# CORPORATIONS AND SOCIETY COURSE

# CORE MODULE

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## 1. COURSE OVERVIEW AND STRUCTURE

This course explores the relationship between corporations and society, and the ways in which corporations, governments and civil society manage issues where the pursuit of profit-oriented business goals is deemed inconsistent with the public interest. There are two modules, each consisting of ten sessions: the first, which has a common curriculum across all Corporations and Society designated courses, examines these issues broadly in the context of the natural environment and the social environment. The content of the second module varies according to the specific instructor and focuses in detail on a subset of particular issues covered in the first module. Students select one from several options for the second module. Topics of these second modules include business sustainability, business and government, environmental supply chain management, and women in management. The combination of the two modules provides students with both breadth and depth in educational content.

*Core Module: Corporations and Society*

Corporations are the modern engines of economic growth providing employment and income for individuals, goods and services for consumers, and taxation revenues for governments. Corporations are also important sources of new technology, innovation and entrepreneurship. In many ways, corporations underpin the high standards of living achieved in developed countries and improving standards in emerging parts of the world. Political philosophers and economists from Adam Smith to Milton Friedman have identified the benefits to society of competitive markets and private enterprise.

Yet unchecked actions by private corporations can have detrimental consequences too: companies with a dominant position in their industry may raise prices above competitive levels, harming consumers; manufacturing companies may cut corners on workplace or product safety standards, risking the welfare of workers and consumers. In other cases, corporate actions affect stakeholders outside the scope of their market-based interactions as when polluting firms harm the health of a population or the natural environment. Profit-motivated corporate sector actions thus need not necessarily align with broader societal or public interests.

The traditional role of government has been to regulate the excesses of corporate behavior and to strike a balance between private and public interests that improves overall societal welfare. NGOs and activists have adopted "private politics" strategies that also seek to shape and regulate corporate actions. Managers must thus wrestle with a variety of external pressures that can significantly affect financial performance, and make choices on how to best integrate these dimensions in business models and management systems. There is the potential for competitive advantage to be increasingly rooted in new capabilities such as pollution prevention, design for environment, social responsiveness, and stakeholder management. These capabilities draw on a number of functional areas, including marketing, human resources, operations, finance and strategy, to list several.

In the Corporations and Society core module we focus on the interactions between corporations, the natural environment, and society. The first five classes examine in detail the relationship between corporations and the natural environment. An in-class simulation exercise, 'Fish Banks', illustrates how a failure in fundamental market conditions – the 'tragedy of the commons' – generates non-optimal outcomes from an environmental perspective. In this case, when private property rights are not allocated or are unenforceable, a natural resource such as a fish population is exhausted through unfettered private sector actions.

After that we consider how government regulation can mitigate market failure and limit such environmental degradation by the private sector, for instance through the creation of carbon markets and the allocation of tradable emissions permits. The class will investigate the mechanics of how carbon markets work, their impact on businesses in different industries, and their pros and cons relative to alternative regulatory policy instruments.

The fifth class examines how the private sector can, in some cases, also provide solutions to environmental problems. We will examine the strategic decision-making of a small start-up in the 'green' recycling industry, FrogBox, and the challenges and risks that private sector investors confront in the pursuit of both environmentally-friendly and profitable business models.

The subsequent classes of the core module explore some of the major tensions that can arise between corporations and societal interests when corporations pursue profit-maximizing strategies

Two conceptual themes run throughout. The first is whether competitive, well-functioning markets produce outcomes that are perceived by society as being fair or equitable. This issue arises in various contexts, for instance in the public debates around corporate off-shoring and outsourcing strategies – which have provoked claims of "unfair" domestic job losses, "biased" competition from developing countries, and "exploitation" of foreign workers. Another issue concerns the impact of intellectual property rights on the ability of individuals to access affordable health care and pharmaceutical products. In each case, corporations have been criticized for their perceived contributions to outcomes that are judged in some quarters to be unjust.

The second conceptual theme is why some markets fail to function in a competitive manner and thus do not produce efficient outcomes – thereby motivating government intervention to correct 'market failure'. Negative externalities (resulting in over-pollution and environmental degradation) are just one example of a cause of market failure. We will use several cases to explore other causes of failure, specifically the presence of asymmetric information between buyers and sellers (e.g. in the financial services sector), and the purposive creation of dominant market positions through industry consolidation (mergers and acquisitions). In each of the case studies we use we will explore these issues from two perspectives, that of the corporation and that of society at large.

## 2. COURSE OBJECTIVES

- Appreciate the reasons why corporate and societal objectives may or may not coincide, and the issues where conflicts tend to arise

- Understand the ways in which corporations, government, and civil society attempt to resolve conflicting objectives

## 3. EVALUATION

- Mid-term Exam on Module 1 material ($33^1/_3$%)

- Classroom Contribution ($33^1/_3$%)

- Final Written Project for Module 2 ($33^1/_3$%)

***Corporations and Society: Core Module***

***Class and Topic Schedule***

| **Business and the Natural Environment** | |
|---|---|
| ***Case / guest / exercise*** | ***Topic*** |
| 1. Corporations and Society | Course objectives, overview and introduction |
| 2, 3. Fish Banks, Ltd. (simulation game) | Environmental externalities and market failure |
| 4. Carbon Markets and Permit Trading | Government regulation |
| 5. Guest speaker: Doug Burgoyne, CEO of FrogBox | Entrepreneurship and 'green' business |

| **Business and Society** | |
|---|---|
| ***Case / guest / exercise*** | ***Topic*** |
| 1. Hitting the Wall: Nike and International Labor Practices | Globalization, labor standards and off-shoring |
| 2. Life, Death, and Property Rights: The Pharmaceutical Industry Faces AIDS in Africa | Public health and intellectual property rights |
| 3. The Taxi Industry in Four Countries | Markets versus governments |
| 4. Labelstock | Competition policy, mergers and acquisitions |
| 5. The Global Financial Crisis | Regulation and innovation in financial services |

**Class 1: Introduction to the Course: The Role of Corporations in Society**

The course begins with a preliminary assessment of the relationship between business and society. The fundamental question that underpins the first module of the course is whether the pursuit of private gain by corporations (i.e. profit) is good for the public interest. Under what conditions do private and public interests coincide? When is corporate profit-seeking behavior harmful to the broader public welfare? What is the role of government and other institutions in managing any tensions that arise between corporations and society? What are the implications for corporations' business practices and strategies?

During this class we explore these questions using the results of the annual HBA Corporations and Society Attitudes Survey. We will also use selected clips from the award-winning documentary *The Corporation* to stimulate debate.

Assignment: read Crane and Matten (2010), *Business Ethics*, chapters 1 and 2 and The Economist article posted on-line 'Profit and the Public Good' (which is part of an excellent Economist Survey on Corporate Social Responsibility).

Come to class ready to debate the proposition that 'The pursuit of profit is good for society'. Where do you stand in this debate? Why? Should business leaders solely focus on their responsibilities to shareholders?

**Reading**
Crane, A. and Matten, D. 2010. *Business Ethics*. Oxford University Press
The Economist, January 20, 2005. Profit and the Public Good.

**Optional Further Reading**
Jensen, M. C. 2001. Value Maximization, Stakeholder Theory and the Corporate Objective Function. *European Financial Management,* 7(3): 297-317

**Class 2: Environmental Externalities and Market Failure**

In this and the next four classes we shall focus on the relationship and tensions between corporate actions and the natural environment. We begin with an interactive team-based simulation exercise, *Fishbanks*, that illustrates how a failure in fundamental market conditions generates non-optimal outcomes from an environmental perspective. In this case, when property rights are not allocated or are unenforceable, a natural resource such as a fish population is exhausted through unfettered private sector actions. This type of market failure is sometimes referred to as "the tragedy of the commons". Understanding how and why such negative externalities operate establishes the motivation for government regulation of corporations in the industry.

Assignment: As background reading on the topic, read pages 745-755 in the Viscusi et al "Environmental Regulation" chapter in the course reader. Then read the briefing presentation on the Fishbanks game. Organize yourself in your assigned learning team (see attached team list) and work out your team strategy for how to play the game over the course of up to 10 rounds. Come to class with your decisions already made for the first round: where to allocate your existing ships; how many ships to build; how many ships you may wish to buy from or sell to other teams, and at what price; and whether you wish to buy more ships in the first period auction (see slide 26 of the presentation). Since time will be tight, it is important that all teams are prepared and ready to begin the game immediately.

You may also wish to watch the instructional video on the Fishbanks game at https://mitsloan.mit.edu/LearningEdge/simulations/fishbanks/Pages/Video.aspx

In the next class we shall debrief the game's results and discuss broader implications for environmental management, public policy and business.

**Reading**
Viscusi et al., 2005. *Economics of Regulation and Antitrust*. MIT Press.
Fishbanks Briefing document

**Class 3: Environmental Externalities and Market Failure (ii)**

In preparation for class, read the New York Times article, "Building a Green Economy" by Paul Krugman, which recaps the theory of negative externalities and then discusses in greater depth the problem of climate change. Then consider the following:

1. Your team's strategy in the Fishbanks game: What was your strategy? Did it work as expected? Was it a good or bad strategy? Did you adjust your strategy during the game? If so, why and how? What would you do differently next time in order to win the game?
2. Overall industry results: were you surprised at what happened to the fish stocks? When did you realize that depletion was occurring? How did your team react?

Application to business: one of the major market failures confronting society in the 21st century, driven by a tragedy of the commons situation, is that of climate change. Responding appropriately is a central policy priority for governments in most countries, and it is a focal concern for many non-governmental associations and the public at large. Businesses in a wide range of industries will be affected directly or indirectly in some manner, requiring minor or major adaption of business models and strategic planning.

3. Pick a single industry or firm in which you have a particular interest. Identify how climate change may directly or indirectly shape the financial performance of the industry/firm (if at all), and how it may adapt.

**Reading**

Krugman, P. 2010. Building a Green Economy, *New York Times*, April 5, 2010

**Optional Further Reading**

Dietz, T., Ostrom, E. and Stern, P. 2003. The Struggle to Govern the Commons. *Science* 302: 1907 - 1912

**Class 4: Government Regulation of the Environment**

In this class we assess the ways in which governments attempt to regulate environmental pollution by the private sector, and the implications for corporations. We focus on policies that use market mechanisms – e.g. carbon markets – to influence corporate emissions. Even though recent attempts at creating carbon markets in the U.S. have stalled, there is a long history of governments using tradeable emissions permit schemes to successfully reduce pollution levels in various jurisdictions. For instance, the U.S. sulphur dioxide scheme launched during the 1980s has notably drastically curtailed the problems of "acid rain". Policy analysts expect that in the long-run market mechanisms will increasingly be adopted by more governments in a range of industries to address environmental problems.

During the class we will use a simulation game to investigate the mechanics of how carbon markets work, their impact on competitive interactions between corporations within industries, and their pros and cons relative to alternative policy instruments.

Assignment: read pages 1-3 and 12-16 of "The Value of Carbon in Decision-Making" by Sustainable Prosperity. Make sure you understand the concept of Marginal Abatement Cost. Skim the article by Goulder and Parry (2008).

It is also worth reading these news stories about energy industry requests for the government to implement carbon pricing, and about new government emissions standards:

http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/president-of-royal-dutch-shell-canadian-division-urges-carbon-price/article4534929/
http://www.theglobeandmail.com/news/national/ottawa-to-unveil-weakened-emissions-rules-for-coal-fired-power/article4519655/

**Reading**
The Value of Carbon in Decision-Making. *Sustainable Prosperity Policy Brief,* Nov 2011
Goulder, L. and Parry, I. 2008. Instrument Choice in Environmental Policy. Published in *Review of Environmental Economics and Policy*, Oxford University Press

**Optional Further Reading**
Newell, R., Pizer, W. and Raimi, D. 2013. Carbon Markets 15 Years after Kyoto: Lessons Learned, New Challenges. *Journal of Economic Perspectives*, 27(1): 23-46

Schmalensee, R. and Stavins, R. 2013. The SO2 Allowance Trading System: The Ironic History of a Grand Policy Experiment. *Journal of Economic Perspectives*, 27(1): 103-122

Forrister, D. and Bledsoe, P. 2013. Pollution Economics. *New York Times*, August 9, 2013
Porter, E. 2012. Taxes Show One Way to Save Fuel. *New York Times*, September 11, 2012

**Class 5: Entrepreneurship and 'Green' Business**

Guest speaker: Doug Burgoyne, Founder/President of FrogBox

Shifts in societal and consumer attitudes in favor of environmental protection over the last two decades have created new opportunities for the private sector to directly address environmental externalities. FrogBox is one such example. The firm has had success in creating a business model that operates in both a profitable and environmentally-sustainable manner. Doug Burgoyne, the President and an Ivey alumnus, will talk about his experiences in the sector, his appearance on Dragons' Den, and lessons for future entrepreneurs in 'green' business.

In advance of the class, please watch Doug's appearance on Dragons' Den at http://www.cbc.ca/dragonsden/2011/01/frogbox.html (Season 5, Episode 13)

Please be prepared to engage in thoughtful q&a after the talk.

**Class 6: Globalization, Labor Standards, and Off-shoring**

In this and the next four classes, we will consider a range of issues where corporate and societal interests have tended to clash. In each of the case studies we will explore these issues from two perspectives, that of the corporation and that of society at large.

In the mid-1990s, Nike, one of the world's most successful footwear companies, was hit by a spate of bad publicity. After years of high profile media attention as the company that could "Just do it", Nike was suddenly being painted as a firm that relied on low-cost, exploited labor in its overseas plants. Like many other manufacturing firms and industries, Nike had chosen to outsource and off-shore the manufacturing of its products. The case study traces the path of a company caught in the highly emotional debates surrounding globalization and human rights. It describes the actions, motivations and influence of non-governmental organizations, a group of actors that are increasingly setting the rules of international business, especially in developing countries. It describes how these groups are highlighting contentious issues such as labor conditions and human rights, and how high-profile firms such as Nike can respond to their claims.

Assignment: read the HBS case study, *Hitting the Wall*, and the McKinsey Quarterly article on *Exploding the Myths of Off-shoring*. Read the case carefully, paying attention to the details and to the exhibits. Be prepared to discuss the following questions in class:

1. For students on the right side of the classroom (when looking towards the boards): Imagine you are Jeff Ballinger and that you are being interviewed by a reporter: What charges have you levied against Nike? What do you think is a "fair" wage in Vietnam? Should Nike require its subcontractors to raise the wages they pay their workers beyond the market level? Make sure you support your arguments using facts and data from the case and exhibits.

2. For students on the left side of the classroom (when looking towards the boards): Imagine that you are the CEO of Nike, Phil Knight, and that you are being interviewed by a reporter: How would you respond to the Ballinger allegations? What do you think is a "fair" wage in Vietnam? Should Nike require its subcontractors to raise the wages they pay their workers beyond the market level? Make sure you support your arguments using facts and data from the case and exhibits.

3. For students in the middle section of the classroom: Imagine you are an observer of the debate between Ballinger and Knight/Nike. Who do you think has the more compelling arguments and points? Why?

4. For all students: How much was Nike hurt by the campaign? What were Nike's options for responding to Ballinger and other activists? What do you think Nike should have done? What do you recommend Nike should do going forward?

**Reading**
Spar, D. 2002. Hitting the Wall: Nike and International Labor Practices. *Harvard Business School*
Exploding the Myths of Offshoring. *McKinsey Quarterly*, June 2004

**Optional Further Reading**
Chang, L. 2008. *Factory Girls*, Spiegel and Grau

Selected news articles posted on-line on Loblaws' response to the garment manufacturing crisis in Bangladesh during 2013

**Class 7: Public Health and Intellectual Property Rights**

In this class we consider how firms deal with some of the ethical challenges associated with intellectual property rights. On the one hand, property rights provide incentives for private innovation and risk-taking investment, yet on the other hand they can lead to issues of social inequity as only certain segments of the population reap the benefits of these innovations. We will focus our discussions on the pharmaceutical industry and the issue of AIDS in Africa where pharmaceutical companies face major pressures to balance the demands for maximum profitability with public expectations to address one of the greatest health issues of modern times. A related issue that applies in developed countries is whether companies should be able to patent human genes and have exclusive rights to associated gene testing and treatments.

Assignment: Read the HBS case, "Life, Death and Property Rights: The Pharmaceutical Industry Faces AIDS in Africa". Come to class prepared to discuss the following questions:

1. What are the causes of the central problems outlined in the case?
2. How should the pharmaceutical companies respond to the crisis? What strategy should they follow to protect their intellectual property rights? How far should they be willing to go? What are the costs and benefits?
3. Is there a compromise solution that could be acceptable to all stakeholders?

**Reading**

Spar, D. and Bartlett, N. 2005. Life, Death and Property Rights: The Pharmaceutical Industry Faces AIDS in Africa. *Harvard Business School*

**Optional Further Reading**

Stiglitz, J. 2013. How Intellectual Property Reinforces Inequality. *New York Times*, July 14, 2013

Stiglitz, J. 2010. Amicus brief on human genome patent lawsuit against Myriad Genetics.

Boldrin, M. and Levine, D. 2013. The Case Against Patents. *Journal of Economic Perspectives*, 27(1): 3-22

**Class 8**: **Markets versus Governments**

Governments intervene in virtually every industry and market in some manner. According to a major recent McKinsey survey, executives ranked government as having the second greatest influence on their firm's economic value after customers. In some industries such as banking, pharmaceuticals and utilities, governments have a relatively strong degree of control of various aspects of market fundamentals, such as pricing, entry and quality standards. In other industries, such as retail or consulting, government regulations are more 'light handed', leaving market outcomes to be determined primarily by competitive forces. Approaches to government regulation can also change over time within an industry, as we have observed in the trends towards deregulation in telecommunications and other infrastructure sectors. What explains these differences in government intervention across industries and time?

From the firm's perspective, changes in public policies and regulations can affect company performance and its competitive position, thereby representing a risk factor that needs to be assessed and managed. Understanding why and how governments intervene enables firms to account for these factors when developing competitive strategies.

Assignment: read the Ivey case study, The Taxi Industry in Four Cities Around the World. You should also read the chapter on "Regulation: Law, Economics, and Politics" in David Baron's textbook, *Business and Its Environment* as this summarizes the major theoretical reasons why governments intervene in markets. Be prepared to discuss the following questions in class:

1. Looking at the four cities profiled in the case, what are the major areas of regulation of the taxi industry by governments? In other words, what, specifically, is regulated?
2. What do you think the rationale is for the various kinds of regulation you identified in Question 1? Do you think price should be regulated by government or determined by the market? Should entry be regulated by government or determined by the market?
3. If you had to make a decision as a City councilor (here in London, Ontario), would you vote to deregulate price and/or entry in the local taxi industry?

**Reading**

Baron, D. 2009. *Business and Its Environment*. Prentice Hall.
Frost, T., Holburn, G. and Bonardi, J.P. 2007. The Taxi Industry in Four Cities Around the World. *Ivey Business School*

**Optional Further Reading and Listening**

How Business Interacts with Government. *McKinsey Global Institute*, 2010
Schleifer, A. 2005. Understanding Regulation. *European Financial Management,* 11(4): 439-451
Boudreaux on Market Failure, Government Failure and the Economics of Anti-trust Regulation. EconTalk podcast at www.econtalk.org/archives/2007/

**Class 9: Competition Policy, Mergers and Acquisitions**

In this session we turn to another area in which governments regulate corporate actions in order to protect the public or societal interest: competition policy, or as it is also commonly known 'anti-trust policy', which concerns corporate mergers and acquisitions. We will start by looking at an obscure but important industry -- labelstock -- to develop lessons about the purpose and goals of competition policy. The case also allows us to examine the issue from the perspective of firms and managers, so you can develop some ideas about do's and don'ts in situations where competition policy concerns are likely.

A) Read the case "Sticky Business: Rivalry in the North American Labelstock Industry" and consider the following questions:

1. What is the business logic for UPM's acquisition of MACtac? Assuming the acquisition is approved in the U.S., what is your assessment of UPM's decision to acquire MACtac? Is it a good decision by UPM? Now take Avery Dennison's position: Is this merger a good thing or a bad thing for Avery?

B) Read the Overview in "Horizontal Merger Guidelines" published by the U.S. Department of Justice, and skim read the rest of the document. It is an excellent introduction to competition policy as currently enforced in the U.S. (where anti-trust law has been at the forefront since the beginning of modern capitalism).

2. Now take the position of a judge hearing the case from an anti-trust perspective. Would you allow the acquisition to proceed? Why or why not? Prepare to defend your decision. To answer this question you will need to inform yourself about the basics of US anti-trust law and enforcement. The relevant statute for making your decision is known as the Clayton Act:

§7 Clayton Act, 15 U.S.C. § 18: Acquisition by one corporation of stock of another

"No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

**Reading**

Frost, T., Holburn, G. and Bonardi, J.P. 2012. Sticky Business: Rivalry in the North American Labelstock Industry. *Ivey Business School*

Horizontal Merger Guidelines. U. S. Department of Justice, 2010

**Class 10: Regulation and Innovation in Financial Services**

In this class we will take a close look at the origins of the 2008 financial crisis with an emphasis on the relationship between the financial sector and government. We will examine the fundamental reasons why the financial sector is one of the most heavily regulated industries, and the challenges that governments face in effectively regulating it in the 'public interest'. Understanding these tensions sheds light on the complex causes of the 2008 crisis and the subsequent policy reforms implemented by governments and banks in the U.S. and other OECD countries. During the class we will use several clips from the Academy award-winning movie "Inside Job" to spark discussion and debate.

**Questions**

1. Why do governments regulate the banking sector? Refer to the McCoy article to make sure you understand the 'moral hazard' rationale.
2. Who or what was responsible for the 2008 financial crisis? What roles did consumers, government and business have in its inception?
3. What was the nature of the relationship between the banks and government? Should big business be banned from lobbying government? What might be a balanced approach to limiting the power of business in influencing government policy decisions?

**Readings**

McCoy, P. 2007. The Moral Hazard Implications of Deposit Insurance: Theory and Evidence. Unpublished manuscript.

Cassidy, J. Rational Irrationality. *The New Yorker*, October 5, 2009.

Brill, S. Government for Sale: How Lobbyists Shaped the Financial Reform Bill. *Time Magazine*, July 1, 2010.

**Optional Further Reading**

Lowenstein, R. Wall Street: Not Guilty. *Business Week Magazine*, May 12, 2011.

Gorton, G. and Metrick, A. 2012. Getting up to Speed on the Financial Crisis: a One Weekend Reader's Guide. *Journal of Economic Literature*