagnose the reasons for differing views people have about that intensity.[23]

moral intensity
the degree to which people see an issue as an ethical one

The **magnitude of the consequences** associated with the outcome of a given action is the level of impact anticipated. This impact is independent of whether the consequences are positive or negative. For example, laying off 100 employees because of a downturn in the economy has a lower impact than if 1,000 employees were laid off. Likewise, many people would judge the consequences of a 20 percent increase in the price of lawn fertilizer to be of a lower magnitude than an explosion in the fertilizer plant as the result of poor safety procedures, in which 500 people were killed or seriously injured.

magnitude of the consequences
the anticipated level of impact of the outcome of a given action

Social consensus involves the extent to which members of a society agree that an act is either good or bad. For example, in the United States, there is greater social consensus

social consensus
the extent to which members of a society agree that an act is either good or bad

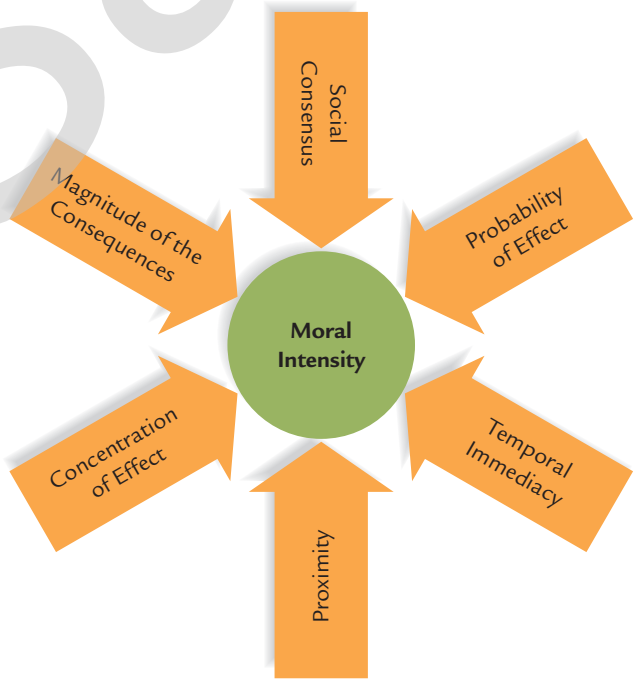


EXHIBIT 2.1

Factors of Moral Intensity

concerning the wrongness of driving drunk than speeding on the highway. Recent research suggests that social consensus is potentially one of the more powerful dimensions of moral intensity.[24]

probability of effect
the moral intensity of an issue rises and falls depending on how likely people think the consequences are

Probability of effect concerns the likelihood that a given consequence will happen. For example, even if people agree that 500 people dying from a chemical explosion is a very bad consequence, the intensity of the issue rises and falls depending on the perceived likelihood of a chemical explosion. For example, one of the reasons so many countries have restricted cigarette advertising is because smoking can cause health problems, including serious ones such as lung cancer. However, cigarette ads and smoking itself have not been completely outlawed in part because the probability of health problems is not 100 percent. The higher the probability of the consequence, the more intense the sense of ethical obligation. Because people are highly likely to be injured if they are in a car accident, the intensity regarding the moral obligation of auto manufacturers to make safer cars with options such as side-impact air bags is increasing. However, because there is no certainty that you will be in an automobile accident, the law does not require many of the available safety features.

temporal immediacy
a function of the interval between the time the action occurs and the onset of its consequences

Temporal immediacy is the fourth component of moral intensity. It is a function of the interval between the time an action occurs and the onset of its consequences. The greater the interval between action and consequences, the less intensity people typically feel toward the issue. For example, even if industrial pollution were certain to lead to global warming and result in catastrophic changes to weather patterns, because the consequences are likely to happen 50 years or more from now, the moral intensity of industrial pollution is much less than if the effects were to happen next year.

proximity
the physical, psychological, and emotional closeness the decision maker feels to those affected by the decision

Proximity refers to an individual's physical and psychological closeness to the outcome. All other factors being equal, the closer the decision maker is or feels to those affected by the decision, the more the decision maker will consider the consequences of the action and feel it has ethical implications. Proximity can involve physical closeness as well as psychological and emotional closeness and identification. Consequently, an affinity between the decision maker and those affected could be a function of many factors, including people's nationality, cultural background, ethnic similarity, organizational identification, or socioeconomic similarity. For example, if you feel a psychological and emotional affinity for young people, making a decision to lay off workers based on their seniority (meaning younger workers will get laid off first) will have greater moral intensity for you. Likewise, a decision to close down a poor-performing but slightly profitable factory that could put your parents and neighbors out of work will also likely have greater moral intensity for you than would the closing of a different factory. Recent research suggests proximity may be an especially powerful dimension.[25]

concentration of effect
the extent to which consequences are focused on a few individuals or dispersed across many

The **concentration of effect** is the extent to which consequences are focused on a few individuals or dispersed across many. For example, even though laying off 100 people has a lower magnitude of effect than laying off 1,000 people, laying off 100 people in a town of 5,000 has a greater concentration of effect than laying off 1,000 people in city of 10 million.

The importance of these six facets of moral intensity is twofold. First, as a manager, you can use them to anticipate issues that are likely to be seen as significant ethical dilemmas in the workplace.[26] If you can better anticipate issues that are likely to become ethical debates, you have more time to prepare for and may be more effective at handling ethical dilemmas. Second, if you are working with a group that uses the same basic ethical approach and still can't agree on the ethical course of action, you can use these facets to determine the source of the disagreement.[27] The disagreement may stem from different perceptions of the situation on one or more of the moral intensity components.

Nike had to deal with a lot of negative media coverage regarding the alleged use of child labor in factories it did not own but that manufactured its shoes and other products (see A Manager's Challenge, "Laboring for Nike Around the World"). Nike executives were both caught off-guard by the intensity of the global and domestic public scrutiny and somewhat unprepared to respond at first. If Nike executives had used the moral intensity framework, could they have better anticipated and predicted public reaction? Would the framework have helped them make some anticipatory changes in how they managed the manufacturers around the world that make Nike's shoes?

GLOBALIZATION

A MANAGER'S CHALLENGE

Laboring for Nike Around the World

Nike has always wanted the spotlight on its products and this is one of the reasons that it has sponsored some of the most visible stars across golf, basketball, soccer, track and field, and other sports. However, in the late 1990s, when the spotlight began to focus on Nike factories and the over 400,000 workers laboring in those factories, Nike executives were not so happy with the media attention. According to critics, employees at these factories experienced substandard working conditions, such as exposure to carcinogens and other dangerous toxins, poor ventilation and/or air quality, forced overtime, sexual harassment, and corporal punishment and abuse. In addition, critics argued, workers did not receive a fair wage and many employees were too young to legally work.

Nike quickly responded by pointing out that these were contract manufacturers and that Nike did not own any of the factories or directly employ any of the workers. Groups like the Fair Labor Association, or FLA (www.fairlabor.org), however, felt that Nike's response, rather than appease the public, only demonstrated that its executives were evasive or trying to hide from the truth.

This episode marked the beginning of what chairman and founder, Phil Knight, described as four key "chapters" in Nike's efforts to improve conditions:

> In the first chapter, we upgraded processes and conditions behind closed doors. The second chapter began with critics bringing working conditions in underdeveloped countries to the attention of the world. After a bumpy original response, an error for which yours truly was responsible, we focused on making working conditions better and showing that to the world.

Reflecting back on the second chapter of Nike's response, in 2009 president and CEO Mark Parker commented:

> In the early 90s, we came under intense scrutiny for labor conditions in our supply chain. Our critics were smart (and right) to focus on the industry leader. Our first reaction was to defend the practices in the developing economies. . . . In those days the Internet was brand new, but we began to see the power of instantaneous information and new communities enabled on a global scale. . . . We learned to view transparency as an asset, not a risk.

Peter Charlesworth/OnAsia Images Pte Ltd.

Nike contracts with other companies to manufacture its sporting goods. Frequently these companies outsource the work to factories with low-cost labor in countries abroad, similar to this factory in Ho Chi Minh City, Vietnam. In recent years, numerous human rights organizations have called attention to the terrible conditions workers at these factories endure, casting Nike in a negative light. If Nike executives had used the moral intensity framework outlined in the text, could the company have averted the bad publicity?

The third chapter of Nike's response began in 2003 when Nike and a handful of other apparel companies allowed the FLA to post factory condition audits on the Internet. According to the FLA's 2006 annual report, 856 of Nike's factories were subject to FLA audits and the FLA made 22 independent visits. For its own internal audits, Nike employed a staff of 1,000 labor-practices managers to run a program called Safety, Health, Attitude of Management, People, and Environment (SHAPE). According to the FLA, Nike conducted 509 SHAPE assessments and gathered base-level environmental, safety, and health data on 650 factories in 52 countries. It also conducted 99 pre-sourcing evaluations. Of these, 80 factories were approved and 19 were rejected. Nike has also agreed to apply U.S. safety standards for air quality to its foreign suppliers and converted its use of toxic chemical solvents to water-based products in assembling its footwear. The firm has also increased the age requirements for its subcontractors Footwear manufacturers must employ workers who are at least 18 years old; apparel workers, at least 16 years old. These standards exceed those established by the International Labor Organization.

(*continued*)

Nike's fourth chapter began in earnest in 2005. CEO Mark Parker commented:

> We thought that we could be a unilateral force for systemic change. Instead, we learned that meaningful reform was not going to come from external pressure alone. Awareness and monitoring of any mandated Code of Conduct had to be embraced and enforced at the local level. And it had to be based on real business-based solutions driven by strong market signals. If we are to enable systemic change, we can't do it alone. We need partners. We need collaboration from industry, civil society and government. And we need to show the real benefits of lean manufacturing and human resource management.

Nike's fourth chapter continues today at a more collaborative level with external organizations than ever before. Still, Nike faces several practical challenges when it comes to improving contractors' factories. For example, when conditions are substandard and contract manufacturers do not improve, ultimately Nike can withdraw its contracts from noncompliant factories. However, even this is a challenge, as it found in Indonesia when it terminated a contract with a substandard supplier. All of the company's 7,000 workers lost their jobs because Nike projects constituted 100 percent of the factory's work.

CEO Mark Parker summarizes Nike's past and future this way:

> I believe our work in sustainable business and innovation has equal potential to shape our legacy. For that to happen, we have to focus on the lessons we've learned:
>
> - Transparency is an asset, not a risk.
> - Collaboration enables systemic change.
> - Every challenge and risk is an opportunity.
> - Design allows you to prototype the future, rather than retrofit the past.
> - To make real change, you have to be a catalyst.
> - There is now only one path and it leads to greater sustainability, equity, growth and prosperity.

Sources: Nike, *Corporate Responsibility Report FY 07, 08, 09*; Fair Labor Association, *2006 Annual Public Report*; Nike, *Fiscal Year 2004 Corporate Responsibility Report*; A. Maitland, "Big Brands Come Clean on Sweatshop Labor," *Financial Times,* June 10, 2003; D. Akst, "Nike in Indonesia, Through a Different Lens," *New York Times*, March 4, 2001.

Social Responsibility

Corporate social responsibility is concerned with the obligation corporations have to constituencies and the nature and extent of those obligations. Companies have a wide variety of constituencies, including current shareholders, customers, employees, specific communities, society at large, governments, and so on. These constituencies typically have expectations of companies but do not always share the same expectations. In many instances, they have competing desires. For example, shareholders may want companies to maximize their returns, whereas local communities may want companies to give something back to them. Do companies have a higher obligation to shareholders or the specific communities in which they operate? Suppose a company's trucking activities created noise pollution that bothers citizens but falls well within the legal limits. Should the company take money from shareholders by paying them lower dividends and investing that money in exhaust and muffler systems in order to reduce engine noise? Suppose the safety standards for brakes on the trucks were different in two neighboring countries. Should the firm insist on the higher of the two standards for all its trucks and as a consequence pay the extra cost? Do all their truck drivers, regardless of their nationality or employment location, have the same rights when it comes to equipment standards, such as those for brakes?

Questions such as these form the substance of social responsibility debates. Both corporate social responsibility and managerial ethics focus on the "oughts" of conducting business. Although several approaches to corporate social responsibility exist, an examination of two fundamental perspectives will help you reflect on how you personally view the issue and how you might effectively interact with others holding differing perspectives.

The Efficiency Perspective

efficiency perspective
the concept that a manager's responsibility is to maximize profits for the owners of the business

Perhaps no contemporary person presents the **efficiency perspective** of social responsibility more clearly than the late Nobel Prize-winning economist Milton Friedman.[28] Quite simply, according to Friedman, the business of business is business. In other words, a manager's responsibility is to maximize profits for the owners of the business. Adam Smith is perhaps the earliest advocate of this approach. Smith concluded nearly 200 years ago that the best way to advance

the well-being of society is to place resources in the hands of individuals and allow market forces to allocate scarce resources to satisfy society's demands.[29]

MANAGERS AS OWNERS When a manager of a business is also its owner, the efficiency perspective argues that the self-interests of the owner are best achieved by serving the needs of society. If society demands that a product be made within certain environmental and safety standards, it is in the best interests of the owner to produce the product to meet those standards. Otherwise, customers will likely purchase competing product from rivals. Customers are more likely to purchase from firms that comply with widely shared and deeply held social values, so it makes sense for businesses to incorporate those values into their operations and products. To the extent that the cost of incorporating society's values is less than the price customers are willing to pay, the owner makes a profit.

Critics of the efficiency perspective, however, argue that quite often customers and society in general demand safety, environmental protection, and so on only after firms have caused significant visible damage. For example, society might hold strong values about not polluting the water and causing heath problems. However, if the consequences of polluting a river are not visible and people are not immediately hurt, social pressure might not emerge in a manner to cause the owner to align his actions with societal values until years after the fact.

MANAGERS AS AGENTS In most large organizations today, the manager is not the owner. The corporate form of organization is characterized by the separation of ownership (shareholders) and control (managers). Managers serve as the agents of the organization's owners. Within this context, Friedman argues that managers should "conduct business in accordance with [owners'] desires, which will generally be to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom."[30] From Friedman's perspective, managers have no obligation to act on behalf of society if it does not maximize value for the shareholders. For example, a company should package products in recycled paper only if doing so maximizes shareholder wealth. Whether such an action satisfies or benefits a small group of activists is irrelevant. Managers have no responsibility to carry out such a program; in fact, they have a responsibility *not* to undertake such an action if it is more costly (and therefore does not maximize shareholder wealth). Similarly, charitable donations are not the responsibility of corporations. Instead, managers should maximize the return to shareholders, and then shareholders can decide if and to which charities they want to make their contributions. Simply put, the profits are not the managers' money, and, therefore, managers have no right to decide how—or if—they should distribute the profits to charitable causes.

From the efficiency perspective, it is impossible for managers to maximize shareholders' wealth and simultaneously attempt to fulfill all of society's needs. From the efficiency perspective, it is the responsibility of government to impose taxes and determine expenditures to meet society's needs. When managers pursue actions that benefit society but not shareholders, they are exercising political power, not managerial authority. While it is hard to find any comprehensive studies detailing which companies or managers subscribe to the efficiency perspective (sometimes called the "classical view") a recent study of managers in the Middle East found that less than a quarter reported that they subscribed to the efficiency perspective.[31]

CONCERNS WITH THE EFFICIENCY PERSPECTIVE The efficiency perspective assumes that markets are competitive and that competitive forces move firms toward fulfilling societal needs as expressed by consumer demand. Firms that do not respond to consumers' demands in terms of products, price, delivery, safety, environmental impact, or any other dimension will, through competition, be forced to change or be put out of business. Societal values not expressed through market forces should be reflected in governmental laws and regulations. As with competitive forces, companies that do not abide by these laws and regulations will also find themselves out of business. Unfortunately, however, corrective action often occurs only after people are injured. The Manager's Challenge on Peanut Corporation of America (PCA) illustrates this point. In this case, the company bought inexpensive peanuts from overseas and then manufactured them into various products and ingredients for various food companies. PCA's low costs meant that they could undercut competitors and win business with major food companies. These lower costs to food companies meant that they could protect their profit margins. In the end, eight people lost their lives.

ETHICS

A MANAGER'S CHALLENGE

Poisoned Profits at Peanut Corporation of America

In January 2009, the Peanut Corporation of America (PCA) was forced to recall products after eight people died and over 19,000 fell ill across 43 states from salmonella poisoning traced to contamination at the PCA plant in Georgia. People were outraged. "Our whole family was angry," said Jeff Almer of Savage, Minn., whose 72-year-old mother, Shirley Mae, died in December after eating tainted peanut butter from the plant. "This could have been avoided." The company was a large supplier of peanut and peanut butter ingredients to such name brand companies as Jenny Craig, Kraft, Kellogg, and General Mills. A Food and Drug Administration (FDA) inspection team discovered that on 12 occasions in 2007 and 2008, PCA had found salmonella contamination in its products. However, when PCA re-conducted its tests and found no contamination, it sent the products out to customers. An outbreak in 2009 hit children especially hard: half of those stricken were under age 16, and 21 percent were under 5.

Both poor physical plant and working conditions were thought to have contributed to the problems. For example, to avoid salmonella, the physical plant must be kept bone-dry, but investigators found that the factory's roof leaked when it rained. In addition, many of the hourly workers earned only minimum wage and had gone years without a raise. Frederic McClendon, 31, a shift supervisor, reached $12 an hour last year but still could not afford health insurance for his two boys; the famliy lived in a weather-beaten trailer. "If you pay your workers, you get the best out of them," Mr. McClendon said. "If you don't, you don't."[32] In addition, PCA also used a large number of temporary workers, lowering labor costs but increasing the need to retrain as new temporary workers came on board.

Peanut Corporation of America served a wide variety of food processors from peanut butter to cookies to ice cream. In total, more than 2,100 packaged and processed foods were affected by the recall. While big companies like Kellogg or Kraft had the experience and staff to handle the recalls, many small businesses struggled to cope. Receiving and shipping records had to be thoroughly searched and products tracked. In some cases, small business owners had to keep employees on overtime or hire additional help to handle the recall-related work. "It's not our fault this recall went through," said Tom Lundeen, who co-owns Aspen Hills Inc., in Garner, Iowa, which makes frozen cookie dough for fund-raisers. "We do everything correct and we have an incredibly high level of quality control, and we still have to pay for the mistakes of PCA." Stephanie Blackwell, co-owner of Aurora Products, an 11-year-old manufacturing and packaging company said she knew about the danger of salmonella in nuts but was not prepared for the impact of the recall. She calculated her losses at about $1 million. She said plans to hire two people were put on hold, and company efforts to help out with Habitat for Humanity were also affected.

The impact on large and small customers of PCA was significant. The impact on the 19,000 people who became ill was serious. For the eight people who died, the impact on them and their families was catastrophic. In the end, the impact from the negative publicity and lawsuits on the Peanut Corporation of America was fatal and the company had to declare bankruptcy.

Sources: Peanut Corporation of America, press release, January 13, 2009 (http://www.peanutcorp.com/pdf/Peanut%20Corporation%20of%20America%20Recall.pdf); "Peanut Corporation of America Expands Nationwide Recall of Peanut Butter," *US Recall News*, January 19, 2009 (http://www.usrecallnews.com/2009/01/fda-3224.html); Sue Kelly, "Peanut Recalls Still Trickling In," *USAToday,* March 20, 2009 (http://www.usatoday.com).

externality
an indirect or unintended consequence imposed on society that may not be understood or anticipated

The other major concern with the efficiency perspective is that corporations can impose indirect consequences that may not be completely understood or anticipated. In economic terms, such an unintended consequence is called an **externality.**[33] For example, plastic shopping bags are lightweight and convenient. On a per-bag basis, the production externalities are small, but on an aggregate basis the chemicals used to manufacture them are toxic and the pollution from delivering them are nontrivial. However, because the plastic bags are distributed at no charge in most stores, people often don't factor in these externalities. As a consequence, even though plastic bags can be recycled, only 5.2 percent were recycled in 2005 and that amount increased only to 6.7 percent by 2008.[34]

However, even when externalities can be anticipated, consumers often cannot correctly factor in the true cost or may not be willing to pay them. For example, the consequences of poor safety controls at a fertilizer plant (explosion, fire, toxic fumes, injury, and death) can be devastating.

The question is, can fertilizer consumers correctly assess the costs of a chemical disaster and how much extra they should have to pay to cover the needed safety expenditures? If the answer is "no," a plant manager will more likely skip the necessary safety practices to keep costs low and enhance profits. Only after a chemical disaster occurs will the impact of the externality (the disaster) be fully appreciated by consumers and, therefore, appropriately priced in the market.

The Social Responsibility Perspective

The social responsibility perspective argues that society grants existence to firms. Shareholders simply supply risk capital. Therefore, firms have responsibilities and obligations to society as a whole, not just to shareholders. Thus, while the efficiency perspective states that it is *socially responsible* to maximize the return to the shareholder, the social responsibility perspective states that it is *socially irresponsible* to maximize only shareholder wealth because shareholders are not the only ones responsible for the firm's existence. The most common form of corporate existence is one of *limited liability*—a privilege granted to corporations by society, not by shareholders.[35] In this form of existence, corporations' financial liability to others is limited to the company and doesn't extend to its shareholders. In other words, creditors and people seeking redress (for example, if a chemical disaster occurs) cannot go beyond the assets of the corporation and seek repayment or restitution from the assets of the owners (i.e., shareholders in a public company). Thus, the existence of the firm, in general, and the limited liability existence, in particular, are not solely a function of shareholders and, therefore, the responsibilities of the firm cannot be restricted just to shareholders.

STAKEHOLDERS From the social responsibility perspective, managers must consider the legitimate concerns of other stakeholders beyond just the firm's shareholders. A **stakeholder** is an individual or group that has an interest in and is affected by the actions of an organization. Besides an organization's shareholders, other stakeholders include current and future customers and employees; financiers; suppliers; the media; the communities in which the business operates; and society at large. A firm's customers have a special place within this set of constituencies because they pay the bills with the revenue they provide.[36] Shareholders are also given special status, but in the stakeholder approach, shareholders are viewed as the providers of "risk capital" rather than as sole owners. Consequently, shareholders are entitled to a *reasonable* return on the capital they put at risk, but they are not entitled to a *maximum* return because they are not solely responsible for the existence of the firm. To maximize the return to shareholders would take away returns owed to the other stakeholders. Thus, managers must balance the returns shareholders earn against the legitimate concerns of other stakeholders. The research evidence regarding the relationship between corporate social responsibility and financial performance is mixed, meaning that there is no definitive evidence that being more socially responsible leads to higher financial performance.[37]

stakeholder
an individual or group who has an interest in and is affected by the actions of an organization

CONCERNS WITH THE SOCIAL RESPONSIBILITY PERSPECTIVE One of the key concerns with the social responsibility perspective is that important terms such as *reasonable returns* and *legitimate concerns* cannot be defined adequately. Given that reasonable returns to shareholders and legitimate concerns of other stakeholders could conflict, not knowing exactly what is reasonable or legitimate makes it hard for managers to find the appropriate balance and act in socially responsible ways. This is why, from a practical standpoint, even if you believe in the stakeholder framework of corporate social responsibility, making decisions that balance the interests of various stakeholders is a significant challenge for which there is no magic solution. It is not only possible but quite likely that customers, employees, financiers, etc. will have conflicting and competing concerns. Moreover, it isn't clear from research whether greater corporate social responsibility leads to greater profits for firms.[38]

Consider the case of a manager in a corrugated-box factory. His customers want sturdy boxes that can be stacked several levels high. Society increasingly seems to want a higher use of recycled paper. However, boxes made of recycled paper either have higher costs for the same strength or lower strength at the same cost compared to boxes made of nonrecycled paper. Shareholders want competitive returns. In such a case, how would you determine the most socially responsible action? If customers tell you that boxes must meet a certain strength requirement regardless of whether they use recycled paper, does this outweigh the desires of other stakeholders? Should you devote more money to researching and developing stronger recycled boxes even though it takes money away from shareholders today?

ETHICS

A MANAGER'S CHALLENGE

The Eco-Cup at Starbucks

The general success of Starbucks likely needs no summary. The company sells nearly $10 billion worth of coffee and other beverages across nearly 9,000 company-operated stores and nearly 8,000 licensed operations in more than 50 countries around the world. In the process, Starbucks goes through nearly 2.3 billion cups annually. Although the company was started in 1971, it wasn't until 1996 that executives determined that they wanted to stop "double cupping"—giving customers a second cup to insulate the hot coffee in the first cup. That year Starbucks, along with Environmental Defense, held a competition for designs for a recycled cup.

This might seem like an easy target to achieve, but the design would need to meet several criteria. First, the new design would have to stand up well when filled with a hot beverage and held in a customer's hand. Second, because taste is highly influenced by smell, the new cup could not emit any odor that would compete with or detract from the beverage served. Third, the new cup would need FDA approval ensuring the safety of the recycled material for direct contact with cold or hot beverages.

The contest in 1996 resulted in no winners. Most designs were rejected because they crumpled easily, smelled bad, or both. As a consequence, in 1997 Starbucks moved to a 60 percent recycled sleeve in place of the second cup. This "saved some trees" but was not what company executives ultimately wanted. In 1999, the company tested a cup made of 50 percent post-consumer fiber but it was too flimsy and sometimes leaked.

In 2001, company executives decided to start over and work directly with a group of partners. They selected pulp maker Mississippi River Corp., paper mill MeadWestvaco, and cup manufacturer Solo Cup to help them create an eco-friendly cup. The team's new design and product received FDA approval in 2004 and was launched at selected locations in January 2006.

Although the eco-cup is made up of just 10 percent postconsumer fiber, it will conserve 5 million pounds of paper per year. According to Starbucks' director of environmental affairs Ben Packard, "We had our eyes on the prize of an earth-friendly cup. Ten percent is just the first step. Increasing the recycled fiber in any paper product for environmental reasons must be balanced with product durability and safety considerations. In the future, we will look for ways to increase the percentage of post-consumer recycled fiber contained in our cups, but first we want to be assured of the quality, safety and durability of these new cups. In the meantime, we are actively exploring additional innovations to reduce the environmental impacts of our paper cups and other packaging." The Environmental Defense Fund estimates that Starbucks' eco-cup saves nearly 80,000 trees, enough energy to power 640 homes annually, and 47 million gallons of waste water each year.

Don Ryan\AP Wide World Photos

As early as 1996, Starbucks wanted to stop using a second container as insulation for its coffee servings. Hence began the company's quest to develop an "eco-cup" made out of recycled material. After much trial and error, in 2006, the company began successfully rolling out such a cup to its stores around the world, saving five million pounds of paper, or approximately 78,000 trees, a year.

Sources: Starbucks's *Corporate Social Responsibility 2005 Annual Report*; "Creating the Eco-Cup," *Fortune*, October 2006, 42; http://www.edf.org/page.cfm?tagID=2155, updated September 14, 2009, accessed March 24, 2010; *Starbucks's Annual Report, 2009*.

Even when you try to balance the concerns of competing stakeholders, it isn't easy, as Starbucks found out (and as illustrated in A Manager's Challenge, "The Eco-Cup at Starbucks"). Starbucks's quest to create a coffee cup made of recycled paper took 10 years, and in the end yielded a cup made with just 10 percent recycled paper. After reading the Challenge, do you think Starbucks achieved the right balance among different stakeholders? If you were a shareholder, what would be your perspective? As a customer, how would you view the effort and results? If you were an employee, how would you view these efforts? Would they make any difference to you?

EXHIBIT 2.2

Comparing Efficiency and Social Responsibility Perspectives

Comparing the Efficiency and Stakeholder Perspectives

The efficiency and social responsibility perspectives differ mainly in terms of the constituencies to which organizations have responsibilities. However, the two perspectives differ little in terms of how they evaluate actions that either harm or benefit both shareholders and society (see Exhibit 2.2). When actions benefit both shareholders and other stakeholders from both perspectives, managers should undertake these actions. For example, in January 2010, the Walt Disney Company drained its "Rivers of America" amusement at Disneyland in Anaheim, Calif., in order to restore it with clean water and to perform maintenance on systems normally submerged. In the past, Disney typically drained the 5 million gallons of water directly to the ocean. This time, however, the company worked with the local water district to drain it through the water district, which purified it and added it to county storage. When park officials refilled the river, they used the same amount of water they had banked with the water district. This approach didn't cost them any more than the previous approach, but it helped conserve water in drought-prone southern California.

The efficiency and stakeholder evaluations differ most markedly when actions help one group and harm the other. Actions that benefit shareholders but harm the other stakeholders would be viewed as managerially responsible from the efficiency perspective but socially irresponsible from the social responsibility perspective. Actions that harm shareholders but benefit other legitimate stakeholders would be viewed as managerially irresponsible from the efficiency perspective but socially responsible from the social responsibility perspective.

How Corporations Respond to the Efficiency and Stakeholder Perspectives

How corporations react to the various pressures and constituencies connected to the topic of social responsibility varies widely. These reactions can be simplified and laid out on a continuum that ranges from defensive to proactive, as illustrated in Exhibit 2.3.

DEFENDERS Companies that might be classified as defenders tend to fight efforts that they see as resulting in greater restriction and regulation of their ability to maximize profits. These firms often operate at the edge of the law and actively seek legal loopholes in conducting their business. Typically, they change only when legally compelled to do so.

ACCOMMODATERS These companies are less aggressive in fighting restrictions and regulations, but they too change only when legally compelled to do so. This type of firm tends to obey the letter of the law but does not make changes that might restrict profits unless they are required to.

REACTORS Reactor firms make changes when they feel that pressure from constituencies is sufficient such that nonresponsiveness could have a negative economic impact on the firm. For example, the firm might change to recycled paper for boxes only when pressure from customers becomes strong enough that nonresponsiveness would lead customers to boycott their products or to simply choose products from a competitor that uses recycled paper.

EXHIBIT 2.3 Corporate Responses

	Defenders	Accommodaters	Reactors	Anticipators
Belief:	We must fight against efforts to restrict or regulate our activities and profit-making potential.	We will change when legally compelled to do so.	We should respond to significant pressure even if we are not legally required to.	We owe it to society to anticipate and avoid actions with potentially harmful consequences, even if we are not pressured or legally required to do so.
Focus:	Maximize profits. Find legal loopholes. Fight new restrictions and regulations.	Maximize profits. Abide by the letter of the law. Change when legally compelled to do so.	Protect profits. Abide by the law. React to pressure that could affect business results.	Obtain profits. Abide by the law. Anticipate harmful consequences independent of pressures and laws.

ANTICIPATORS Firms in this category tend to believe that they are obligated to a variety of stakeholders—customers, employees, shareholders, general citizens, and so on—not to harm them independent of laws or pressures that restrict or regulate their actions. Firms in this category not only abide by the law, but might also take action to avoid harming constituencies, even when the constituencies might not be aware of the potential danger. For example, a firm might take steps to protect employees from harmful chemicals within the workplace even before employees suffered negative side effects sufficient for them to demand work environment changes or before safety laws are passed.

Though we might imagine that firms adopting the efficiency perspective are more likely to be defenders, accommodaters, and reactors while firms adopting the stakeholder perspective are more likely to be anticipators, we know of no research that has examined this specific association. The accompanying "Manager's Challenge" helps illustrate some of these corporate responses in the face of advancing technology. A Manager's Challenge, "Cleaning Up Dirty Little Engines" focuses on how firms making two-stroke engines for handheld power tools are responding to the emissions and pollution these engines create. As you read the feature, ask yourself what the motivation seems to be for each firm mentioned to explore new combustion technology. For even the anticipators, are they motivated primarily to try and help the environment and reduce air pollution or are they motivated because they believe meeting or beating the proposed regulations with new technology could enhance their competitive position? What would you do if meeting or exceeding environmental or other societal goods potentially hurt your business? For example, what would you do if the technology for exceeding environmental standards for two-stroke engines resulted in engines that were 30 percent more expensive and at the same time weighed 20 percent more? What would you do if your market research suggested that commercial users of handheld tools (for example, trimmers or leaf blowers) were unlikely to pay the premium price or want the extra weight? After all, it is one thing for a consumer to deal with the extra weight for an hour or so once a week, but it is quite another thing for a small landscaping and yard work company to ask its employees to pack around 20 percent more weight six to eight hours a day, five days a week. What would you do if commercial sales accounted for half of your company's total sales?

The Strategic Corporate Social Responsibility Perspective

strategic corporate social responsibility perspective a three-criteria model that can help managers focus on social areas where there is the highest possibility of creating shared value for the business and society

A more recent approach to corporate social responsibility tries to address the balancing act managers must engage in when responding to the concerns of all their stakeholders.[39] Called the **strategic corporate social responsibility perspective,** it argues that three fundamental criteria can guide managers.

The first criterion takes an "inside-out" approach. In other words, managers can look inside the company at issues that are more rather than less important as a function of the company's strategy and business activities. For example, if you are a manager at Wal-Mart, the labor-intensive

A MANAGER'S CHALLENGE

TECHNOLOGY

Cleaning Up Dirty Little Engines: Dealing with Technology

The whine of a two-stroke engine powering a leaf blower, chainsaw, or trimmer; the puff of blue smoke it emits; and the pungent smell of its oil and gas mixture are as common as a warm day in summer. Whether you are walking through a residential neighborhood or driving by the tidy landscape of an office building, you see, hear, and smell this $15 billion-dollar-a-year industry. At least 30 million of these handheld products are currently in use in the United States. Two million blowers, 2.5 million chainsaws, and 6 million trimmers are sold each year. About two-thirds of the sales are to consumers. The rest involve more heavy-duty products for commercial users. The Environmental Protection Agency (EPA) estimates that blowers, trimmers, and the like contribute 5 percent of the total nonfactory hydrocarbon and oxides of nitrogen (NOx) emissions. (Manufacturers contend the number is closer to 2 percent to 3 percent.)

Two-stroke engines are so popular because they are extremely reliable, lightweight yet powerful, and fairly inexpensive. However, they are also dirty because, unlike four-stroke engines, there is no separate intake and exhaust stroke, and, as a consequence, 30 percent of the gas-oil mix escapes unburned.

In 1990, the California Air Resources Board (CARB) began a three-phase emissions initiative, with Phase I requiring emissions from handheld engines to be reduced by 30 percent by 1995. Phase II required a reduction of 80 percent from Phase I levels by 1999. Phase III required a further 40 percent reduction by 2007. Fred Whyte, president of Stihl, one of the largest manufacturers of two-stroke handheld engines, echoed the sentiments of many manufacturers: "Is this the greatest challenge ever faced by handheld engine manufacturers? No question." Larry Will, vice president of engineering at Echo, stated even more bluntly: "Meeting the regulations is one thing; meeting them and surviving is another."

Companies like Echo, McCulloch, Stihl, and other members of the Outdoor Power Equipment Institute enlisted powerful lobbyists to lower and delay the emission reductions. Representatives argued that the regulations would "virtually eliminate" all two-stroke engines and impose unreasonable cost burdens on consumers. Even if the standards could technically be met, the engines would cost 15 percent to 30 percent more. Given consumers' price sensitivity and the fact that "big-box" retailers like Home Depot, Wal-Mart, and Lowes control about two-thirds of consumer sales, no one wanted to be the first company to invest in the new technology and introduce the higher-priced products.

By 1995 virtually all the manufacturers were able to meet CARB's Phase I standards simply by capturing more hydrocarbons in the exhaust system, a further 80 percent reduction looked technically impossible. So in the mid-1990s, the manufacturers' association again took up the fight against the regulations.

However, three manufacturers broke ranks. RedMax (a subsidiary of Japan's Komatsu), Tanaka, and Deere & Co. (the $13 billion-a-year farm machinery giant) tried to be anticipators. Both RedMax and Tanaka created new technology for injecting a shot of pure air between exhaust gases and fuel intake that significantly reduced emissions in two-stroke engines beyond the Phase II standards. Although Deere had originally opposed the California standards, it subsequently lobbied both CARB and the EPA to *not* lower standards or delay their implementation. Deere had perfected a new technological design called "compression wave" for its Homelite brand that was similar to RedMax's solution. However, after big-box retailers pressured Deere to lower its prices on the higher-cost, lower-emission engines, its Homelite division lost $100 million over the next 21 months. Subsequently, Deere sold Homelite to TechTronics Industries of Hong Kong.

To meet the CARB standards and deadlines, virtually all the other manufacturers trying to sell the engines in California had to buy engines from RedMax and Tanaka; Stihl, for example, bought 60,000 engines from RedMax. To meet the EPA standards set to take effect nationally in 2007, manufacturers such as Stihl, Echo, and Briggs and Stratton finally launched their own attempts at technological breakthroughs. For example, Stihl moved from being a defender to an accommodater, and then to a reactor. At a cost of $12 million, Stihl developed an engine that acts like a four-stroke engine but is lubricated like a two-stroke engine and weighs only 10 percent more.

By 2009, advances in reducing emissions in two-stroke engines and advances in power and reductions in weight of four-stroke engines (which have significantly lower emissions than two-stroke engines) had pushed nearly every

(*continued*)

major manufacturer out of the Defender role. The result is that today these once "dirty little engines" have gotten a lot cleaner. Over the last 10 years, improvements in outdoor power equipment design have resulted in the reduction of exhaust emissions by over 70 percent according to the Outdoor Power Equipment Institute.

Source: Outdoor Power Equipment Institute, www.opei.org, accessed March 24, 2010; "U.S. Power and Hand Tools Demand to Reach $15.5 Billion in 2009," *Grounds Maintenance*, http://grounds-mag.com/news/tools_demand_051705/index.html, accessed February 23, 2009; E. Chapman, "Handheld Lawn and Garden Products," *Grounds Maintenance,* July 2003, 12; M. Boyle, "Dirty Little Engines Get Cleaner," *Fortune*, May 13, 2002, I146[B–L].

nature of your business places a heavy emphasis on workers. In contrast, the capital-intensive nature of Boeing places a heavy emphasis on technology.

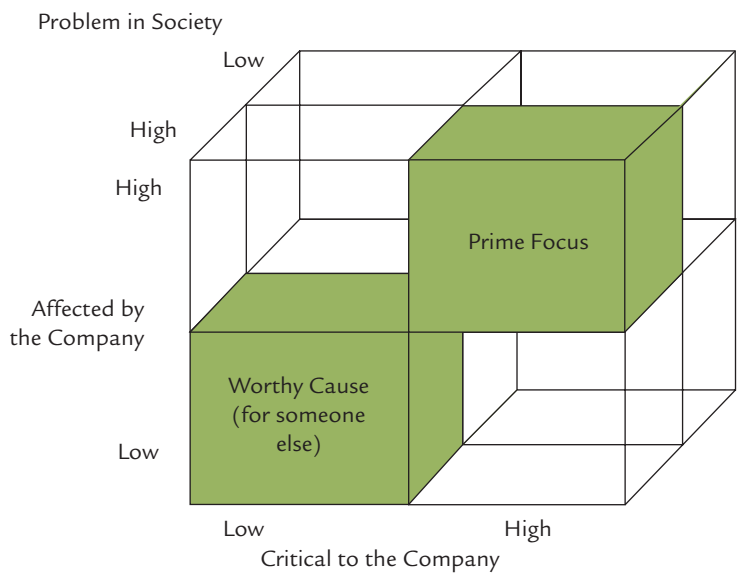
The second criterion takes an "outside-in" approach. In other words, managers can look outside the company at issues the company can influence. For example, suppose you are a Wal-Mart manager in charge of the energy costs consumed by all the company's stores. As such, not only would you have a significant impact on the stores' energy consumption and greenhouse gas emissions, you would also be able to influence the power companies that produce electricity for your stores. For example, you might be able to get those companies to use alternative fuels that would enable the production of energy with lower greenhouse gas emissions.

The third criterion takes an "outside-out" approach. In other words, managers look at social issues in general terms of the extent to which they are problematic. Clearly, there are nearly an unlimited number of social issues to consider—everything from poverty to literacy to sanitation and more. However, the strategic social responsibility approach does not advocate looking at all social issues, rather assessing those that come into focus as a function of the first two criteria.

Taken together, the three criteria form a three-dimensional matrix that can help managers focus on those social areas with the highest possibility of creating shared value for society *and* the business. Exhibit 2.4 illustrates this matrix. Marriott provides an illustration of the framework in action. It is critical that Marriott, as a labor-intensive business, maintains a substantial supply of workers to do relatively low-tech jobs, such as housekeeping. Most of the company's larger, upscale hotels are in big cities like New York, where chronic unemployment is a problem, particularly among poorly educated individuals with fewer skills. Chronic unemployment leads to a number of socially undesirable consequences including homelessness and drug abuse. As a large employer of low-skilled labor, Marriott's social outreach efforts targeting chronically unemployed workers in large cities like New York create the opportunity for shared value creation for employees, communities, shareholders, and customers.

EXHIBIT 2.4

Strategic Corporate Social Responsibility: A Criteria Matrix



Marriott provides 180 hours of paid classroom and on-the-job training for chronically unemployed individuals. More than 90 percent complete the program and are hired by Marriott. After one year, more than 65 percent are still in their jobs—a high retention rate for the industry in general and a much, much higher rate for the chronically unemployed. In the end, Marriott, its newly trained employees, and their communities all benefit.

Suppose you were a manager in the human resource department at Marriott and someone suggested that the company should also get involved in another inner-city problem: HIV/AIDS. Should you recommend that the company invest time and resources in this issue? Although it's an important issue, the problem is that HIV/AIDS does not seem to affect the company's key activities, such as recruiting. Furthermore, because Marriott is a small employer in the scheme of this set of individuals, it seems unlikely that the company's actions could have a significant impact on the issue. The company lacks the potential to create shared value for society and the business. However, if you are a Marriott human resource manager in Bangkok, Thailand, or Johannesburg, South Africa—where HIV/AIDS seriously compromises the supply of low-skilled workers—the same analysis might yield different conclusions. Low-skilled workers constitute a critical group for the company's operations, and Marriott is a large employer in the two cities. For these reasons, its approach to preventive health care could have a significant impact on the incidence of HIV/AIDS in each city. As a consequence, what potentially is for Marriott in New York a "worthy cause for someone else" may be a "strategic corporate social responsibility issue" for Marriott in Bangkok and Johannesburg.

How People and Firms Can Make Better Ethical Decisions

While the media helps uncover the ethical misconduct of high-profile people, such as CEOs of major companies, there is some evidence that ethical misconduct at all levels is rising.[40] If this is the case, a significant challenge remains to you as a manager: How can you foster and encourage ethical decisions?

The Manager

As mentioned at the outset of the chapter, part of the reason for exploring various approaches to ethical decision making is to help you refine your own approach so that when pressures arise, you can make decisions consistent with your ethical framework and avoid ethical lapses. To this end, there is perhaps no substitute for taking personal responsibility for your decisions.

Even after you have become more comfortable and explicit about how you would resolve ethical dilemmas, the question still remains: How much should you change your approach to fit in with others or try to change their approaches? If you were at Nike, how hard should you work to change the public's perception, persuading them to see the positive benefits workers in their factories enjoy and what their lives would be like without jobs making Nike products? It is probably impossible to argue that one of this chapter's approaches is best. However, applied consistently, each approach will result in a consistent pattern of ethical decision making. Even if people don't always agree with your decisions, they will appreciate the fact that you are consistent.[41]

The Organization

Just as managers try to foster ethical decisions, organizations have a significant impact on ethical decision making. A company's overall culture plays a significant role. For example, the emphasis on generating revenues and keeping clients happy seemed to contribute to a number of rather lax audits of companies like Enron and WorldCom by accounting firm Arthur Andersen. Andersen subsequently went out of business. In contrast, firms can also have a positive impact on ethical decision making and behavior. In many firms, senior managers go out of their way to encourage managers to behave ethically. Codes of ethics and whistle-blowing systems are perhaps two of the more visible efforts.

CODES OF ETHICS Many firms have adopted codes of ethics to guide their managers' decision making. A **code of ethical conduct** is typically a formal one- to three-page statement outlining the types of behavior that are and are not acceptable. Exhibit 2.5 displays the Johnson & Johnson credo, one of the oldest among U.S. corporations. The credo was first adopted in 1945 and has been revised four times.

code of ethical conduct
a formal settlement that outlines types of behavior that are and are not acceptable

EXHIBIT 2.5

Johnson & Johnson Credo

We believe our first responsibility is to the doctors, nurses, and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality. We must constantly strive to reduce our costs in order to maintain reasonable prices. Customers' orders must be serviced promptly and accurately. Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees: the men and women who work with us throughout the world. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs. Compensation must be fair and adequate, and working conditions clean, orderly, and safe. Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development, and advancement for those qualified. We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities in which we live and work and to the world community as well.

We must be good citizens—support good works and charities and bear our fair share of taxes. We must encourage civic improvements and better health and education.

We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to our stockholders. Business must make a sound profit. We must experiment with new ideas. Research must be carried on, innovative programs developed, and mistakes paid for. New equipment must be purchased, new facilities provided, and new products launched. Reserves must be created to provide for adverse times.

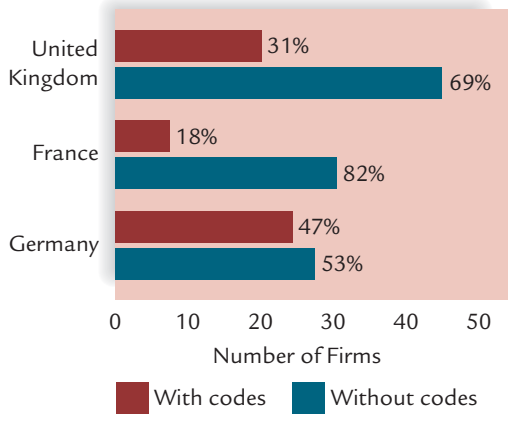
When we operate according to these principles, the stockholders should realize a fair return.

An examination of 84 codes of ethics in U.S. firms found three specific clusters of issues addressed in these statements.[42] The first main cluster includes items that focus on being a good "organizational citizen." The second cluster includes items that guide employees to restrain from unlawful or improper acts that would harm the organization. The third cluster includes items that address directives to be good to customers. Each of these clusters was further divided into subcategories.

A study of codes of ethics for firms in the United Kingdom, France, and Germany found that a higher percentage of German firms had codes of ethics than do British or French firms (see Exhibit 2.6).[43] Although only about one-third of the European firms in this study had codes of ethics, approximately 85 percent of U.S. firms have formal codes.

EXHIBIT 2.6

Adoption of Codes of Ethics



In a separate study, researchers found that important differences in codes of conduct exist among U.S., Canadian, and Australian firms.[44] For example, ethics codes differ substantially in terms of explicitly defining acceptable ethical conduct on such issues as gifts, meals, and entertainment for domestic government officials (87 percent of U.S. firms, 59 percent of Canadian, and 24 percent of Australian firms include this information).

Exhibit 2.7 provides information about the content of the codes of ethics for the firms that had formal codes. While 100 percent of the European firms' codes cover issues of acceptable and unacceptable employee behavior, only 55 percent of U.S. firms address these issues. By contrast, only 15 percent of the European firms covered issues of political interests (that is, business-government relations) and 96 percent of U.S. firms covered these issues in their codes.

Research indicates that executives believe codes of conduct are the most effective way of encouraging employees' ethical behavior.[45] Unfortunately, the

EXHIBIT 2.7 Subjects Addressed in Corporate Codes of Ethics

	UNITED KINGDOM N = 33		FRANCE N = 15		GERMANY N = 30		TOTAL EUROPEAN COUNTRIES		UNITED STATES N = 118		SIGNIFICANCE
Subjects	**Number of Firms**	**%**	**Number of Firms**	**%**	**Number of Firms**	**%**	**Number of Firms**	**%**	**Number of Firms**	**%**	**Europe vs. U.S.**
Employee conduct	33	100	15	100	30	100	78	100	47	55	SIG
Community andenvironment	21	64	11	73	19	63	51	85	50	42	NS
Customers	18	39	14	93	20	67	52	87	96	81	SIG
Shareholders	13	39	11	73	18	60	42	64	NA	NA	NA
Suppliers and contractors	7	21	2	13	6	20	15	19	101	86	SIG
Political interests	4	12	3	20	5	17	12	15	113	96	SIG
Innovation and technology	2	6	3	20	18	60	26	33	18	15	SIG

NS = Not significant NA = No comparable data available SIG = Significantly different

research does not support a strong link between codes of ethics and actual employee behavior. Firms without formal codes seem to have no higher or lower incidents of unethical behavior than those with formal codes.[46] This may be because simply having a formal, documented statement is not sufficient. For example, although nearly all *Fortune* 500 firms in the United States have codes of ethics, only about one-third have training programs and ethics officers, and only half have distributed formal codes to all their employees.[47]

SUCCESSFULLY IMPLEMENTING CODES OF ETHICS Actions speak much louder than words; employees are unlikely to conform to the formal code unless other actions taken by the organization reinforce the code and communicate that the company is serious about compliance.[48] Some companies have instituted "ethics officers" or ombudsmen: individuals responsible for communicating ethics information and policies to employees and ensuring that their concerns and observations of misconduct are reported to senior managers so corrective actions can be taken.

Communication For maximum impact, communicating a company's ethical standards must take a variety of forms and be repeated. It is not enough to simply disseminate a one-time memo. Rather, the company must repeatedly communicate the code in memos, company newsletters, videos, and speeches by senior executives over a period of time if people are to embrace and internalize the message.

Training For the code of ethical conduct to be effective, people will likely need training.[49] For maximum impact, training must be engaging. For example, Motorola developed approximately 80 different short cases. Each case presents a situation requiring a manager to make a decision. Trainees are asked to individually and collectively decide what they would do in similar situations. They then compared their decisions to those of senior executives, including Motorola's CEO, to examine what these executives believe is in keeping with the firm's code of ethics.

Lockheed Martin also has taken an engaging approach to ethics training—with an interesting and innovative twist. In the late 1990s, the company developed a board game based on Scott Adam's "Dilbert" character. The game features 50 ethical dilemmas for players (employees) to consider. Participants found this approach to be more satisfying than traditional ethics training.

They also seemed to recall the learning points more effectively. After the Dilbert craze wore off, Lockheed Martin used real business ethics problems as a basis for discussion. The company also maintains an ethics hotline employees can call for advice if they are experiencing a business dilemma.[50]

Sometimes, the need for training emerges because of embarrassing problems. For example, in early 2010 AstraZeneca PLC paid a $250 million fine for promoting its drug Seroquel for conditions other than those approved by the FDA. Marketing and promoting a drug for "off-label" uses is illegal. As a result, AstraZeneca increased its ethics training for employees. According to a company spokeswoman, "Last year, AstraZeneca took a number of steps to strengthen its ethics training for employees, including introducing a new 'openness' program designed to encourage staff to report alleged ethics violations."[51]

Although officials at organizations often think that ethics training programs are effective, current research is less conclusive. What we can say based on research is that the greater employees' psychological and emotional involvement in the training, the greater their retention of the learning points. This may explain Lockheed Martin's positive experience with ethics training.

Reward and Recognition In addition to communicating the code to employees and training them, it is critical to make sure that compliance is recognized and rewarded. Otherwise, employees will simply view the code as the "formal rhetoric but not the real deal." ExxonMobil regularly celebrates individuals who honor the company's code of conduct, even when doing so might have cost the company money. For example, when a government official in a developing company solicited a bribe from one of ExxonMobil's drilling teams in exchange for permission to drill there, the team manager refused to pay. The drilling team and their expensive equipment sat idle for more than a week at a cost of over $1 million. Finally, the government official admitted that all the paperwork and permits were in order and the team was allowed to proceed. ExxonMobil described this incident in its employee newsletter to reinforce that the company takes its code of ethical conduct seriously and rewards people who honor it, even when doing so may be costly for the organization.

whistle-blower
an employee who discloses illegal or unethical conduct on the part of others in the organization

Whistle-Blowing A **whistle-blower** is an employee who discloses illegal or unethical conduct on the part of others in the organization. Although some firms have implemented programs to encourage whistle-blowing, most have not.[52] As a group, whistle-blowers tend *not* to be disgruntled employees but conscientious, high-performing employees. In general, whistle-blowers report these incidents not for personal fame but because they believe the wrongdoings are so grave that they must be exposed.[53] For example, nuclear power-plant supervisor Randy Robarge never intended to be a whistle-blower. In his mind, raising concerns about the improper storage of radioactive material at ComEd's Zion power plant on Lake Michigan was just part of doing a good job.[54]

Research suggests that the more employees know about internal channels for whistle-blowing and the stronger the protection of past whistle-blowers, the more likely they are to initially use internal rather than external channels, such as the media, to call attention to problems.[55] IBM receives up to 18,000 letters a year from employees making confidential complaints through IBM's "Speak Up" program. Firms such as Hughes Tool Co., General Motors, and Bloomingdale's offer financial rewards to employees who report valid claims.[56] In general, research suggests the following steps can be effective in encouraging valid whistle-blowing:[57]

- Clearly communicate whistle-blowing procedures to all employees.
- Allow for reporting channels in addition to the chain of command or reporting incidents to one's boss.
- Thoroughly investigate all claims based on a consistent procedure.
- Protect whistle-blowers who make valid claims.
- Provide moderate financial incentives or rewards for valid claims.
- Publicly celebrate employees who make valid claims.

Examples Set by Top Managers The examples top managers set—both in terms of how they behave personally and how they reward, punish, or ignore the actions of others—probably has the biggest impact on ethical conduct.[58] Managers' behavior can severely damage the best

intentions and implementation of any corporate ethics program. Middle managers are rarely persuaded by top executives to "do as I say not as I do."

Leaders at Enron, such as Ken Lay and Jeff Skilling, set an example of reporting growth at any price. Standard accounting rules were ignored so that higher revenues and profits could be recorded immediately. Once one rule, law, or policy is ignored by senior officers, who is to say that others shouldn't be? This pattern of illegal and unethical conduct was not confined to Enron but was complemented by the behavior of senior partners in the accounting firm engaged to monitor and certify Enron's accounting practices: Arthur Andersen. In an effort to retain Enron's auditing business and its more lucrative consulting engagements, leaders at Arthur Andersen ignored Enron's accounting irregularities despite their legal and ethical obligation to report them. In the end, leaders even instructed subordinates to destroy and shred documents (against company policy and legal statutes) in an effort to hide wrongdoing on both sides.

By following the steps outlined earlier, managers can catch problems before they become national media events and seriously damage the firm's reputation. In addition, new laws in the United States both protect and reward whistle-blowers. Employers cannot discharge, threaten, or otherwise discriminate against employees because they report a suspected violation of the law. Employees who blow the whistle on companies with federal government contracts can actually receive a small portion of the judgment if the company is found guilty. Jane Akre was one of the first to receive such a reward. Akre received $425,000 when she blew the whistle on her employer, a TV station, that deliberately distorted the news.[59] However, an award of $52 million to three men who blew the whistle on pharmaceuticals giant SmithKline Beecham really grabbed people's attention.[60] And an even bigger eye-opener occurred when Jim Alderson and John Schilling helped disclose Medicare fraud on the part of HCA, the nation's largest hospital chain. Alderson and Schilling shared a $100 million whistle-blower award granted on a $1.7 billion fine levied on HCA.

Scott J. Ferrell/Congressional Quarterly/Alamy Images

Joseph F. Berardino, managing partner and CEO of Arthur Andersen testifies during the House Capital Markets Insurance and Government Sponsored Enterprises Subcommittee hearing on the collapse of Enron and the unethical accounting practices of Arthur Andersen that hid Enron's accounting irregularities.

How Governments Can Foster Ethical Behavior

The governments of the United States and many other countries have also tried to foster ethical behavior. For example, the U.S. government has enacted a number of laws and regulations designed to achieve this objective. Perhaps the most discussed, given today's global environment, is the Foreign Corrupt Practices Act.

Few issues of ethical behavior have received more attention than questionable payments or bribes. For American managers, this is the heart of the **Foreign Corrupt Practices Act (FCPA).** The act was passed in 1977 primarily because U.S. firms were making payments to foreign government officials to win government contracts and receive preferential treatment.

Foreign Corrupt Practices Act (FCPA)
a law prohibiting employees of U.S. firms from corrupting the actions of foreign officials, politicians, or candidates for office

One of the key incidents that sparked the FCPA was the revelation that Lockheed Martin had made over $12 million in payments to Japanese business executives and government officials in order to sell commercial aircraft in that country. Subsequent discoveries showed that nearly 500 U.S. companies had made similar payments around the world, totaling over $300 million.

Lockheed's chairman at the time, Carl Kotchian, argued that the payments represented less than 3 percent of the revenue gained from the sale of aircraft to Japan. Kotchian also claimed the sales had a positive effect on the salaries and job security of Lockheed workers, with beneficial spillover effects for their dependents, communities, and shareholders. He said he was "between a rock and a hard spot": If he made the payments, people would say they were unethical; if he did not make the payments, a competitor would, and some Lockheed workers would lose their jobs. Do you agree with Kotchian? Whether you do or not, can you figure out which

Managerial Challenges from the Front Line

The Rest of the Story

After her mother died of lung disease in 1995, Sharon Anderson Wright became the CEO of Half Price Books. "I think we've grown more than she could have imagined," said Wright about her mom. In fact, even though the company now has about double the number of stores it did in 1995, it has never taken a lot of debt. Nonetheless, the growth of the business forced the firm to become more organized, which has involved investing additional finances in things like computer and inventory systems. The expansion also made it too costly to maintain full health care benefits for part-time workers, a decision that Wright said she made "not lightly."

Wright still lives in her childhood Dallas home with her children and husband Ken (who also works for the company). She pays herself a relatively small five-figure salary. Employees are also paid modestly but receive shares in the company. Wright says that she and her sister, Ellen O'Neal, executive vice president of Half Price Books, have turned down many buyout offers from competitors and venture-capital firms. "We could have been rich many times over," she says. "But my mom made a commitment to do the right thing, and it's my job to uphold it."

Sources: H. Landy, "Founder's Daughters Write Their Own Chapter," *Fort Worth Star-Telegram,* May 12, 2007, 1C, 6C; "Strong Results Fuel Chain's Decision to Add Stores," *Fort Worth Star-Telegram,* January 9, 2007; J. Lynch and G. Cosgriff, "Shelf Help," *People,* May 20, 2003, 127, 2p, 3c.

ethical approach he seems to be following? Is it a moral right approach, justice approach, or utilitarian approach?

Until the passage of the FCPA, these dilemmas were purely ethical ones. Upon its passage, they became legal ones: The FCPA made it illegal for employees of U.S. firms to corrupt the actions of foreign officials, politicians, or candidates for office. The act also outlaws an employee from making payments to *any* person when the employee has "reason to know" that the payments might be used to corrupt the behavior of officials. The act also requires that firms take steps to provide "reasonable assurance" that their transactions are in compliance with the law and to keep detailed records of them.

The FCPA does not cover payments made to business executives, though. For American managers, payments made to executives are ethical decisions, not legal ones. The FCPA also does not prohibit payments to low-level government employees to perform their duties in a more timely manner—duties they normally would have performed anyway. These types of payments are typically called *facilitating payments.* For example, a payment of $100 to a customs inspector not to delay the inspection of an imported product would not violate the FCPA because the payment simply facilitates something that the customs inspector would do anyway. However, the payment of $100 to pass a product *without* inspecting it would be a violation of the FCPA because the payment would entice the customs agent to do something he or she is not supposed to do.

Companies can be fined up to $1 million for violating the FCPA. Individuals face a $10,000 fine and up to *five years in prison.* Clearly, a $1 million fine is not a deterrent when deals can be worth $100 million. Rather, the prison terms for individuals are the real teeth in the law.

The general debates concerning ethics and social responsibility have raged for generations. The purpose of this chapter has not been to resolve the debate but rather to examine the assumptions and rationales of fundamental perspectives. If there were a magic formula for meeting these challenges, there would likely be little need for bright, capable people as managers wrestling with these issues (we could just turn the problem over to computer algorithms). Nor would there be much excitement in being a manager. We hope this examination enables you to evaluate your own views so that you will be prepared when situations arise concerning ethics or social responsibility. Perhaps then the pressure of the moment will be less likely to cause you to take actions that you might later regret. Understanding the general frameworks also helps you to better appreciate others who have differing perspectives and, thereby, interact more effectively with them.

Summary

- The four basic approaches to ethical decision making include utilitarian, moral rights, universal, and justice approaches. The utilitarian approach is based on the premise that the right thing to do is that which brings about the greatest good. The moral rights approach assumes that actions should be consistent with existing principles with moral standing. The universal approach is based on the notion that actions should be guided by principles that you believe should be universally applied, including to yourself. The justice approach is predicated on the notion that costs and benefits should be equitably distributed, rules should be impartially applied, and those damaged because of inequity or discrimination should be compensated.
- Moral intensity is the degree to which people see an issue as an ethical one. It is influenced by six factors: (1) the magnitude of the consequences, (2) social consensus, (3) the probability of effect, (4) temporal immediacy, (5) proximity, and (6) the concentration of effect.
- Poor judgments regarding social responsibility and lapses in ethical decision making can inflict irreparable damage to a firm's value. As a consequence, as a manager, you need to be able to make sound, ethical decisions and encourage your subordinates to do likewise.
- The efficiency perspective argues that "the business of business is business." Therefore, a manager's obligation is to maximize shareholders' returns. The values of society should only be reflected in a manager's decisions insofar as those values are codified by law.
- The social responsibility perspective argues that corporations owe their existence not just to shareholders, who provide risk capital, but to society at large. As a consequence, managers should provide a reasonable return to shareholders while also meeting the legitimate concerns of society.
- The strategic corporate social responsibility approach argues that the best social responsibility is that which creates shared value for society and the business. Determining which issues have the highest probability of fulfilling this objective comes from assessing the activities that are key to the business, issues that the company affects, and issues that are of concern to society.
- When it comes to fostering ethical decisions and behavior throughout an organization, few things are more important than the example set by senior executives. Codes of conduct, communication, training, and rewards (and punishments) are all additional steps that can have an effect on the decisions and behavior of employees.

Key Terms

code of ethical conduct 45
compensatory justice 32
concentration of effect 34
distributive justice 32
efficiency perspective 36
ethical dilemma 30
ethical lapse 30
externality 38
Foreign Corrupt Practices Act 49
justice approach 32
magnitude of the consequences 33
managerial ethics 29
moral intensity 33
moral rights approach 31
probability of effect 34
procedural justice 32
proximity 34
social consensus 33
stakeholder 39
strategic corporate social responsibility perspective 42
temporal immediacy 34
universal approach 31
utilitarian approach 31
whistle-blower 48

Review Questions

1. What is the major premise of the efficiency perspective regarding corporate social responsibility?
2. What are the key concerns with the efficiency perspective of social responsibility?
3. What is the fundamental objective of the strategic social responsibility approach?
4. What are the key differences between managerial ethics and corporate social responsibility?
5. Contrast and compare the utilitarian approach, moral rights approach, universal approach, and justice approach.
6. What six factors influence moral intensity?
7. What are five powerful means of enhancing the influence of formal codes of conduct on actual employee behavior?
8. What is a whistle-blower?
9. What is the Foreign Corrupt Practices Act?

Assessing Your Capabilities

An Honesty Test

Have you ever cheated on a test? What about calling in sick at work when you weren't ill? Have you ever downloaded music from an Internet site and not paid for it? In 2005, *Reader's Digest* surveyed nearly 2,000 readers with questions such as these. To take the quiz and find out how you stack up against the survey respondents in terms of your honesty, go to http://www.readersdigest.ca/mag/2005/05/honesty.html.

Team Exercise

The Limits of Privacy

Divide into teams of three. One person will play the role of the employee. One person will play the role of the supervisor. The third person will observe the encounter and provide a summary. Each person should read the following scenario. The individuals playing the roles of the employee and boss should then engage in a five- to ten-minute conversation to try and resolve the issue. The questions at the end of the scenario will stimulate your thinking and prepare you for the conversation.

Your firm has a stated policy that e-mails constitute company correspondence and, therefore, are subject to screening. Although the company includes the policy explanation in the thick orientation document that every new employee receives, most employees aren't aware of the policy. Most of those who are aware of it do not believe that the company reviews their e-mail or other Internet activities.

Your boss comes to you with the password to all your subordinates' e-mail accounts and asks you to review them. He has some concern but no hard evidence that one of your subordinates either may be talking with a competitor about coming to work for them or may even be leaking sensitive marketing information to them. He instructs you to not be fooled by what appears in the subject line of the e-mails because anyone with any smarts would not put the real nature of the e-mail there if he or she were up to something unethical. Therefore, he wants you to read through all the employees' e-mails over the last four weeks and monitor them over the next few weeks until the allegation is proven to be true or groundless. He has transferred a small project from you to ensure that you have the time to complete this review over the next week.

1. What would you do? Would you take the assignment?
2. If so, why? If not, why not?
3. If you didn't want to take the assignment, how could you turn it down without hurting your relationship with your boss or potentially damaging your career?
4. Is it ethical to read employees' e-mail that they may consider private?
5. Is it ethical to not inform employees of what you are about to do?

Closing Case Nicolo Pignatelli and Gulf Italia

Nicolo Pignatelli, president of Gulf Italia (a subsidiary of Gulf Oil), stared at the notice from the Italian government. "How could this be possible?" he thought. The government had given Pignatelli permission to build an oil refinery with a capacity of almost 6 million tons. He had just completed it at a cost of several hundred million dollars. Now the Italian government was telling him that he could only operate at slightly more than 50 percent capacity (3.9 million tons of the total 6 million ton capacity). On top of that, the notice from the government also said that not only would he need to get "production permission" to go from 3.9 million to 6.0 million tons in actual production, he would also need a *separate* "implementation permission" to put into effect the "production permission."

Pignatelli didn't know whether to be intimidated or infuriated. The government had given him permission to build a 6 million ton facility. However, they were now allowing him to operate at only 3.9 million tons. Because of the plant's high fixed cost, it needed to operate near capacity to make money. Operating at 3.9 million tons would lose millions of dollars and was out of the question. Shutting down the plant completely would also cost money.

Pignatelli was understandably upset—he had spent seven long years implementing a strategy to take the company from one of the small fries in the Italian oil and gasoline industry to one of the major players. When Pignatelli took over, Gulf gas stations were located in northern Italy. To build a national presence, Pignatelli acquired 700 gasoline stations, primarily in central and southern Italy, from Marathon Oil. This purchase allowed Gulf to have gas stations throughout Italy. Gulf also had crude oil operations in southern Italy and in the nearby Middle East, which it could use to supply crude oil to Italy. What Gulf lacked was the middle part of the chain—a refinery. Without it, Pignatelli was dependent on competitors for a refined gasoline supply and had to take whatever wholesale prices they dictated. Pignatelli felt Gulf needed its own refinery to complete the chain from the wellhead to the gas pump and thereby control its own destiny.

Building a refinery in Italy was a long and expensive task. Even after receiving permission to build the refinery in northern Italy, local community opposition resulted in five location changes before construction could finally start. These location changes alone cost Gulf an additional $16 million. To ensure that the smoke and fumes would not contribute to city smog, Pignatelli spent extra money on a 450-foot smokestack (twice as tall as normal). Pignatelli also installed a special combustion chamber so that flare towers (used to burn off waste gas) and the loud noise and noxious fumes associated with them weren't necessary. He also added a state-of-the-art water purification system. Pignatelli demonstrated the quality of the system by personally drinking the waste water. These environmental additions added several million dollars to the project.

So that the refinery would be profitable, Pignatelli wanted to assure strong demand for the supply created by the refinery. In addition to the internal demand from Gulf gas stations, Pignatelli arranged a joint venture with Mobil Oil. Mobil had many service stations in northern Italy where Gulf's refinery was located but no refinery of its own. This would secure demand for the refinery's products, and the money Mobil was to invest for its equity share would reduce Gulf's financial burden in building the refinery. However, Mobil had the option of pulling out of the deal if Gulf's refinery could not operate at capacity because in that case, the refined gas would be too expensive for Mobil to buy.

It had taken seven years for the refinery to be approved and built. Hundreds of millions of dollars were on the line. On top of this, Pignatelli personally had sold the expansion strategy (both the acquisition of the retail stations and the building of the refinery) to senior executives at Gulf's global headquarters. As a consequence, his personal reputation was also on the line. Trying to obtain approval to operate at capacity and a separate authorization to implement that approval might take many more months, if not years. Pignatelli wondered if he was being purposely set up by government officials.

Four options occurred to Pignatelli:

1. He could play it straight and try to gain government authorization.
2. He could ask his more-influential partners (for example, Mobil) to pressure government officials to quickly grant the two needed permissions.
3. He could pay a large sum of money ($1 million deposited to a Swiss bank account) to a "consultant" who had "debottlenecked" problems like this before and who promised Pignatelli that he could fix the situation quickly.
4. He could pay money "under the table" directly to government officials to obtain the permissions needed to run the refinery economically.

Pignatelli considered each option. Playing it straight would likely take several months and possibly years before government authorization could be obtained. In the meantime, the refinery would not operate, or would operate at such a low capacity that it would lose millions of dollars. Pignatelli was not certain that pressure from his partners would influence government officials. He wondered about the effect of going to the media. Given the current cost of the project, the thousands of jobs that depended on an

operating refinery, and time pressures, $1 million seemed like a small price to pay to a consultant to get things debottlenecked. He might be able to gain approval for even less money if he went directly to government officials.

Questions

1. What should Pignatelli do? What would you do and why?
2. Pignatelli seems to be leaning in the direction of hiring a consultant who might use part of the money for bribes. If Pignatelli does not pay the bribes directly, does this absolve him of responsibility?
3. Bribes are illegal in Italy. Even if bribes were common practice there, would this justify paying them?
4. Does Pignatelli have a responsibility to Italian citizens to build an environmentally friendly refinery above and beyond what the law requires? Is it appropriate for Gulf to spend this extra money and essentially take it away from shareholders?
5. How would you feel if you were a lower-level employee in the company and learned that Pignatelli intended to pay bribes to get things "debottlenecked"? What would your ethical obligations be? Should you ignore the situation or confront Pignatelli? Should you inform your direct boss or go to the media?

Source: Personal conversations with Nicolo Pignatelli.

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3 International Management and Globalization

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

Explain what globalization is and how it affects firms and countries.

Identify and differentiate the two major elements of the global environment.

Name and explain the three major institutions of a country's institutional environment.

Define the term *culture* and identify four primary cultural dimensions.

Describe the five international market entry strategies and explain when to use each strategy.

Explain the three types of international organization focus.

Discuss the benefits and challenges of managing across cultures.

Describe how to effectively manage multicultural teams.

Define the term *global mind-set* and explain its importance for managers.

Courtesy of Chetan Chadhury

Managerial Challenges from the Front Line

Name: Chetan Chadhury

Position: Manager, Strategy & Operations

Alma mater: St. Xavier's College, Calcutta University (Bachelor of Commerce), Institute of Chartered Accountants (Associate Chartered Accountant), Arizona State University (Master of Science and Master of Business Administration)

Outside work activities: Reading, watching movies, trivia

Book reading now: *The Bhagavad Gita*

Person(s) most admired: Krishna (from the epic "The Mahabharata") and Steve Jobs (Apple)

Motto to live by: Do unto others as you would have others do unto you

Management style: Hands-on approach that is both collegial and collaborative, keeping team members informed and involved, trusting them and allowing them to work independently

Chetan Chadhury was originally hired by Deloitte as a summer intern while working on his MBA at Arizona State. After completing his MBA, he accepted a job with Deloitte located in one of its major offices in California. He primarily worked on large-scale implementation projects in the public sector. In 2006, Chadhury left Deloitte to start a new company in India. He gained valuable experience from this entrepreneurial venture. He and his partners worked on the development of sustainable models to improve the quality of education for the less fortunate (those at the "bottom of the pyramid").

In 2008, Chadhury sold the company and rejoined Deloitte to work in its strategy practice in Ottawa, Canada. He currently manages Deloitte's strategy and operations consulting unit in Ottawa. He spends most of his time on consulting work in business process improvement, operations excellence, citizen service, and technology strategy for public-sector organizations. Because Deloitte is a global organization, Chadhury's work takes him to many places overseas; for example, he recently worked on a major project in the Middle East. Having studied and worked in both India and the United States, Chadhury has a basic understanding of cultural differences and the importance of adapting to the local culture when operating in that environment. Yet, he explains a challenge that he and his colleagues encountered while working on a complex but interesting business transformation project for a public-sector client in Asia. They experienced general working conditions that differed from their norm. For example, there was a strict dress code and standing meetings were commonly cancelled while impromptu meetings were called with little notice. It was not uncommon for clients to come late to meetings and for them to converse with each other in their native language during meetings. Furthermore, client meetings rarely had an agenda and included little or no introductions. Clients did not like to communicate through e-mails, preferring phone conversations or text messages. Clients rarely examined and responded in a timely manner to the materials and recommendations provided by the consulting teams. Because of these conditions, the Deloitte team suffered from low morale and some left the project, causing further problems in the client relationship.

Chadhury and his colleagues were concerned about the potential for losing the account and felt a need to act. They analyzed the situation carefully and decided that the basic problem was related to cultural differences. Therefore, they set out to correct the problems and adapt to the local culture to better respond to and satisfy the client's needs. In this chapter, we examine the issues addressed by Chadhury and his colleagues working to provide effective advice and service to their Asian client. We begin discussing globalization and its effects on markets and businesses. We then examine the different institutional and cultural environments of countries and the strategies firms use to enter international markets, the reasons firms use each strategy, and the risks that they pose. We also discuss how to manage people and teams across cultures, an issue of importance in the situation described by Chadhury. We examine both as they have become highly important in our global economy and with multinational companies such as Deloitte. Finally, we discuss what's called a "global mind-set," what it is, and the importance for managers to have one.

Globalization

globalization
the flow of goods and services, capital (money), and knowledge across country borders

Globalization refers to the flow of goods and services, capital (money), and knowledge across country borders. Globalization enhances the economic interdependence among countries and organizations across countries.[1] According to Thomas Friedman, author of the popular book, *The World Is Flat,* we are in the third stage of globalization, with the first involving internationalization of countries, the second involving companies moving into international markets, and the current and third stage involving individuals collaborating (and competing) on a global basis.[2] The increasing interdependence among countries, companies, and even individuals across country borders has reduced the influence that a national government can have on its economy.[3] The interdependency of country economies across the globe became exceedingly clear in the most recent financial and economic crisis. The crisis began in the United States and spread to many other countries.

In recent years, increasing globalization has dramatically changed the competitive landscape for everyone. For example, when coupled with new technology, especially in information systems, small firms now have access to markets and resources in other countries. This has allowed them to compete effectively with larger and often more established firms. Additionally, even firms from less-developed economies can better compete in international markets.[4]

According to Thomas Friedman, globalization has gone beyond the point where small and large companies have moved into international markets. Today, even individuals are collaborating (and competing) on a global basis.[5] Friedman suggests that, regardless of our country of origin, increased globalization has made all of us "next-door neighbors"—and competitors.[6] This is exemplified by the foreign sales of Orb Audio and Air Transport described in A Manager's Challenge. In fact, Air Transport—located in a small rural town in West Texas—is an unlikely competitor of companies based in Europe and Latin America, which manufacture and market similar types of aircraft.

In the professional services area, many functions have shifted to countries like China and India because their workers have the ability to do a quality job at a much lower cost. Many U.S. firms are outsourcing services such as software development and tax-return preparation to India. Some U.S. companies are sending their U.S. employees to India for surgery because it is less expensive there, and the quality of care is excellent.

India and China are expected to be major players in the global economy over the next 30 to 40 years. Some have argued that, by the year 2040, the combined economies of Brazil, China, India, and Russia are likely to outstrip the total economies of what are currently the six largest economies: Canada, France, Germany, Japan, the United Kingdom, and the United States.[7]

The reach of globalization has become longer through the use of technology that allows a person in a tiny country like Bhutan in the Himalayas to become an international celebrity through a photo posted on Facebook. And, partly because of the changes in the world, Bhutan has also undergone major changes in the first decade of the twenty-first century. For example, it introduced a new constitution in 2005 and had its first parliamentary voting in 2008. In addition, it has its first Miss Bhutan, 25-year old Tsokye Tsomo Karchung, the object of a Facebook posting and an international following.[8] Undoubtedly, globalization has both positive and negative effects on most countries, as suggested in Friedman's *The World Is Flat.* It provides opportunities for companies to expand and grow by entering new foreign markets. It can also improve a country's economic development. Yet, competition from foreign firms entering a country's home market can harm local companies. Some of the questions about China relate to its effect on U.S.–based firms and their U.S.–based employees. For example, competition in United States markets from Chinese firms has seriously harmed U.S. furniture and textile firms. Government officials have to weigh the benefits of globalization against the costs. Often, these officials are under significant pressure by different constituencies to institute trade barriers that make it more difficult for foreign firms to compete effectively in their home markets.

Understanding a Country's Environment

Wal-Mart, the world's largest company, had total sales of more than $400 billion in 2010. The company serves approximately 200 million customers per week from its 8,400 stores in 15 countries.[9] To continue to grow and be profitable, it is important for Wal-Mart to know which markets to enter and how to compete in them. And, to this end, managers need to understand two major aspects of a country's environment: institutions and culture.

GLOBALIZATION

A MANAGER'S CHALLENGE

Small Business: Going Global

Because of increasing opportunities in international markets, many businesses have entered new foreign markets in recent years. In fact, some firms were able to offset domestic sales reductions related to the economic recession with increased international sales. For example, Orb Audio, a small manufacturer of high-end home theatre systems, has increased its foreign sales from 10 percent to 35 percent of annual sales, which recently totaled more than $5 million. During that same period, the company experienced a 10 percent decline in its U.S. domestic sales due to the recession. The company is making sales in developed markets such as Australia and Great Britain and also in developing countries such as Zimbabwe and Nigeria. And 10 percent of its total sales are now in Finland. Likewise, Air Tractor, the Olney, Texas–based manufacturer of crop dusters and other aircraft used for agricultural purposes, has been able to avoid sales declines related to the recession by selling in other parts of the world. The U.S. Export-Import Bank has helped Air Tractor sell in foreign markets. This bank helps ensure that small businesses are paid for goods and services exported to foreign markets. In a recent year, the bank provided $4.36 billion to support 2,540 transactions involving exports into international markets.

Real estate developer Gale International largely focused on building office parks in the United States until 2001 when it was approached by the government of South Korea to build a completely new city, Songdo. Korea's banks helped finance the project with $35 billion in loans to Gale. Although the new city will not be finished until 2015, Gale is making good progress. In 2010, it completed Songdo's 100-acre Central Park, modeled after the park by the same name in New York City. Songdo is to be fully wired with the latest technology—this part of the project is being managed by Cisco. Based on its experience in South Korea, Gale has partnered with Cisco, 3M, United Technologies, and architectural firm Kohn Pedersen Fox to build new cities in other countries. For example, Gale recently announced that this consortium will build 20 new cities in China and India using Songdo as the model. With China projected to need at least 500 new cities the size of Songdo, Gale's new global business could be very lucrative indeed.

These examples suggest that international markets provide significant opportunities for growth in both large businesses, such as Cisco, and small businesses like Orb Audio. The U.S. Commercial Service helps businesses expand overseas. Funded by the U.S. government, the organization can be particularly helpful to small firms because it provides free consulting services on many topics, including cultural sensitivity and developing effective business plans. Such services could be useful for such companies as EQ Smart Energy, which manufactures and distributes an energy drink. The company recently announced approval for its first attempt to enter foreign markets. It announced plans to export its effervescent tablets used to create the energy drink to Mexico and Brazil. Likewise, Dickinson Brands Inc., in East Hampton, Connecticut, distributes its witch hazel products globally, allowing it to balance sales across economic surges and declines in various countries. Globalization has been a boon to many businesses but has also made the management of those companies much more complex and challenging.

Sources: E. Maltby, "Three Best Ways to Expand Overseas," *Wall Street Journal*, May 28, 2010, http://www.wsj.com; "EQ Smart Energy Brand Goes International," *Business Wire*, May 28, 2010, http://www.businesswire.com; I. Mount, "Tips for Increasing Sales in International Markets," *New York Times*, April 21, 2010, http://www.nytimes.com; G. Linsday, "Cisco's Big Bet on New Songdo: Creating Cities from Scratch," *Fast Company*, February 1, 2010, http://www.fastcompany.com; E. Olson, "Some Small Businesses That Grew in 2009," *New York Times*, December 31, 2009, http://www.nytimes.com.

institutional environment the country's rules, policies, and enforcement processes that influence individuals' and organizations' behaviors that operate within the country boundaries

The Country's Institutional Environment

Each country has a distinct institutional environment composed of multiple institutions, including economic development, political-legal, and physical infrastructure. Institutional environments are often complex, having many important institutions that interact to create unique effects in each country.[10] The **institutional environment** consists of the country's rules, policies, and enforcement processes. This, in turn, influences the behavior of the individuals and organizations that operate within the country.[11]

THE ECONOMIC DEVELOPMENT INSTITUTION Countries vary in their level of economic development. Economic development and growth is vital to most countries because it contributes to better living standards and citizens' health and welfare.[12] Economic development is important to local and foreign firms as well because it opens up greater market opportunities.

Country economies may be classified into developed, emerging, and developing economies. Some countries, such as the United States and Japan have highly developed economies. Others such as Sudan and El Salvador have less-developed economies. Still others, like China and India have economies that are not highly developed but are growing rapidly. These economies are classified as emerging.[13] Countries in Western Europe have developed economies, whereas most of the countries in Eastern Europe are considered to be emerging economies.

Developed economies tend to be larger than less-developed or emerging economies. They also tend to have more effective capital markets. In effective capital markets, people and businesses are readily able to borrow money from banks and other financial institutions or raise it by selling shares in stock markets. Developed economies tend to be larger than those in other countries. Emerging economy countries such as China often have rapidly growing economies and their capital markets tend to be young and underdeveloped. Finally, the weakest economies exist in developing economies.

THE POLITICAL-LEGAL INSTITUTION This dimension of the institutional environment refers to a country's political risks, regulations, and laws, and their enforcement. Governments develop laws and policies to govern the behavior of their citizens and organizations operating within the country's boundaries.[14] Regulations can have a major influence on a country's economy for countries can institute regulatory changes to encourage more entrepreneurship. The level of entrepreneurship has a strong influence on a country's economic growth.[15] Among the important regulations that affect businesses are those related to the way foreign firms operate. These regulations include laws that impose tariffs and quotas on imported goods, laws that dictate the way employees are treated, and laws dictating how publicly traded firms listed on major stock exchanges in the country must behave.

For example, after China began to relax its markets (partially at least), all foreign firms entering the country were required to form joint ventures with Chinese firms. Foreign firms' behavior was also regulated in order to protect local firms that often lacked the necessary resources and capabilities to compete with firms from developed countries.[16] the Sarbanes-Oxley Act (often

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Workers ride tricycles past the first Wal-Mart store in Shanghai as preparations are made for the grand opening of China's 48th store. Wal-Mart is the biggest company on the planet, employing more than a halfmillion people in 2,700-plus stores worldwide.

referred to as SOX), enacted by the United States in 2002, was designed to curtail scandals like the ones at Enron and WorldCom. Both domestic and foreign firms registered on U.S. stock exchanges must adhere to the provisions in SOX. For example, all CEOs and CFOs must certify that their firms' financial statements published by the firm are accurate and satisfy the rules set forth by standards in the industry and legal requirements. Also legal rights given to shareholders can influence the strategies used by firms. For example, firms based in countries with strong shareholder rights are better able to restructure assets of acquired firms based in another country because of the supporting laws and regulations.[17] Primarily, the rules established by the law are intended to make the management of public firms more transparent. Yet, the rules can be excessive and discourage investment from abroad. Furthermore, an increasing amount of companies are going private (buying back their publicly traded stock) in order to avoid having to deal with the costly reporting rules required by the law. Laws such as SOX play an important role in countries' institutional environments.

Among the important laws are those regarding intellectual property rights. When laws related to enforcement of intellectual property rights (e.g., patents) are weak, firms with valuable technologies are reluctant to bring them into the country; And, if they do enter the country's markets, they may not use the valuable technology in that market or will disallow their local partners from accessing it. However, when barriers to such knowledge exist, they reduce the value of a joint venture, especially to the local partner. Local partners in developing and emerging markets often seek to gain technological and managerial capability from their more capable foreign partners.[18]

THE PHYSICAL INFRASTRUCTURE INSTITUTION Institutional infrastructure is critical to the operation of businesses within a country because it facilitates business communications and the movement of goods from their source to the ultimate consumer. Physical infrastructure includes such aspects as the amount and quality of roads and highways, number of telephone lines per capita, and the number of airports. The availability of physical infrastructure often plays an important role in decisions to enter a new international market by a foreign firm because it tends to perform more poorly in countries with underdeveloped infrastructure.[19] Therefore, countries that wish to attract foreign investment must try to develop their physical infrastructure.[20]

Without a good physical infrastructure, it is difficult for firms to distribute their products to potential customers. Thus, they either have to sell to smaller markets because they are unable to reach as many potential customers, or they have to distribute their products in much more costly ways. In either case, the firm earns lower profits than it would if the country's physical infrastructure was well developed.

Table 3.1 depicts clusters of selected country institutional environments. As shown, developing countries e.g., Nigeria and Brazil, with relatively weak economies and central regulations (largely government control/low political rights), form the first cluster. Emerging market countries form the second cluster. These countries are experiencing generally strong economic growth and are beginning to develop the other institutions needed for further economic growth (e.g., enhanced transportation, new laws and regulations such as intellectual property rights). The third cluster of countries has relatively advanced institutional environments exemplified by Western European countries. Finally, the most advanced institutional environments are in Japan and the United States.[21]

IMPORTANCE OF THE INSTITUTIONAL ENVIRONMENT Economic growth is vital to most countries because it contributes to the standards of living, health, and welfare of their citizens.[22] Economic growth is important to local and foreign firms as well. Higher rates of economic growth suggest greater market opportunities for all firms and attract new business development and foreign investments in the country's economy.

Beyond the attractiveness of a country's economic development and health, its laws, regulations, political stability, and physical infrastructure play an important role in firms' behaviors.[23] In particular, multinational firms seeking to invest in new international markets need to understand these elements of a country's institutional environment. These institutional dimensions can greatly affect a firm's willingness to make direct investments in a country's markets. Furthermore, recent research shows that the large presence of multinational firms in a country strongly influences the development of the country's institutional environment. For example, the greater number of multinational corporations in a country, the greater the pressure on government to develop and enforce legislation to reduce corruption.[24] The influences are partly because of these firms' effects on the country's economic development and growth. Corruption

TABLE 3.1 Country Institutional Environment Clusters

Cluster 1: This cluster largely consists of developing and transition economies. These countries are high in regulatory control and low in political rights.
Examples: Brazil, Russia, and Nigeria
Cluster 2: This cluster largely consists of emerging market countries that are more advanced than Cluster 1 countries but still need greater development of institutional dimensions. These countries score a little higher on political rights but the lowest on monetary policy and second highest on investment restrictions.
Examples: China, India, the Netherlands, and Singapore
Cluster 3: These countries have the second highest regulatory controls but also score high on political rights. They also have strong physical infrastructures.
Examples: Countries in Western Europe to include Finland, France, Germany, Portugal, and Sweden
Cluster 4: This cluster of countries has the most developed institutional infrastructure overall, with balanced regulatory controls and political rights; strong economic and physical infrastructure institutional dimensions
Only two countries are in this cluster, Japan and the United States

Source: M. A. Hitt, R. M. Holmes, T. Miller, and M. P. Salmador, "Modeling Country Institutional Profiles: The Dynamics of Institutional Environments" paper presented at the Strategic Management Society Conference, Vienna, November 2006.

also discourages foreign companies from making major investments in a country.[25] As explained later in this chapter, institutional environments have a major effect on firms' international strategies and especially affect which countries firms enter.

While institutional forces play an important role in determining firms' behaviors within a country, societal culture plays an equally strong role. Culture's effects may be more pervasive because of its influence on human behavior.

Culture

Although institutional forces play an important role in terms of how and where businesses globalize, a society's culture is critical. **Culture** is a learned set of assumptions, values, and beliefs that have been accepted by members of a group and that affect human behavior.[26] Some scholars refer to culture as a collective programming of the mind that has a powerful effect on individual behavior.[27] Although a culture can exist among any group of people, our focus is on national cultures.

culture
a learned set of assumptions, values, and beliefs that members of a group have accepted and that affect human behavior

Understanding culture is critical because it can dramatically influence how people observe and interpret the business world around them—for example, whether they see situations as opportunities or threats. A person's culture likely affects his or her opinion about the "right" managerial behavior. For example, only 10 percent of Swedish managers believe they should have precise answers to most questions subordinates ask them, whereas 78 percent of Japanese managers think they should.[28] As this example illustrates, culture can contribute to preexisting ways of interpreting events, evaluating them, and determining a course of action. And, national culture exerts a strong influence on the nature of a country's institutions.[29]

CULTURAL DIMENSIONS The two most prominent studies of culture were conducted by Dutch scholar Geert Hofstede and by a large number of researchers led by Robert House referred to as GLOBE.[30] Both of these complex studies identified at least four prominent dimensions of national culture: power distance, uncertainty avoidance, individualism versus collectivism, and gender focus.

Power distance is the extent to which people accept power and authority differences among people. Power distance is not a measure of the extent to which a group has power and status differences; most countries have richer and poorer citizens, and more and less powerful citizens. Power distance does not suggest whether status and power differentials exist in a country, rather, the extent to which people in the country accept those differences. In Hofstede's study, people from the Philippines, Venezuela, and Mexico had the highest levels of acceptance of power differences. In contrast, Austria, Israel, and Denmark had the lowest levels of acceptance.

power distance
the extent to which people accept power and authority differences among people

Cultures differ in the extent to which they need clarity or can tolerate ambiguity. This dimension of culture has been labeled **uncertainty avoidance.** Citizens in nations high in uncertainty avoidance prefer clear norms (rules that govern behavior). Groups high in uncertainty

uncertainty avoidance
when cultures differ in the extent to which they need things to be clear or ambiguous

avoidance create structures and institutions to reduce uncertainty. By contrast, groups that are low in uncertainty avoidance prefer to have fewer rules and tend to be more comfortable in ambiguous situations. For example, managers from Sweden, the Netherlands, and the United States are most comfortable with uncertainty; managers from Indonesia and Japan are least comfortable with high uncertainty.

individualism
the extent to which people's identities are self-oriented and people are expected to take care of themselves and their immediate families

collectivism
the extent to which identity is a function of the group(s) to which an individual belongs (e.g., families, firm members, community members, etc.) and the extent to which group members are expected to look after each other

gender focus
the extent to which people in a country value masculine or feminine traits

Individualism is the extent to which people's identities are self-oriented and people are expected to take care of themselves and their immediate families. People from the United States and Great Britain often score high on individual orientations. Individuals from these countries exhibit high emotional independence from organizations and institutions and tend to emphasize and reward individual achievement and value individual decisions.[31] Alternatively, **collectivism** is the extent to which a person's identity is a function of the group(s) to which the person belongs (his or her family, firm, community, and so forth) and the extent to which group members are expected to look after each other. People from China, Venezuela, and Pakistan have high collective orientations. People from these countries tend to exhibit emotional dependence on organizations and institutions to which they belong, emphasize group membership, and value collective decisions.[32]

Gender focus represents the extent to which people in a country value masculine or feminine traits. Countries emphasizing masculine traits value activities that lead to success, money, and possessions. Alternatively, those emphasizing feminine traits value activities that show caring for others and enhance the quality of life.

Countries such as the United States tend to emphasize masculine traits. In the United States, people often work many hours a week (over 60 hours is not uncommon), and take shorter vacations. In countries that do not emphasize masculine traits, work often has lower value. Table 3.2 presents the culture scores of selected countries.

Understanding cultures can be valuable for a number of reasons. For example, cultural characteristics can predict how managers will respond to socially responsible actions. Research has shown that managers in cultures that emphasize collectivism and are low in power distance engage in greater amounts of socially responsible activities than cultures with high individualism and high power distance.[33]

Globalization has greatly enhanced the extent to which cultural diversity plays a role in business. As companies globalize and expand their operations around the world, they create an increased opportunity and demand for people from different cultures to effectively interact

TABLE 3.2 Cultural Values and Scores (for Select Countries)

	Power Distance[a]	Uncertainty Avoidance[b]	Individualism/ Collectivism[c]	Gender Focus[d]
Brazil	5.33	3.60	3.83	3.31
Canada	4.82	4.58	4.38	3.70
China	5.04	4.94	4.77	3.05
England	5.15	4.65	4.27	3.67
France	5.28	4.43	3.93	3.64
India	5.47	4.15	4.38	2.90
Japan	5.11	4.07	5.19	3.19
Mexico	5.22	4.18	4.06	3.64
Netherlands	4.11	4.70	4.46	3.50
Poland	5.10	3.62	4.53	4.02
Russia	5.52	2.88	4.50	4.07
United States	4.88	4.15	4.20	3.34

[a]Higher scores indicate higher power distance.
[b]Higher scores suggest more uncertainty avoidance.
[c]Higher scores indicate greater collectivism.
[d]Higher scores suggest greater gender equality whereas lower scores indicate male domination.

Source: Based on data from R. J. House *et. al.*, eds., *Culture, Leadership and Organizations: The GLOBE Study of 62 Countries* (Thousand Oaks: Sage Publications, 2004).

together. Managers must interact and deal with suppliers, customers, and partners from different cultures. We discuss the management of cultural diversity within companies and relationships across cultures later in this chapter.

Knowing and understanding different institutional environments and cultures is important if managers are to make good strategic decisions about which foreign markets to enter and how to manage operations established in these markets. We examine these strategies next and discuss how different institutional and cultural environments affect the strategies chosen and how to implement and manage them.

International Market-Entry Strategies

Choosing which international markets to enter and how to enter them has become critically important to many small, medium, and large firms. With increasing globalization discussed at the beginning of this chapter, a large number of firms are servicing international markets at their birth. International markets are attractive to firms for several reasons. They increase the size of a firm's potential markets and sales revenue. When they sell more products abroad, these firms gain greater economies of scale which, in turn, increases potential profit. Firms can also gain access to special resources (e.g., lower-cost labor, valuable raw materials) in some international locations that can help them become more competitive in global markets. These are referred to as location advantages.[34]

The previous information suggests that firms have considerable motivation to enter international markets. Yet, all international markets are not created equal. As stated earlier, countries vary in their institutional environments and cultures. Thus, the attractiveness of countries' markets also varies. First, early in their internationalization efforts, firms prefer to enter markets with institutional environments and cultures similar to their own. Typically, they have a better understanding of these environments and therefore entry seems less risky. This is important, especially for small firms with less capital, because entering international markets requires resources and learning about the new market and environment rapidly.[35] For these reasons and to reduce potential costs, firms often cluster their international operations in one or a few geographic regions.[36] As firms gain more experience entering and operating in international markets, they are willing to enter markets where the differences in institutional environments and cultures are greater. Yet, the institutional environments and cultural differences also influence the means by which firms enter new international markets.[37]

Firms can enter new foreign markets in a variety of ways. Each poses different risks and requires different levels and types of resources. Among the ways to enter a new market are by exporting products to the market, licensing products to firms there, either acquiring or creating strategic alliances with local firms, or establishing your own operations in the country.

Exporting

The most common way to enter an international market is by exporting goods. This is especially true for smaller firms and for firms initially entering into foreign markets. **Exporting** involves manufacturing products in a firm's home country and shipping them to a foreign market. It is a popular entry strategy because of its lower risks and capital requirements. Because exporting does not require establishing operations in the country, firms avoid making a large capital investment. However, the exporting firm must establish a means of marketing and distributing its goods within the country.[38] Thus, exporters may have to combine exporting and strategic alliances with local firms in order to distribute their goods to customers. As a result, the costs of transportation and sharing profits with a local firm can reduce a firm's net gain from the international market. Therefore, although an export strategy is less risky, it is unlikely to provide big returns because of the associated costs. If the exporting firm's transportation costs are high, for example, it might be limited to exporting only to countries in close proximity of its home base of operations. Exports are also particularly sensitive to fluctuations in exchange rates.[39]

exporting
manufacturing products in a firm's home country and shipping them to a foreign market

Licensing

Licensing arrangements allow a local firm in the new market to manufacture and distribute its product. Usually, the licensing contract provides the specifications necessary to maintain quality

licensing
arrangements establishing how to allow a local firm in the new market to manufacture and distribute its product

and for the quantities to produce and sell along with the royalty percentages on the sales. In these cases, the licensor has low costs and takes little risk; the licensee assumes the major risks. Yet, licensing is unlikely to produce major returns for the licensor unless the potential sales in the new market are large.[40]

The Altria Group, owner of Philip Morris brand cigarettes, is losing sales in the United States due to declining cigarette use. Thus, Altria licenses its products for sale in 160 countries. For example, it has a licensing agreement with two Chinese firms to manufacture and market cigarettes in China under the Marlboro brand. This arrangement is lucrative for the Altria Group because the market for cigarettes in China is large and growing.[41]

Although licensing has advantages, it also has disadvantages. The primary disadvantage is that the licensing firm has little control over its product and the use of its brand in the new market. This underscores how important it is for a firm's licensing contracts to be clear and enforceable. Unfortunately, contracts with Chinese firms often are difficult to enforce. As suggested earlier, most of China's legal and regulatory institutions are relatively new. Thus, the Altria Group could experience problems if it doesn't like how China is marketing the Marlboro brand. Similar to exporting, licensing is also unlikely to produce big returns for a firm unless sales in the new market are large.

Creating Strategic Alliances

strategic alliance
a cooperative arrangement between two firms in which they agree to share resources to accomplish a mutually desirable goal

The most popular strategy for international expansion has become strategic alliances. A **strategic alliance** is a cooperative arrangement between two firms in which they agree to share resources to accomplish a mutually desirable goal. Strategic alliances allow firms to share the costs and risks of entering new markets, and they provide the opportunity for firms to access resources they do not have. As such, it also allows them to sometimes learn new capabilities from their partners.[42] In this way, alliances can contribute to a firm's ability to maintain or increase its competitiveness in global markets.

Strategic alliances allow firms to outsource functions that they completed in-house previously. The "A Manager's Challenge" "Outsourcing and Offshoring," explains the advantages and disadvantages of outsourcing. In general, outsourcing allows firms to gain access to better and often cheaper performance of functions. In this way, firms can compete better in international markets and even to enter and compete in some markets where they could not compete previously. The vignette also suggests that outsourcing alliances benefit large and small firms alike. The top outsourcing countries are India, China, and Malaysia, with much of the outsourcing to India focused on information technology and services while manufacturing is the primary emphasis in China.

Not all strategic alliances are successful; a large number of them fail. Yet equity-based alliances, such as joint ventures whereby companies share risks and rewards, tend to be more successful because the firm has more voice in and control of the activities completed by the alliance or venture. Trust also seems to be an important factor in the success of an alliance.[43] So is the way in which firms manage alliances. As such, many firms are establishing alliance management functions to increase the success because of the large number of strategic alliances firms are forming.[44]

A country's institutional environment affects the decision to enter its markets and the means chosen to enter. In addition to the particular institutions in place, the stability of the institutions is of interest to foreign firms. Uncertainty in the institutional environment can stunt economic growth, making markets less desirable.[45] At the very least, firms entering uncertain institutional environments need to do so in ways that lower their risk. Forming strategic alliances to share resources and risks is one way of doing so.[46] Uncertainty in the country's institutional environment also affects the type of alliance formed and the type of partner desired. For example, in uncertain environments, firms look for short-term partners. In more stable institutional environments, firms select alliance partners with whom they can work over the long term. In other words, they seek long-term returns from their alliance partnerships.[47]

A MANAGER'S CHALLENGE

CHANGE

Small Business: Outsourcing and Offshoring

Outsourcing has been popular for several years but its use dipped during the economic recession in 2008-2010. However, in 2010, outsourcing began to increase again, driven primarily by lower costs (because of the economic decline). Yet, although lower cost is often a benefit of outsourcing, perhaps a more important benefit is that the outsourced activities can be performed by those with high-quality specialized capabilities. Thus, tasks are accomplished more effectively.

The top three countries in receipt of outsourcing are India, China, and Malaysia, respectively. In particular, India and the Philippines account for 50 percent of business process outsourcing but India holds a large lead. India's quality technical capabilities, low costs, and use of the English language facilitate continued growth as the leading recipient of outsourcing activities. However, China has major goals to lead these rankings. For example, the Chinese government recently provided $1 billion in subsidies, incentives, and training to garner more outsourced activities. It has a goal of increasing the number of vendors to 1,000, attracting 100 additional foreign customers and developing ten hubs of outsourcing in the country, creating 1.2 million jobs by 2013. Currently, China's largest outsourcing company has $540 million in annual revenues, with 15,000 employees and 8,000 corporate customers.

Many companies and countries are getting into the act. For example, Xerox recently acquired Affiliated Computer Services (ACS), the leading business process outsourcing company, for $6.4 billion. Snapple has outsourced much of its information technology services to Noida in India. And the *San Francisco Chronicle* quit printing its own newspaper in favor of outsourcing all printing to Transcontinental Printing, a Canadian-based company.

Alternatively, some firms have reduced or eliminated their outsourcing activities, instead favoring offshoring. Offshoring involves firms establishing their own operations in another country. In this way, the firm can save money (e.g., access to lower labor costs) and also gain the help of those with special capabilities. Banks have increased their offshoring activities because of concerns about the financial crisis and the need to control the quality of the tasks performed. Importantly, banks are concerned about fraud and even inadvertent errors in outsourcing over which they do not have control. A benefit for small businesses is that outsourcing can help give them access to the same economies of scale, efficiency, and expertise that large companies enjoy. Outsourcing providers also assume and manage a certain amount of risk for their companies. This can be beneficial because markets, competition, government regulations, and technology abroad often quickly change.

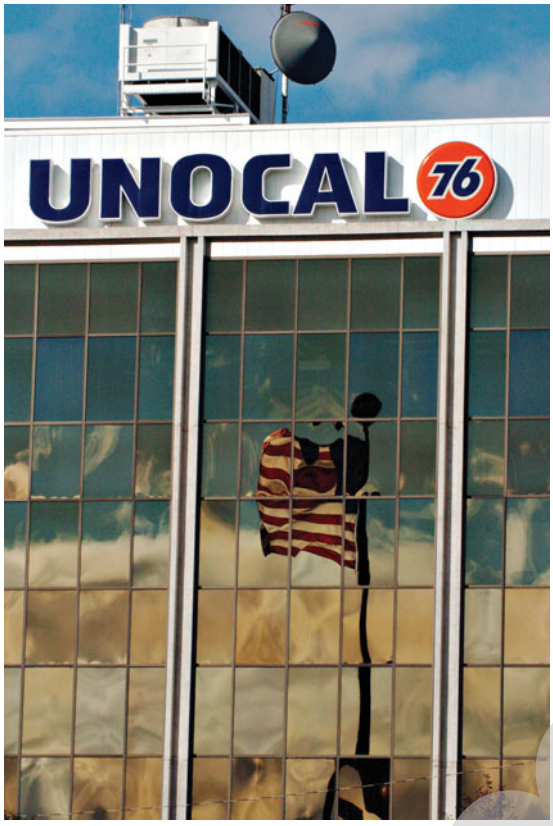
Sources: G. Colvin, "Ursula Burns Launches Xerox into the Future," *Fortune*, April 22, 2010, http://www.money.cnn.com; R. Fannin, "China: $1 Billion and Ambition," *Forbes*, March 10, 2010, http://www.forbes.com; G. Dennis, "The True Benefits of Outsourcing," *Fast Company*, March 16, 2010, http://www.fastcompany.com; E. Sperling, "Outsourcing Makes a Comeback," *Forbes*, January 25, 2010, http://www.forbes.com; R. Perez-Pena, "*San Francisco Chronicle* Outsources Its Printing," *New York Times*, July 13, 2009, http://www.nytimes.com; N. Heath, "Banks: Offshoring, Not Outsourcing," *BusinessWeek*, March 10, 2009, http://www.businessweek.com; N. Shivapriya, "India Remains World's Top Outsourcing Destination," *BusinessWeek*, July 10, 2010, http://www.businessweek.com; H. Timmons, "Snapple Deal to Outsource May Add Jobs in America," *New York Times*, July 1, 2009, http://www.nytimes.com.

Acquisitions

The purchase of a local firm made by a foreign firm to enter a new international market is referred to as a **cross-border acquisition.** The number of cross-border acquisitions has increased in recent years. Such acquisitions are more common among non-U.S. firms. For example, the number of cross-border acquisitions by European firms has grown dramatically in recent years; in fact, in a recent year they exceeded those made by U.S. firms for the first time in history.[48] Even firms from emerging market countries have used this strategy, as exemplified by the Chinese firm Lenova's acquisition of IBM's laptop computer business.

cross-border acquisition
acquisitions of local firms made by foreign firms to enter a new international market

In recent years, approximately 40 percent to 50 percent of acquisitions made worldwide are cross-border acquisitions.[49] Acquisitions of a local firm in order to enter a new foreign market have several advantages. For one, it provides a fast way to enter a market. Operations in the new market are immediate with the acquired firm's customers, facilities, and relationships (e.g., with suppliers, government units, etc.). It generally represents the largest new market entry of the



Daniel Acker/Blommberg News/Landov Media

Globalization is fraught with difficulties. A Chinese firm found out as much when it tried to acquire Unocal, a large U.S.-based oil company. But U.S. citizens and Congress objected strenuously to the deal, effectively killing it.

different alternatives. With the recent acquisition of Kuwaiti telecommunications firm Zain, India's Bharti Airtel became the fifth-largest mobile phone operator in the world.[50] Cross-border acquisitions are sometimes controversial with the local public or government. Such was true when CNOOC, the large Chinese petroleum company, attempted to acquire Unocal, a large U.S.-based oil company. CNOOC withdrew its bid because of objections from many in the U.S. Congress. Thus, there are disadvantages to cross-border acquisitions as well.

Cross-border acquisitions usually entail many of the potential advantages of acquisitions made within a firm's home country, but problems with a cross-border acquisition can be severe. For example, a common problem in acquisitions is the challenge of integrating two previously independent companies. Differences in the corporate cultures between the acquiring and acquired firms make integration difficult. Yet, cross-border acquisitions face a double-layered cultural integration problem.[51] Integration requires overcoming differences in corporate culture and national culture. Outside of selecting the right target, integration is the largest reason for the failure of acquisitions.[52]

Costs are another major disadvantage of cross-border acquisitions. It has become common for acquiring firms to pay a premium (that is, more than market value) for target firms. Yet, premiums may be a larger problem in cross-border acquisitions because the acquiring firms frequently have less information on the target than in domestic acquisitions. And, research has shown that premiums are highest in host countries known for having a large amount of corruption.[53] Additionally, greater differences in the institutional environments of the home countries of the acquirer and target firms increase the challenges of making the acquisition successful.[54]

When an acquiring firm makes the correct choice of target and does not overpay for the acquisition, entering a new foreign market can be a positive opportunity. Yet, the acquiring firm still must achieve integration, and that is likely to present a challenge.

Establishing New, Wholly Owned Subsidiaries

wholly owned subsidiary
a direct investment to establish a business in a foreign market in which the local firm owns and controls 100 percent of the business

Some firms prefer to establish a new, wholly owned subsidiary to enter a new international market. When a company creates a **wholly owned subsidiary** in a foreign country, it makes a direct investment to establish a business that it solely owns and controls. Such a subsidiary is often called a *Greenfield venture.*

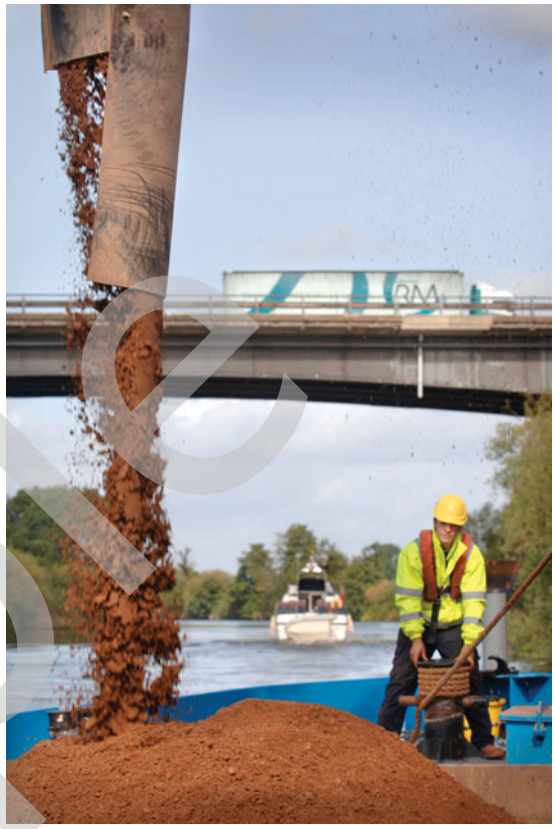
Greenfield ventures afford a firm maximum control over the operations. Firms such as Starbucks—those with strong intangible resources including a good brand name, human capital, and so forth—may prefer to enter international markets through Greenfield ventures because it allows them to buffer these assets from current and potential competitors in the new market.[55]

Greenfield ventures are often complex and expensive to launch, however. To maintain control requires that not only must the firm build its own facilities, it must also establish relationships with suppliers, build distribution networks within the foreign country, and foster a positive relationship with potential consumers. Thus, the new business must attract customers from existing competitors or convince new customers to buy its product. Firms establishing Greenfield ventures must learn about the national culture and institutional environment—on their own. If the cultural or institutional distance between home and host countries is high, a firm may experience difficulties establishing a new wholly owned subsidiary or making it successful. Therefore, the risks of establishing these subsidiaries can be quite high.[56]

With the development of China's economy and the significant amount of cross-border trade between Western and Chinese firms, UPS established a new wholly owned subsidiary in Shanghai and FedEx did the same in Guangzhou. The firms entered the markets with Greenfield investments because they needed to ensure fast and reliable service and desired to maintain control over their logistics operations.[57]

While wholly owned subsidiaries are valuable and allow firms to control their operations, they are risky and not always successful. In 2002, eBay entered the China market with a partial

acquisition of Eachnet.com, and fully acquired the company the following year for $180 million. In 2005, eBay invested over $100 million in marketing for its wholly owned Chinese subsidiary. Even with the acquisition, eBay was unable to manage the Chinese marketplace and fend off competition. Its primary competitor in China, Taobao, took market share from eBay's subsidiary. In December 2006, eBay announced it was shutting down its main Web site in China and forming a joint venture with Tom Online, Inc., to operate in the Chinese market. Analysts said eBay lost market share because not only did it not understand the Chinese market and culture, it did not move quickly to counter Taobao's challenge.[58] The decisions regarding what foreign markets to enter and how to enter them are very important. Yet, the management of international operations also affects their success. In the following sections, we explore the management of international operations, examining the corporate approach used and how to manage across cultures, with an emphasis on managing cross-cultural teams.



Adrian Sherratt/Alamy Images

A worker helps load product at a Cemex dock in England. Cemex, a company headquartered in Mexico, has operations in Europe, North America, South America, and Asia. Because the company sells a largely standardized project—ready mix cement—it's been able to take a more centralized approach to globalization and achieve economies of scale as a result.

Managing International Operations

Companies must choose the manner in which they manage their international subsidiaries. These choices carry important meaning for the management and flow of resources and information throughout a company's international operations. Of critical importance is the degree of autonomy granted to individual subsidiaries to develop and implement their own strategies. The home office can choose from three different approaches: a global focus, a region/country focus, or a transnational focus.

Taking a Global Focus

In a **globally focused organization,** the firm's home office makes major strategic decisions. Thus, the global organization has centralized authority, and international subsidiaries usually follow the same or similar strategy in each of their markets. These organizations normally attempt to market a relatively standardized product across geographic markets. Such an approach provides economies of scale and helps to manage costs and thereby enhance profits. Thus, it helps firms to gain returns on innovative products developed in the home country market, especially firms that compete in markets where price is a critical competitive concern. In a globally focused organization, subsidiaries often share resources, allowing the most efficient allocation of resources throughout the company.

globally focused organization
an organization that invests the primary authority for major strategic decisions in the home office

While a global focus offers several advantages as noted previously, it also presents some disadvantages. Because it does not allow the international subsidiary the flexibility to decide how to compete, it may be unable to take advantage of market opportunities when they occur. Furthermore an international subsidiary operating in a globally focused organization does not have the flexibility to react quickly to competitors' strategic moves. As such, they are vulnerable to competitors taking strategic actions with the intent of "stealing" market share in the local market. These international subsidiaries cannot respond easily to changes in customers' needs in the local market. When Vodaphone used a global focus, it was unable to respond to local customers' needs in Japan and lost market share. On the other hand, Cemex, the world's third-largest cement company, uses a global focus successfully. In this case, the type of product sold (ready-mix cement) can largely be standardized. Cemex, headquartered in Mexico, has operations in North America, South America, Asia, and Europe. The centralized approach used by Cemex provides economies of scale and higher returns.[59]

Taking a Region–Country Focus

In an organization using a **region–country focus,** the primary authority to determine competitive strategy rests with the managers of its international subsidiary based in a region of the world or a specific country.[60] In this way, the region or country managers can tailor their strategies to local market conditions and demands. For example, subsidiaries can design, manufacture, and sell products that best satisfy local market customers. In this sense, subsidiaries can customize

region–country focus
a situation in which primary authority for determining competitive strategy rests with the management of the international subsidiary based in a region of the world or a specific country