

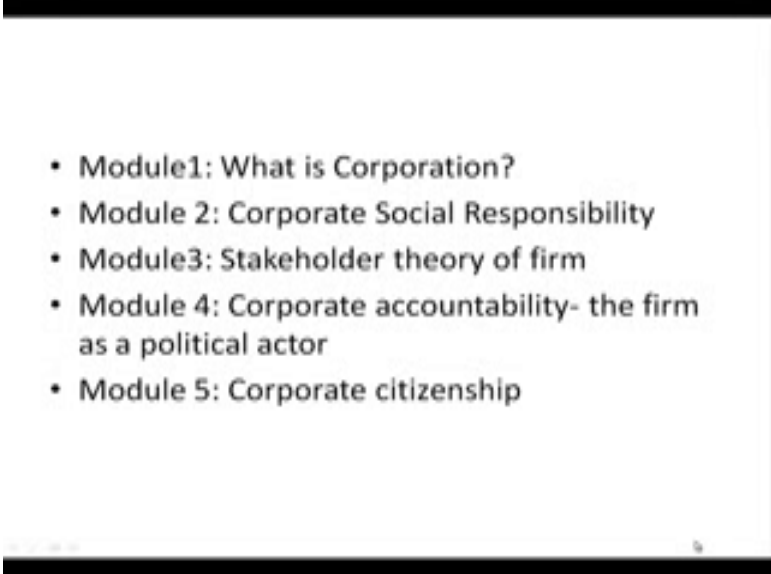
Business Ethics
Prof. Susmita Mukhopadhyay
Vinod Gupta School of Management
Indian Institute of Technology, Kharagpur

Lecture - 05
What is Corporation?

Welcome you all to the second session of learning of business ethics. Today we will be discussing on the second module that is framing business ethics CSR, stakeholders and citizenship. The lessons that we are going to discuss now are mainly adapted from the book of business ethics by Crane and Matten; second edition, oxford university publication.

So, in the last lecture we have come to understand business ethics as a field of study and practice, where we try to study the business situations, activities and decisions and try to find out what are morally right or wrong with respect to a particular business situation. We have also discussed about how the situations are different for different natures of organization. We have discussed 4 different organizational types and differences in business ethics situations and activities and decisions across these 4 types of organizations. We have also studied the context of globalization as where business takes place and the ethical issues related to it. We have also studied sustainability as a key goal for business ethics, where we have discussed about sustainable development, the concept of sustainability and sustainable business practices. Today we are going to discuss about the framing of business ethics.

(Refer Slide Time: 02:48)

- 
- Module1: What is Corporation?
 - Module 2: Corporate Social Responsibility
 - Module3: Stakeholder theory of firm
 - Module 4: Corporate accountability- the firm as a political actor
 - Module 5: Corporate citizenship


Here we are trying to discuss mainly about 5 modules, which consist or sub modules which consist of module 1: which discusses about what is corporation? Module 2: which will discuss about corporate social responsibility, module 3: which will discuss about the stakeholder theory of the firm, module 4: will discuss about corporate accountability and the firm as a political actor and module 5: will discuss about corporate citizenship behavior. So, let us start with the discussion of what is corporation?

So, generally when we talk of business ethics and the responsibilities of a corporation the question which immediately comes to our mind is, what is a corporation? How is it different from other business organizations, which are there? Is it not the corporation by taking in resources from the society, giving employment to people of the society in the process of producing the goods or services and paying taxes to the government are doing a major part of their responsibility towards the society? Do they actually have any sort of moral or social responsibility that we are discussing under the corporate moral responsibility or social responsibility? There are different views which have come which to defend either to defend, like yes corporates do have moral and social responsibility or tell no, corporates do not have any moral and social responsibility just like individual entities like human beings have.

So, to discuss over this issue of whether corporates do have moral or social responsibility first it is essential to understand what we understand by what is a corporation. So, when

we understand what is a corporation? We have to keep in mind like all businesses like businesses, where there is a sole trader are not corporates. Also all corporates like universities or like NGOs if formed at very large level these are not for these are not labeled as for profit businesses. So, we have to understand like all businesses are not corporates and also all corporates are not commercial businesses or for profit businesses. When we will be discussing ethical responsibilities, corporate social responsibilities, what you are trying to discuss here mainly about focus will be mainly on organizations which are for profit organizations. But we will also try to focus on extend our discussion when we are discussing business ethics and right and wrong for the activities practices and decisions taken in business scenario. We will extend our discussion not only to for profit organizations, but we will extend it to all types of organizations where certain practices are followed to move forward with the purposes for which the organizations are formed and how the transactions takes place over there. So, we will widen the scope of discussion to all types of organizations, where there are transactions going on and there are practices followed to reach certain vision missional objectives, for which the organizations are formed and they deliver certain things to the society either in terms of goods or services.

(Refer Slide Time: 07:57)



The slide is titled "What is Corporation" in a bold, black font. Below the title, there are four bullet points, each preceded by a small black square. The text of the bullet points is as follows:

- A corporation is essentially defined in terms of *legal status* and the *ownership of assets*
- Corporations are typically regarded as 'artificial persons' in the eyes of the law
- Corporations are notionally 'owned' by shareholders, but exist independently of them
- Managers and directors have a 'fiduciary' responsibility to protect the investment of shareholders

So, let us now define try to understand what we mean by what is a corporation. So, we can see like corporation is mainly defined in terms of its legal entity and the assets which are possessed by the corporate. So, when we are talking of the legal status or corporation

as a legal entity, we understand that corporates are regarded as artificial persons in the eyes of law, means it has its existence which is not limited to the existence of its shareholders its consumers or its employees and it has what we call a perpetual presence or succession. In the sense even if the share one or one or the other shareholders die, employees leave, the consumers quit, the corporate does not cease to exist it has its own existence its own entity and the only the people need to be replaced. If one shareholder is quitting or leaving to whatever reason or consumers are leaving or employees are leaving, the only thing that the corporate needs to do is to replace these people. But, its existence does not cease or become non-existent due to the absence of one or some of these people. So, we now come to define corporation as artificial persons in the eyes of law which has its own existence

Next, corporations are notionally owned by shareholders, but they independently exist of them, means the though the shareholders own the corporation, but it means they own only the shares of the corporation and are in return they have the benefit of the dividends or a say in the decision making of the organization to certain extent. But the corporation itself has its own assets, in terms of the physical infrastructure, in terms of machineries, in terms of land and other things. So, these are the assets which the organization possesses and which the corporate possesses and it is not possessed by the shareholders. Also, the consumers enter into a contract with the corporation and not with the shareholders. So, the corporation though notionally owned by shareholders has an existence which is independent of the shareholders because it has its own assets.

Third; managers and directors have a fiduciary responsibility to protect the investment of the shareholders. This means that the managers and directors have a responsibility to see that the money invested by the shareholders are invested in a proper way. So, that it yields returns for the shareholders and they have to be trustworthy to the shareholders and their money of the shareholders. So, it is understood managers and directors have a fiducial responsibility to protect the investment of shareholders. So, in a nutshell the legal entity or the status of the corporation as an artificial person, which is independent of the entity of its shareholders, its consumers, its employees and others and the assets which are possessed by the corporation these 2 qualities primarily define the qualities of a corporation.


Next after we have defined the corporation in this way next important question which; obviously, comes to understand if corporation has an artificial existence like a person. Then does it have moral responsibility and obligations just like a person have let us look into this issue now.

(Refer Slide Time: 14:02)



Can a corporation have social responsibilities?

- Milton Friedman's classic article is "The social responsibility of business is to increase its profits" (1970)
- Friedman vigorously argued against the notion of social responsibilities for corporations based on three main arguments:
 - Only human beings have a moral responsibility for their actions
 - It is managers' responsibility to act solely in the interests of shareholders
 - Social issues and problems are the proper province of state rather than corporate managers



When we are discussing can corporations have social responsibility. So, first in this context we will discuss whether corporations do have a moral responsibility. According to a classic paper, in 1970 by Milton Friedman; He discussed about the fact like only human beings have a moral responsibility for their actions. Because corporations are artificial entities and so human beings actually make the decisions which are made by the corporates. So, it is ultimately the human being who makes the decisions. So, whether any decisions is right and wrong that onus lies on the individual. So, only human beings have a moral responsibility for their action. It is the manager second point according to Friedman; it is the manager's responsibility to act solely in the interest of shareholders. Because, what we saw as a part of definition of what is a corporation, we found like it is the manager's fiduciary responsibility to take care of the shareholder's money. So, when are talking of the moral responsibility of the corporation or the social responsibility of the corporation. It is, according to Friedman; it is limited towards the money and protection you know of the shareholders' money, because the fiduciary responsibility the managers and directors have a fiduciary responsibility for the shareholder's money.

Third; whenever we are talking of social problems and corporate social responsibility it comes to the fact. according to Friedman; that the managers or the corporation per se do not have the social responsibility towards the greater society at large because they are not meant for it or they are not properly trained for it also, because according to him it lies in the province of the government per se or the political leaders, per se who are properly trained for taking up issues related to social issues and problems and it is beyond the province of corporation to deal with these type of issues. So, in his classic paper the social responsibility of business he stated that the social responsibility of business is to increase its profits.

(Refer Slide Time: 17:52)



Next, we are going to discuss about corporate social responsibility. And before we are going to discuss this corporate social responsibility again, we have to make up a case for advocating that yes corporates do have a social responsibility. In that case, first as we have established the moral responsibility, legal entity of the corporate as a separate entity for the; which is beyond the entity of its shareholders or its consumers or the employees. If we can establish like yes corporations also have a moral entity which is independent of the agency of its shareholders and its consumers and employees then we can tell the corporation is also morally and socially responsible for its activities.

And the way to argue that the way to advocate this thing first, we have to understand the internal decision making system where are there in place in the organization which are

institutionalized internal decision making mechanism, which are there in the organization which helps in the decision making process. So, it can be argued that every organization has a organizational chart and a internal decision making process, internal decision making system which influences or facilitates the decision making process and which is institutionalized by the nature of policies framed by the organization which acts as a guideline regarding what are the expected right and wrong for these what the organization thinks to be right and wrong.

So, when the decision making processes get institutionalized through these internal decision making mechanisms present in the organization, which are evident not only from the organizational chart which shows how the information flows throughout the decision flows throughout the organization. But there is systems in place which help in these decision support systems then though individual is taking the decisions, but it no longer remains to be one particular individual who is responsible for the particular decision being made, but it is a well like networked mechanism where group decisions and organizations input into the decision through its policies and practices comes to play. Where we can also tell it is not only the individual, but the organization through its chart organizational chart and the decision support mechanisms present within the organization influences the; what actually gets decided by the human being present in the organization and that is how it has a major responsibility in deciding what is right and wrong.

Also the organizational culture which speaks about the beliefs the values of the organization gives evidence about what the organization thinks about how to do certain things? What is the standpoint? It takes about its certain practices to be followed and what happens to individuals who follow the culture and what happens to people who question this culture? And so this all this together defines the organization's take on what they feel or what they want to propagate what is right or wrong according to them.

So, if we are focusing on these 2 things like internal decision mechanism within the organization, organizational chart and the organizational culture these 2 talks of the systems present in the organization, which to some extent makes the organization also responsible for the ethical decisions taken the moral decisions right and wrong taken for the organization. Though we cannot like the weightage is same like you are talking of individual moral responsibility and the corporate's moral responsibility because it is

ultimately given a certain system in place, given a certain culture in place at the end of the day it is always a particular individual or group of individual who gives certain decisions or who takes certain decisions who interprets the system and the situations around and takes certain decisions.

So, we just cannot tell like the onus or the weightage of the responsibility is equally same for both, but we also cannot deny the fact that the corporates also do have certain moral responsibilities. When it has its existence as an artificial entity drawing analogy with that organizational culture can be drawing analogy with the personal value system of the individual and the organizational culture is the value system of the artificial entity which is the corporate and the internal decision making systems present are just like the ways that the individual also processes information and takes the certain decisions.

So, these are just like we process information and take decision through the input, throughput and output is the decision that we take. So, likely the internal decision making mechanisms that are present in the organization are its decision support system and it is the path through which the mechanism through which the organization is also thinking or facilitating thinking and we can take like it is the decision making mechanism for the organization and if we are comparing them then we can understand this also gives a artificial this is the part of the artificial and existence of the organization and we can; obviously, tell like yes corporations also do have some moral responsibility. So, when we have stated for these 2 things now we move forward to discussion of corporate social responsibility.

(Refer Slide Time: 27:04)



Why do corporations have social responsibilities?

- *Business reasons* ('enlightened self-interest')
 - Extra and/or more satisfied customers
 - Employees may be more attracted/committed
 - Forestall legislation
 - Long-term investment which benefits corporation
- *Moral reasons:*
 - Corporations cause social problems
 - Corporations should use their power responsibly
 - All corporate activities have some social impacts
 - Corporations rely on the contribution of a wide set of stakeholders in society, not just shareholders

In corporate social responsibility when we are talking of. So, what we can think of is why do corporations have social responsibility? Because in Friedman's when we talked of Friedman's things we first discussed like according to Friedman; he told like the corporations do have limited responsibility to the; limited responsibility which is limited to the to the trust or the shareholders, the shareholders have trusted them with their money and it is a limited responsibility of the organization to take care of the money that the shareholders have trusted them with and invest it properly. So, that they get proper returns for the shareholders and they are in agency relationship with them. So, if that is done properly then why do we take care of, why should we think something for the social responsibility for the extended society at large?

So, this when we are discussing about corporate social responsibility mainly we have to broaden our perspective of discussing about the whom the corporation is accountable to is we have to shift our concept from the stake like shareholder orientation to the concept of stakeholder orientation. So, when you are shifting your concept from shareholder orientation to a stakeholder orientation and we incorporate society as one of the important stakeholders of the whole business then we can discuss about the corporate social responsibility where we find yes the corporation is also responsible to the society at large.

So, next we will try to focus on the details of first we try to argue do corporates have a social responsibility which we have already discussed about. Next we will try to see why do you feel that the corporations do have a social responsibility? Is it due to some moral reasons or is it due to some reasons which are confined to the specific business itself and then we will move forward to define the different nature or the different steps of the corporate social responsibility following a certain model and then we move forward with what it gives to the organization to the society at large.

Thank you.