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Journal of International Business Ethics

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FOREWORD

The Journal of International Business Ethics (JIBE) opens a platform for scholars, business practitioners, and government officials to share research, perspectives and action proposals on the topic of international business ethics with a special focus on the Asian context. JIBE attempts to clarify crucial concepts and principles as well as to bring to light realities in the field of business ethics. Ethics by its very nature pervades every facet of business life: finance, accounting, human rights, labor conditions, consumer relations, environmental protection, and anti-corruption efforts. We welcome contributions in all these areas as well as the whole range of sociological, philosophical, and economical perspectives related to ethical issues.



Business ethics as an academic subject originated in the United States some forty years ago in an attempt to instill more decency and honesty within business as well as within political life. Some business schools in other countries followed suit but it never became a required subject in all business schools, even in the U.S. It is also significant to note that some ethics scholars gave up teaching in the discipline as they felt that values and other main issues of the field could not be communicated with academic precision and rigor.

In China, despite significant attempts to popularize business ethics and integrate it within the curriculum of various business schools, this subject remains marginal in these institutions, with the mere payment of lip service to business ethics. Leading figures in the area of management education are either unconvinced of the need to teach ethics, or they assume that it is substitutable by the current compulsory political courses. As a result, ethics is ultimately detruncated as “the practice of soft skills” and a hindrance in the pursuit of wealth and economic growth. In order to demonstrate the relevance and urgency of international business ethics, JIBE is commissioned to continuously explore the economic, philosophical, sociological, and cultural foundations of its subject. Business ethics needs to critically evaluate concepts that simultaneously relate to a Western frame of mind while including a broader view, especially Asian perspectives.

JIBE’s constant challenge will be to bring into play the vast array of different and nuanced perspectives from varied cultural and social perspectives. JIBE will pay special attention to the classic wisdom and philosophies in the Chinese and Indian streams of thought. JIBE will have a special focus on the Chinese and Indian context given the fact that the economies of these most-populous countries continue to take an increasingly central place in the world. It is a most-urgent task to analyze and further develop value systems needed to make the tremendous economic growth sustainable.

Besides the analysis of value systems, JIBE hopes to contribute to the development of the rule of law by linking ethics and law, especially in the Chinese context. Ethics has to spell out and critically analyze all the underpinnings of moral reasoning necessary to understand the law. An exclusive focus on legal compliance tends to overlook the “gray areas” in the decision-making process. In cases where the law is far from clear, a foundation of solid moral and ethical reasoning becomes even more necessary. Business ethics provides the vocabulary and platform to clarify and contribute to the setting of the rule of law.

The business-ethics movement will gain greater momentum when perceived as an interdisciplinary dialogue, while rigorously emphasizing specific ethical analysis of situations. A constant reference for the ethical analysis of situations must be a close link to case studies, especially focusing on recent scandals such as the recall of toys, poisoned food, slave labor in kiln mines, and the constant flow of reports on corruption. It is a special challenge to give the necessary overview of the relevant facts of a given case while making sure that the account reflects reliability, truthfulness, and objectivity. Since the Harvard case model came into use about a hundred years ago, the constant use and update of relevant case studies stimulates teaching and research.

As the Journal mainly targets scholars, business people, practitioners and government officials who have taken a keen interest in ethical issues, especially in the Asian context, the close link between theoretical analysis and practical implementation creates a relevant context in order to engage in discussions from a more thorough and multipronged approach.

Contribution and constructive criticism are always welcome on this platform.

Stephan Rothlin, Ph.D

CIBE

Secretary General

Beijing, August 17, 2008



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THE THIRST FOR HAPPINESS

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Abstract: This paper provides a primer on happiness economics. The survey intends to indicate the general flavor of this new approach to economics. Moreover, it presents a selection of possible applications of economic-happiness research. The fundamental idea of relative utility is discussed by illustrating it with a particular case, namely the relationship between income and happiness. Happiness research is also a new tool for studying individual welfare in the context of a cost-benefit analysis. It allows researchers to capture the good and bad effects on the public. This is shown by the example of a major social issue, terrorism. The intention is to convey to the reader that happiness research opens new avenues to tackle old questions and opens new possibilities to address issues that have been difficult or even impossible to address empirically.

Keywords: happiness, utility, relative position, cost-benefit analysis, life-satisfaction approach

This paper provides a primer on happiness economics. The survey section in the first part is kept short because the authors provided extensive reviews in journals and in a book (Frey & Stutzer 2002a, b, 2005; Frey, 2007). Here we want to indicate the general flavor of this new approach in economics. The second part takes up the fundamental idea of relative utility, illustrating it for a particular case, namely the relationship between income and happiness. The third part looks at happiness research as a new tool for studying individual welfare in the context of cost-benefit analysis. Happiness research allows us to capture the effects of public goods and public bads on experienced utility. This is illustrated with the example of a major social problem, terrorism.

ECONOMIC HAPPINESS RESEARCH

Research on happiness has been one of the most stimulating new developments in economics in recent years. The pursuit of happiness is a central aspect of human behavior. It follows that economics is – or should be – about individual happiness. In particular, the question is how economic growth, unemployment, and inflation, as well as institutional factors, such as good governance, affect individual well-being. Economic activity is certainly not an end in itself but has value only insofar as it contributes to human happiness. However, economists have been reluctant to carry out any direct study on

individual happiness. It is argued that no cardinal measurement of utility is needed to analyze how individuals react to changes in relative prices. The axiomatic revealed preference approach holds that the choices made provide all the information required to infer the utility of outcomes. Welfare judgments can be made by resorting to the Pareto criterion, and, therefore, no comparison of welfare levels among individuals is required.

This view is still predominant in economics. However, numerous scholars have challenged standard economic theory from different angles. There are countless examples of non-objectivist theoretical analyses in economics. They incorporate emotions, self-signaling (self-esteem), goal completion, mastery, meaning, and status. Moreover, the outcome orientation in standard economics is supplemented with individuals' concerns about the processes leading to outcomes.¹ In the vast literature on anomalies in decision-making, it is questioned whether utility can generally be derived from observed choices. The same reservation applies to intertemporal choices when individuals suffer from problems of self-control.² The exclusive reliance on an objectivist approach by standard economic theory is thus open to doubt, both theoretically and empirically. In any case, it restricts the possibility of understanding and influencing human well-being.

The Subjective Approach to Utility

The subjective approach to utility offers a fruitful, complementary path to study the world. It allows well-being to be assessed directly. It follows an interpretation of utility in hedonistic terms, broadly understood. This is emphasized by the term "experienced utility" as proposed by Kahneman et al., (1997). There are many research questions for which it is useful to take experienced utility measured by reported subjective well-being as a proxy for decision utility. It creates a basis for explicitly testing fundamental assumptions and propositions in economic theory and developing and testing new and broader theories of human behavior. If, however, the focus is on the economic consequences of miscalculating utility (Stutzer & Frey, 2007), insights are derived from systematic divergences between the two concepts.

A subjective view of utility recognizes that everybody has his or her own ideas about happiness and the good life and that observed behavior is an incomplete indicator for individual well-being. Accepting this view, individuals' happiness can nevertheless be captured and analyzed: People can be asked how satisfied they are with their lives. It is a sensible tradition in economics to rely on the judgment of the people directly involved. People are reckoned to be the best judges of the overall quality of their lives, and it is a straightforward strategy to ask them about their well-being.

Measuring Individual Subjective Well-Being

Due to extensive work by numerous psychologists spanning many decades, the measurement of experienced utility has made great progress (see the surveys by Diener et al., 1999; Kahneman et al., 1999 and, for a recent discussion, Kahneman & Krueger, 2006). Several indicators of subjective well-being have been designed, relying on different measurement techniques: global evaluations of individual life satisfaction based on representative surveys; the Experience Sampling Method, collecting information on individuals' actual experience in real time in their natural environments; the Day Reconstruction Method, asking people to reflect on how satisfied they felt at various times during the

day; and Brain Imaging, using functional magnetic resonance imaging (fMRI) to scan an individual's brain activities for correlates of positive and negative effect.

Most of the empirical work on happiness research in economics undertaken so far has been based on representative, large-scale sampling of individuals' global evaluations of their life satisfaction. A prominent example is the question in the German Socio-Economic Panel (GSOEP). Study that asks "how satisfied are you with your life, all things considered?" Responses range on a scale from 0 to 10 or from "completely unsatisfied" to "completely satisfied." The great advantage of this measurement approach is its good performance compared to its cost, as well as its availability for a large number of countries and time periods. For many tasks, self-reported measures of life satisfaction have proved to perform in a satisfactory way, especially for the issues economists are mostly interested in. So far, it is the best empirical approximation to the concept of individual welfare used in economic theory that is widely available. The future will tell to what extent and for which specific issues happiness researchers will rely on the various measurement approaches.

There is now a wide-spread consensus among scholars that experienced utility and well-being can be measured with some degree of accuracy (Kahneman et al., 1999; Diener 2005; Kahneman and Krueger, 2006). One indicator that such measurements capture important aspects of well-being in a credible way is that they correlate with behavior and features generally associated with happiness. Reliability studies have found that reported subjective well-being is moderately stable and sensitive to changing life circumstances. Consistency tests reveal that happy people smile more often during social interactions, are rated as happy by friends, family members, and spouses, express positive emotions more frequently, are more optimistic, are more sociable and extroverted, and sleep better (Frey & Stutzer, 2002b).

There is still much room for improvements in the quality and the understanding of happiness measures. One question is whether people's instantaneous level of happiness can be captured by self-reported measures of well-being or whether there is a difference between people's hedonic experiences and their explicit reflective appraisals of experiences in reported subjective well-being (Schooler et al., 2003). Sometimes people are fully engaged in challenging activities and experience great pleasure (or flow). Because of the very nature of this situation, people will never assess and report their well-being when in such a state and, thus, set boundaries for the measurement of instant utility. New insights will be provided when we know more about correlations between reported subjective well-being and physiological measures of well-being (Blanchflower & Oswald, 2007).

Another question is to what extent the 'traditional' measures of subjective well-being accurately capture the different notions of happiness and individual well-being put forward in the literature on the good life (Ryan & Deci, 2001). A common concern refers to the emphasis of momentary positive affects in survey questions on individual well-being. Hedonic well-being is not necessarily the same as happiness. According to the eudaimonic view of happiness, people should live according to their true self "daimon." The underlying factors producing well-being can be seen to be autonomy, competence, and relatedness. Given the possible shortcomings of happiness measures today, it should at the same time be borne in mind that the required quality of happiness data depends on its intended use. Moreover, the quality of the happiness data should be compared with alternative concepts of measuring people's level of well-being.

The Correlates of Happiness

Provided that reported subjective well-being is a valid and empirically adequate measure for human well-being, it can be modeled in a microeconomic happiness function $W_{it} = \alpha + \beta X_{it} + \varepsilon_{it}$. Thereby, true well-being serves as the latent variable. $X = x_1, x_2, \dots, x_n$ are known variables, like socio-demographic and socioeconomic characteristics, or environmental, social, institutional and economic conditions for individual i at time t . The model allows for the analysis of each factor that is correlated with reported subjective well-being separately. This approach has been successfully applied in numerous studies on the correlates of happiness. Technically, multiple regression analyses are conducted. As the dependent variable is measured on a ranking scale, normally ordered logit or probit estimation techniques are applied.

The result is a substantial number of new and insightful empirical findings. Present research provides some preliminary insights on issues dealing with, for example, the relationship between happiness and income, unemployment, inflation, inequality, and democratic institutions (for overviews, see Di Tella & MacCulloch, 2006; Easterlin, 2002; Frey & Stutzer, 2002a,b; Layard, 2005; Oswald, 1997; van Praag & Ferrer-i-Carbonell, 2004).

INCOME AND HAPPINESS: THE ROLE OF INCOME ASPIRATIONS

Persons with higher income have more opportunities to attain whatever they desire; in particular, they can buy more material goods and services. It is, therefore, often taken as self-evident that higher income and consumption levels provide higher experienced utility or happiness. This conclusion also follows from the concept of utility in economics, which is based on a very simple psychological notion. Economics assumes that people always know what is best for themselves and that they make decisions accordingly. Moreover, it is assumed that people's satisfaction depends on what they have in absolute terms. Happiness research allows testing this notion empirically.

Are People with a High Income Happier? Paradoxical Empirical Findings

The relationship between income and happiness at a particular point in time and place (country) has been the subject of a large empirical literature. As a robust and general result, it has been found that richer people, on average, report higher subjective well-being (see Clark et al., 2006). The relationship between income and happiness, both in simple regressions and when a large number of other factors are controlled for in multiple regressions, proves to be statistically (usually highly) significant. With regard to this specific evidence, the standard economic view is upheld in happiness research.

However, there is a second way to study the relationship between income and happiness. This refers to the question whether an increase in income over time raises happiness. A striking and curious relationship is observed. There is systematic evidence that people in industrialized countries are not becoming happier over time, despite economic growth (Blanchflower & Oswald, 2004; Easterlin, 1995, 2001). Consider, for example, Figure 1 for Japan.

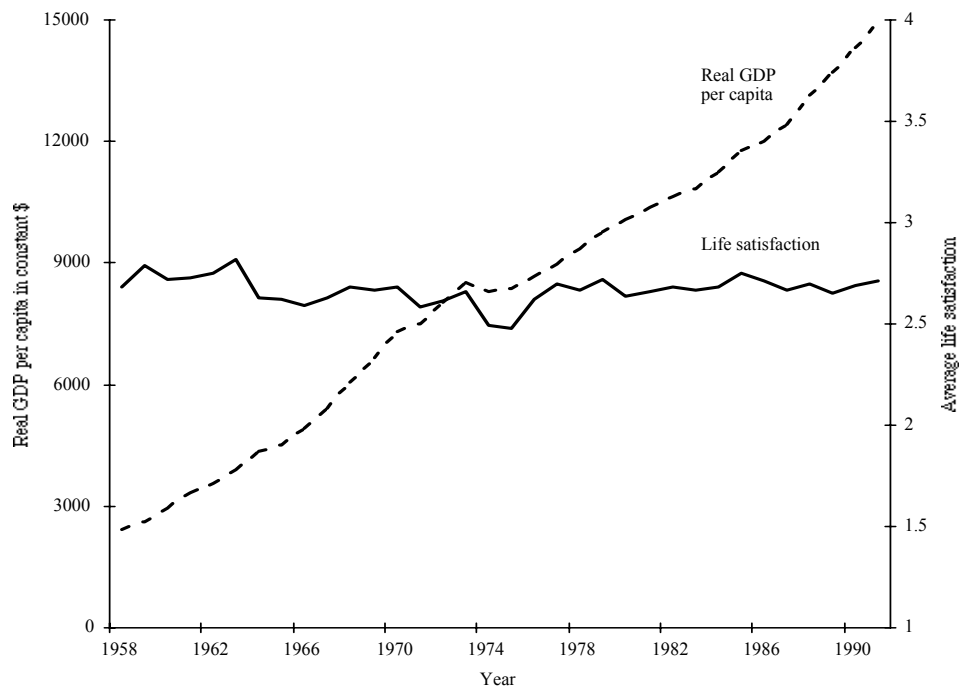


Figure 1. Satisfaction with life and income per capita in Japan between 1958 and 1991.

Sources: Penn World Tables and World Database of Happiness.

Between 1958 and 1991, income per capita in Japan rose by a factor of six. This is probably the most spectacular growth in income since World War II. The rise was reflected in almost all households, as they began to have an indoor toilet, a washing machine, telephone, color television, and a car. The open scissors figure also shows, however, that this tremendous rise in material well-being was not accompanied by an increase in average satisfaction with life. In 1958, average life satisfaction rated on a 4-point scale was 2.7. In 1991, after more than 30 years of increasing affluence, average life satisfaction still scores 2.7 points.

What can be inferred from these and similar observations in other industrial countries? One position that can be taken is to disregard the descriptive evidence (1) because there are other Western countries, like Denmark, Germany and Italy, that experienced substantial real per capita income growth as well as a (small) increase in reported satisfaction with life in the 1970s and 80s (Diener et. al., 2000) and (2) because it depends on the observation period whether a small increase or decrease in reported subjective well-being is measured. Moreover, the relationships presented between income and happiness over time are not analyzed *ceteris paribus*. However, for the United States, a negative time trend is also found when individual characteristics are controlled (Blanchflower & Oswald, 2004). Another position that can be taken is to accept that there is no clear-cut trend, positive or negative, in self-reported subjective well-being over periods of 20 to 30 years in rich countries. The results, rather, indicate that there is more to subjective well-being than just the level of income.

The Missing Variable: Income Aspirations

In order to overcome the reported paradox, happiness research in economics is exploring different aspects of a psychologically sounder concept of utility. Two processes are emphasized. First, one of the most important processes people go through is that of adjusting to past experiences. Human beings are unable and unwilling to make absolute judgments. Rather, they are constantly drawing comparisons from the past or from their expectations of the future. Thus, we notice and react to deviations from reference levels.

Additional material goods and services initially provide extra pleasure, but it is usually only transitory. Higher happiness with material things wears off. Satisfaction depends on change and disappears with continued consumption. This process, or mechanism, that reduces the hedonic effects of a constant or repeated stimulus, is called adaptation, and it is this process of hedonic adaptation that makes people strive for ever higher aspirations. Second, there are social comparisons with relevant others. It is not the absolute level of income that matters most, but rather one's position relative to other individuals. People with a higher income have in particular also a higher relative income and, thus, a higher status in society. Socially comparative or even competitive processes in consumption complement processes of hedonic adaptation.

Many economists in the past have noted that individuals compare themselves to significant others with respect to income or consumption. Thorstein Veblen (1899) coined the notion of "conspicuous consumption," serving to impress other persons. The "relative income hypothesis" has been formulated and econometrically tested by James Duesenberry (1949), who posits an asymmetric structure of externalities. People look upwards when making comparisons. Wealthier people impose a negative external effect on poorer people, but not vice versa. As a result, savings rates depend on the percentile position in the income distribution and not solely on the income level, as in a traditional savings function.

It is suggested that the two processes make people strive for ever higher aspirations. Together, they can also explain why persons with high income at a given point in time are happier than those with low income (social comparison effect), while there is no clear statistical relationship between income per capita and average life satisfaction in industrialized countries over time (adaptation effect). There is now also direct empirical evidence for the important role of income aspirations in individual welfare from two empirical studies for Germany and Switzerland (Stutzer, 2004, Stutzer & Frey, 2004). This is made possible by using two data sets that both include individual data on reported satisfaction with life as a proxy measure for experienced utility, as well as income evaluation measures as proxies for people's aspiration levels.³

It is found that higher income aspirations reduce people's satisfaction with life. In Switzerland and the New German Laender, the negative effect of an increase in the aspiration level on well-being is of a similar absolute magnitude as the positive effect on well-being of an equal increase in income.⁴ This suggests that subjective well-being depends largely on the gap between income aspirations and actual income and not on the income level as such. Thus, the higher the ratio between aspired income and actual income, the less satisfied people are with their life, *ceteris paribus*. This supports the notion of a relative utility concept.

Both studies also explore the determinants of income aspirations. The econometric results show

that, consistent with processes of adaptation, income aspirations increase with personal income. However, the effects of higher income on individual well-being at a fixed point in time are not completely counterbalanced by higher aspirations. In fact, for rich people, the relative gap between income aspirations and actual income is smaller. This can explain the positive correlation between income and reported subjective well-being. For the analysis of relative income concerns in the Swiss data set, individuals' aspirations are merged with data on aggregate income in the community where people live. The results indicate that a higher average income in the community increases people's levels of aspiration. This effect cannot be explained by a higher cost of living alone. It is shown that the aspiration levels of community members who interact within the community react much more to changes in average income than those of members who do not interact.

What are the consequences of research on relative income? The empirical basis is still relatively small to be able to draw firm implications for economic theory and economic policy. Caution is required because the implications might be far-reaching. However, it might be worthwhile to consider household theory, in which people's desires increase according to what they get. In this framework, the marginal utility of income would no longer be defined, as the utility function changes with the income level. It would be interesting to study in greater depth what implications income aspirations have, for instance, on redistributive taxation or on public policy in general.

A NEW APPROACH TO COST-BENEFIT ANALYSIS

The Life Satisfaction Approach

The benefits from public goods are inherently difficult to measure and a wide variety of different approaches for the measurement of preferences have been developed (see Freeman, 2003). With reported subjective well-being as a proxy measure for individual welfare, it is now possible to directly evaluate public goods in experienced utility terms. Moreover, by measuring the marginal utility of a public good or the marginal disutility of a public bad, as well as the marginal utility of income, the trade-off ratio between income and the public good can be calculated. We call this the life satisfaction approach (LSA).

The LSA can be used to value a wide range of different public goods and bads, negative and positive externalities. Hitherto, the approach was exclusively used to value externalities in the environmental realm. Van Praag and Baarsma (2004) analyze the effect of noise nuisance in the area of the Amsterdam Airport. Welsch (2002), Rehdanz and Maddison (2003) identify a negative effect of environmental degradation on average life satisfaction. The life satisfaction approach has several advantages over the standard methods currently used, that is, the revealed preference methods and the stated preference methods (for a discussion see Frey et al., 2004).

The Case of Terrorism

Citizens' well-being must be expected to be negatively affected by terrorism. People living in a country rife with terrorism are less happy than those living under more orderly political conditions. A good example is the Dominican Republic in 1962 where, after president Trujillo's murder, the political situation was very unsettled and political chaos was a real threat. The level of life satisfaction measured

in that country was the lowest ever recorded, namely 1.6 on the normal 0 to 10 scale. By way of contrast, in politically stable democracies, such as Switzerland, Norway or Denmark, the population expresses high life satisfaction. The corresponding values were, for example, in the 1990s 8.16 for Denmark, 8.02 for Switzerland and 7.66 for Norway. Thus, happiness and political stability seem to be closely related.⁵

The causation may, however, again run in both directions; while it seems obvious that political unrest is dissatisfying to people, it also stands to reason that dissatisfied people resort to demonstrations, strikes, and even terrorist actions, thereby creating political instability. However, it would be a romantic view (see Tullock, 1987) to assume that revolutions are normally caused by people's unhappiness with existing political conditions. Most coups d'état, and even revolutions, are undertaken by competing political clans, parties, or the military.

The LSA provides a tool to systematically value the costs of terrorism. Based on panel data, it is possible to compare the life satisfaction of the population in particular regions and cities affected by terrorism to the remaining parts of a country over time. This novel approach is illustrated here for the case of France but has been applied to more countries (Frey et al., 2004). Life satisfaction data are taken from the Euro-Barometer Survey Series (1970-1999); the variable is the categorical response to the following question: "On the whole, are you very satisfied [4], fairly satisfied [3], not very satisfied [2], or not at all satisfied [1] with the life you lead?" An indicator for the salience and intensity of terrorist activity is constructed representing the number of terrorist incidents. The two regions of Ile-de-France (including Paris) and Provinces-Alpes-Côte-d'Azur (which includes Corsica in the Euro-Barometer Surveys Series) are compared to the rest of France for the years 1973 to 1998.

Based on these data sets the life satisfaction of an individual living in a particular region at a particular time is explained by differences in the level of terrorism across regions and over time, the individual's household income, other personal and socio-demographic characteristics, as well as region and time fixed effects. The estimation results suggest that the number of terrorist attacks has a statistically significant negative effect on the reported life satisfaction. For 15 terrorist attacks (i.e. approximately the average number of attacks in Paris during the period studied), an average reduction in satisfaction with life by 0.04 units on the four-point scale of life satisfaction is estimated. This effect is about a fifth of the effect of being unemployed rather than employed. Thus, a frequently used indicator for terrorism is correlated with people's subjective well-being in a sizeable way.

The estimated coefficients can be used to calculate the hypothetical willingness-to-pay for a discrete change in the level of terrorism. For the purpose of comparison, the difference in terrorism between living in the region Ile-de-France (Paris) and living in the rest of France (except Provence-Alpes-Côte d'Azur) is considered. Accordingly, a resident of Paris (with average household income) would be willing to pay around 14% of his income for a reduction in terrorist activity to a level that prevails in the more peaceful parts of the country. These compensations are comparable to those identified by Blomquist, Berger and Hoehn (1988) on the labor and housing markets for individuals living in the U.S. county with the highest rate of violent crime. This exploratory application demonstrates that life satisfaction data are well suited to assess the utility loss of the population due to terrorism.

CONCLUDING REMARKS

This contribution presents only a selection of possible applications of economic happiness research. Many more have been undertaken. No attempt has been made to be comprehensive. Rather, the intention was to convey to the reader that happiness research opens new avenues to tackle old questions, and opens new possibilities to address issues which so far have been difficult or even impossible to address empirically.

NOTES

1. An introduction to the concept of procedural utility is provided in Frey, Benz and Stutzer (2004).
2. Criticism of many aspects of traditional economics is developed in so-called “behavioral economics” or “economics and psychology” (see, e.g., Camerer et al. 2003, Frey and Stutzer 2001, 2007, Rabin 1998).
3. People are asked, “Please try to indicate what you consider to be an appropriate amount for each of the following cases. Under my/our conditions, I would call a net household income per [month] of: about _____ very bad [...] about _____ very good. Please enter an answer on each line [...]” (van Praag 1993).
4. The negative effect of an increase in aspirations is relatively smaller in absolute terms in the Old German Laender.
5. We are, of course, aware that other factors matter too for the observed difference and might even exclusively determine the gap.

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ESSAY: CONSUMER RIGHTS: A PART OF HUMAN RIGHTS

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Abstract: For many ordinary Chinese, assuming obligation and responsibility means almost the same as having ethics and morality. Therefore, when talking about consumer ethics, people first think about consumers' obligation to strive for the virtue of frugality. However, in today's world, especially after the opening up and reform of China's economy, consumers have more courage to safeguard their rights as a result of rising consumer awareness. Consumers' newfound courage showcases the change of people's values. During a discussion of consumer ethics, we naturally take the protection of consumer interests as the starting point. The shift in research from the examination of frugality to consumer interests reflects the transformation of the Chinese moral mentality from obligation-orientation to right-orientation.

Keywords: consumer rights, human rights, consumer ethics

SAFEGUARDING CONSUMER RIGHTS, THE FIRST PRIORITY OF CONSUMER ETHICS

For many conventional Chinese, assuming obligation and responsibility means almost the same as having ethics and morality. Possessing ethics and morality depends on people's self-cultivation as they seek to develop virtues, find cause first in their own persons, and strengthen their characters. Such a mentality has a profound impact on the Chinese thinking on ethics. Therefore, until today, some still claim that ethics focuses on obligations while law focuses on rights. Therefore, people talking about consumer ethics in the past would think of advocating thriftiness or restraining squandering and hedonistic consumption, while, today, the fashionable concept of environmental protection features sustainable consumption.

The above mentioned awareness of ethics is based on an interpretive framework of a reversed relationship between rights and obligations. Logically considered, the starting point of the ethics argument is not the assumption of obligations (an intrinsic part of ethics,) but the protection of basic human rights. It is just because people need to maintain their rights that they have to safeguard others' rights as an obligation. From this starting point, we will, when discussing consumer ethics, put top priority on keeping the rights of consumers and take it as the foundation and the starting point of the interpretive framework of consumer ethics. The shift of research perspective from obligation-orientation to right-orientation reflects the ongoing change in the mentality of ethics in China.

CONSUMER RIGHTS EXPRESS NEEDS FOR HUMAN RIGHTS

A consumer's justifiable and legal consumption closely connects with the satisfaction of his or her basic human rights. As long as his or her consumption is legitimate, then others are not entitled to judge whether his or her behavior is reasonable or not, nor can they condemn his or her "hedonistic

consumption.” Rather, only the consumer can tell whether his or her consumption is reasonable or not. Consumers are not God, but ordinary citizens who have human rights and are entitled by law to free choice.

Therefore, instead of restraining “unreasonable consumption,” consumer ethics should be reflected in consumers’ actions to safeguard their rights. The ultimate purpose of offering products is to satisfy the needs of people, which is a part of human rights. Any misrepresented product characteristics are not simply a minor infraction or trivial breach of trust, but an intentional violation of the basic rights and interests of human beings. In particular, when consumers receive misleading information about the feature of food, medicine, electrical appliances, autos, and housing, the products can pose a threat to the users’ lives or quality of living. Even if the products do not harm the consumers physically, the misrepresented information undoubtedly harms consumer spiritually. The spiritual infringement is certainly a form of damage to human rights, while consumers’ physical suffering is more severe, more strongly condemned and draws more concerns than common violations.

Therefore, consumers’ actions to safeguard their rights is not a short-term project nor aimed at limited benefits, but these actions form an important part of the ambitious task to improve human rights in China. Businesses’ attention to consumer rights is not a favor resulting from charity, but rather validation and consolidation of consumers’ basic constitution-conferred rights. All Chinese consumers, therefore, should devote themselves to the protection of consumer rights and see it as a part of the fight for human rights. To this end, they need to maintain individual rights and interests by resorting to laws while also protecting the collective rights of their fellow citizens by exposing harmful products through the media.

GREEN CONSUMPTION AS PROTECTION OF CONSUMERS’ LONG-TERM RIGHTS

Sustainable consumption, or green consumption, which aims at environmental protection, can effectively safeguard consumer rights, thus constituting an important part of consumer ethics. As we all know, ethics are codes that people set in order that each person fulfills his or her obligations to others and maintains every individual’s own rights. Ethics serve the people, but people do not live for ethics. Therefore, abiding by ethics is consistent with maintaining people’s rights and interests. That is why in economic ethics there is a saying that a good image of ethics is a lasting ethical capital.

However, the accordance of ethics and rights seen from the long-term societal perspective does not mean that every instance of ethical action will bring every individual direct and instant benefits. However, the person acting ethically in terms of consumer rights will usually receive benefits. It is particularly true for consumption: consumers buy products depending on their needs and the price of goods. When weighing options for ethical behavior, people think about the long-term influence of their actions on others besides themselves. Any ethical conduct depends on the agent’s own will. A consumer, as an individual, may not be willing to sacrifice changing his/her consumption patterns for the long-term interests of mankind at large. For example, a consumer may not be willing to buy expensive green products at the cost of his or her own comfort in order to save energy or reduce pollution. For an individual, such ethical conduct driven by conscience may be expected or hoped for, but not presumed.

Therefore, people are urged to practice consumer ethics not through non-binding means, such as demonstration appeals, education or advocacy, but through democratic procedures that integrate the

requirements of ethics into universally binding laws and regulations. The value and significance of “institutional ethics,” “structural ethics,” or “mechanistic ethics” lie in universal, binding laws and regulations. When it comes to consumer ethics, ethics means trying to reach consensus on the criteria of reasonable consumption through negotiation on the condition that people’s basic needs of material and spiritual consumption can be satisfied. On this basis, we should increase the price of globally recognized luxury goods and services. At the same time, we should lower (as much as possible) the price of green products. We should also restrain with the greatest effort the consumption of non-renewable resources and control the emission of pollutants, among other environmental efforts. In other words, we need to transform the “language of morals” to the “language of economy,” which means using price to regulate people’s consumption. This move will ultimately put consumer ethics in place and safeguard the long-term interests of consumers.

THE IMPROVEMENT OF CONSUMER RIGHTS: THE ADVANCEMENT OF HUMAN RIGHTS IN CHINA

Consumers’ shopping decisions and activities are a kind of choice. With the development of the market economy, consumers have more and more choices. Making choices has become one of their habits. As a common model of social behavior, choice-making symbolizes the great respect to people’s autonomy. The recognition and protection of will-autonomy constitutes one of the core values in today’s civil societies. With the rise in citizens’ awareness, consumers now have more courage to safeguard their rights, showcasing the change of people’s values since the reform and opening up.

Economic behavior can provide a model for other fields of a society. With the development of the market economy, choice-making in economic activities will become a common habit and a model of behavior, hence establishing new rules of running a society, contributing to the change in political ecology and eventually helping to make democracy a firm and fundamental guideline for building and organizing a society.

When “bank notes (money) turn to votes,” or when consumers’ purchasing choices bring rewards to some companies and punishments to others, consumers will gain great power over the orientation of companies’ values and behaviors. Propelled by consumers’ actions to protect their rights and autonomous choice, companies are likely to realize that the purpose of offering goods is not only to gain profits, but also to serve consumers by safeguarding their human rights. Governments can also be aware that their function is not only to maintain stable economic and social orders, but also to improve their capacity to safeguard human rights and the level of civilization of the society. Therefore, on the one hand, the significance of research on economic ethics and consumer ethics will go far beyond what people imagine. On the other hand, through advocating consumer ethics, a synergy will be developed among consumers and producers that will be strong enough to promote human rights and democracy in China.

CONTEXTUALIZING CSP STRATEGY: TO ADOPT, ADAPT, OR INTEGRATE INTERNATIONAL CSR PRACTICES¹

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Abstract: Defining corporate social performance (CSP) as a dependent variable, studies of corporations' social responsibility (CSR) often do not pay attention to the influence of country context. Focusing on measures of CSP in the US and China, this paper develops a managerial framework that helps to understand the limits of current CSP conceptualization in international competition. Taking a managerial perspective, this paper develops guidelines for how business leaders can choose between strategic options: adoption, adaptation, or integration to achieve higher CSP internationally.

Keywords: corporate social performance, CSR, international strategy, multinational corporation, transnational corporation

Managers around the globe are concerned with the social responsibility and social performance of their firms. Scandals in Asia, Europe and the US illustrate the importance of better managing non-financial performance. Despite increasing understanding of corporate social performance (CSP) from a Western viewpoint (Mirvis & Googins, 2004; Charkham, 1994; Dierkes & Antal, 1985), which includes increasing corporate accountability and a focus on environmental and social performance (Valor, 2005; Matten & Crane, 2005), research on how to manage CSP in globally operating firms is scarce. While Asia increasingly gains more importance for many globally operating firms (Benedict, 2007), little is known about how firms' CSP is assessed in Asia. Lewin (1995) suggested "a baseline for future studies" (p. 100) on CSP in Japan. However, research on China is not available. How multinational corporations can manage CSP in several countries at the same time is theoretically and empirically unresolved. This paper seeks to develop guidelines to manage for higher CSP on a global scale.

The importance of CSP is rising also in Asia (Matsuoka, 2008). CSP practice and CSP-related expectations in the Asian economies have important implications for Western academics and practitioners. The influence of Western CSP concepts and measures can be a driver of developments in these countries. But Western views on CSP may also be driven by CSP developments in Asia. Western and Asian firms may encounter adverse effects where local notions of CSP make internationalization of practices incompatible with requirements elsewhere. Deeper understanding of the CSP adoption and adaptations in other countries is important for organizational theory and strategic management to help conceptualize the influence of the broader socio-economic context on the adoption of corporate practices. The adaptations of originally Western management practices in Asian countries could also lead to adaptation and improvements of CSP concepts and measures. Adaptation of Western ideas could influence the transferability of practices by Asian or Western multinationals when they go abroad. Asian adaptations of CSP concepts and measures provide insight into expectations and needs in Asia, and they

can be of strategic importance for Western firms in Asia and the future development of CSP worldwide.

The question of how firms can operate successfully worldwide envelopes the question of the degree of divergence between Asian and Western views of CSP. Solving the trade-offs involved in international strategy (Porter, 1980; Bartlett, et al., 2004) by seeking success in multiple locations has been much researched in the international business literature; but less substantial research regarding international CSP strategic options for multinationals exists currently. In this paper the ways in which the Chinese view of CSP is consistent with the Western view of CSP shall be analyzed to develop a framework for strategic decision-making.

CORPORATE SOCIAL PERFORMANCE (CSP)

CSP is “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s societal relationships” (Wood, 1991, p. 693). Carroll (1979) points out, “the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time” (p. 500). It is widely accepted that firms have a responsibility to manage how their actions impact various stakeholders and how their resources might improve the well being of various stakeholders (Frederick, 1994). What these actions specifically are is not yet uniformly accepted.

Corporate social performance results from the firm’s consideration of its relevant context, that is, who its stakeholders are and how the firm serves their interests. The stakeholder perspective (Freeman, 1983) describes the reciprocal relationships between the firm and employees, owners, customers, suppliers, communities, competitors, government agencies, pro-environmental groups, and the media. McWilliams and Siegel (2001) suggest that going beyond what is legally required or directly in the best interests of the firm is how firms truly respond to interests of stakeholders and show CSP. This standard for CSP suggests that context inextricably connects to any measurement of CSP. McWilliams and Siegel’s research suggests that legal systems, culture, and common practice help decide CSP in a given country. Their research suggests that multinational firms may either have a different CSP standard in each of the contexts in which they operate, or may have a super-ordinate standard for CSP (Kostova & Zaheer, 1999; Kolk, Walhain & van de Weteringen, 2001).

Consistent with the idea that CSP ought to vary across countries, Mitchell et al., (1997) present a model in which the salience attached to a stakeholder group relates to their power, legitimacy and urgency. Clearly the institutional environments which give rise to differences in the power, legitimacy and urgency awarded to stakeholders vary considerably across countries (Van Tulder & van der Zwart 2006; Hooker & Madsen, 2004). For example, in the Western world firms pay more attention to environmental activists than comparable firms in countries where the power and legitimacy of environmental activists is much lower. The literature compares a neo-liberal approach to CSP in the US with a neo-corporatist approach in Europe and a business-statist approach in Asia (van Tulder & van der Zwart, 2006) describing the Asian model as characterized by customary/communist regulations, informality, lack of corporate volunteering and philanthropy traditions, very low public advocacy and negligible pressure by activist investors. Summarizing the developments related to CSP may be useful for a country such as the US. However, the developments of CSP for Bangladesh, China, Hong Kong,

India, Indonesia, Japan, Korea, Philippines, Singapore, and Taiwan may be difficult to summarize adequately. As helpful as these generalizing characterizations may be, we now want to test how CSP in Asia differs from elsewhere.

Comparing the different methods of CSP measurement (as a proxy for how it is perceived) in different contexts can provide some insight into how stakeholders are viewed in each country and suggest how multinational firms might understand how to better balance their various global interests. In what follows, CSP is linked to international strategy and propositions on developments of international CSP are developed. Then a US measure is compared with a Chinese measure of CSP. These measures are selected because they represent CSP expectations in two leading economic powers as reciprocal partners in trade and business, but with different cultures and institutions. In what follows we develop propositions on the emergence of a standardized CSP measure, multiple local CSP measures and hybrids between standardized and localized measures.

Host-Country CSP, Multinationals and Domestic CSP

The literature on internationalization and international business has widely discussed the need for firms that are active in multiple markets to respond to locally specific demands while integrating sections of the business across borders to attain efficiencies of scale (Westney, 1993; Yip, 2003; Devinney, et al., 2000; Pla-Barber, 2002). Corporate financial performance has been the focus of attention of most research on international business and multinationals. Hence research on how to enhance financial performance by catering to local needs and standardizing business practices across borders is widely published. Leading scholars in international business (Doz, et al., 1981; Yip, 2003; Bartlett, et al., 2004) posit that transnational corporations master the balance of local responsiveness and global integration.

CSP (in contrast to economic performance) has not been widely discussed in international business and strategic management (for an exception see Karnani, 2007). The case of Nike and the scandal involving production sites in Asia (among other scandals) have created urgency to address questions relating to CSP and internationalization. In analogy to financial performance of transnational corporations, globally operating firms could aspire to balance social performance that responds to local requirements with social performance vis-à-vis universal requirements.

Most Asian firms operating in international markets have encountered CSP abroad. They came to adopt CSP policies and practices matching host-country expectations and requirements as theories of corporate social responsiveness or institutional theory would predict (Frederick, 1994; Ackerman & Bauer, 1976). As in the case of manufacturing management, marketing, and R&D, Japanese firms, for instance, have also looked to the US for models of responding to CSP issues (Lewin, et al., 1995).

The shared interest and the apparent importance of CSP in the leading economies suggest the rapid diffusion of a concept independent from the context of application. The requirements of stakeholders across the globe will – together with globalization – result in a standardized concept of CSP applied worldwide. This development towards a universally accepted standard for CSP is explained by increasing homogeneity of how firms act (imitation) under similar institutional pressures (DiMaggio & Powell, 1983). Publicized measures of CSP and rankings based on these measures can create incentives for imitation across firms and countries. These incentives can lead firms to imitate best practices in CSP of other firms and to create bandwagon effects.

Accordingly in increasingly global industries, competing firms adopt similar approaches to competition such as emphasis on CSP. Also many multinationals are active in multiple markets. In order to escape growing complexity and transaction costs, these corporations will seek a standard approach to CSP in pursuit of optimal performance. Strategic choices (Child, 1997) of multinationals lead to the emergence of CSP. Multinational firms need to cope with complexity and uncertainty exacerbated by their organizational networks that span different countries, cultures and regulatory environments. In order to reduce the transaction costs involved with meeting CSP standards, firms active in multiple locations may choose to select a globally acceptable way of ascertaining CSP. This leads to proposition 1 (P1).

P 1: A global standard of CSP emerges. Firms are deeply embedded in their local context. The argument of social embeddedness of managerial action (Granovetter, 1985; Hambrick & Mason, 1984) suggests that firms would adapt to local conditions of demand for socially responsible behavior. Strategic management suggests that firms would seek differentiation and niche attributes to distinguish themselves from competition, which leads to increasing localization. Consider the US reaction to the Enron scandal and the legislation that followed. The Sarbanes-Oxley Act has dramatically altered the way firms (have to) think about corporate governance, if they intend to do business in the US. Adaptation to such local requirements could provide firms with only a temporary advantage.

The differences in local requirements across industries or countries would result not in a standardized but a locally adapted view of CSP. Firms would pragmatically seek to enhance CSP locally, seizing opportunities by fine-tuning their approach to local demand. Empirically, CSP is still a novel concept in China (Sudhaman, 2004). As a result, concepts and measures used are not available in English yet. Under similar circumstances, Lewin, et al., (1995) examined the results of a first survey on Corporate Social Performance in Japan in 1991. While the concern for CSP was rising it was internally and locally focused. Japanese firms had begun to develop their own unique way to manage CSP. Having a “distinctly Japanese flavor, it is likely that Japanese policies and processes ... will continue to diverge from the Western model” (Lewin et al. 1995, p. 99-100). Proposition 2 (P2, listed below) builds on these findings.

P 2: CSP will evolve in local contexts. The coexistence of local demand and pressures for global integration will lead to the emergence of varieties of CSP that overlap in some universal aspects but differ in locally specific requirements. This idea of hybridization is similar to the theory of transnational firms that combines localization and integration (Bartlett et al., 2004; Devinney, et al., 2000). Global integration can hardly be pursued to its full extent because local preferences and institutions persist and offer incentives to local adaptation. A hybrid measure of CSP would include highly standardized components and locally specific components of socially responsive behavior. Please see an abbreviated version of Proposition 3 (P3) below.

P 3: CSP will evolve standardized and locally adapted components. Unfortunately good quality, longitudinal data on CSP in English has become available only for a few Western markets (Wood, 1991; Graves & Waddock, 1994; Waddock & Graves, 1997). This cannot reliably be said about many other sources of CSP data especially when it comes to emerging markets. As we discuss below, Beijing University has begun to develop a measure of CSP to be used in field research in the future. Without access to other concepts and measures of CSP in China we compare this exemplary approach with a widely accepted US measure.

CSP in China

Being still a novel concept in China (Sudhaman, 2004; van Tulder & van der Zwart, 2006), Chinese firms operating in international markets have encountered pressure to conform to CSP norms abroad. Internationalized firms adopt CSP policies and practices that match host-country expectations and requirements (Frederick, 1994; Ackerman & Bauer, 1976). Pressure from international stakeholders prompt Chinese firms with off-shore operations such as Lenovo or Haier to address social concerns. With a codified CSP in China, firms present invested in different host-countries are exposed to different host-country expectations and requirements. This exposure to simultaneous, yet different expectations requires firms to make trade-offs between adapting to diverse CSP requirements or standardizing their strategy across different locations.

Measures of CSP

Different constructs help to measure CSP in the US. The most widely known constructs in the Western economies, KLD (Kinder, Lydenberg, Domini) data and the CEP (Council of Economic Priorities), are frequently used in empirical research and mirror a Western understanding of CSP (Orlitzky, Schmidt and Rynes (2003) for a list of studies that use KLD and CEP data).² In this paper the more widely used KLD is used for comparison with a construct developed at Beijing University. This comparison offers an opportunity to compare country specific views of CSP. Aiming at presenting a mirror of Chinese understanding of CSP today, there are limitations of comparing selected Western with selected Chinese measures. While data and simple comparison are not enough to corroborate the thesis, comparative analysis is able to illustrate, question theoretical ideas, or disprove general assumptions.

Large overlap between these measures would illustrate that a standard of CSP shared in the US and China might be emerging. Such a standard would encourage adoption worldwide. Large differences between the measures in the US and China would illustrate how local versions of CSP develop. This scenario may lead firms to adapt to local requirements. If the measures show partial overlap and partial differences, firms may consider integrating international CSP approaches with local ones. In what follows, the two measures of CSP, the Beijing University (BU) and the KLD instrument are discussed. By comparing the two measures of CSP, tentative guidelines for decision makers have been developed and future avenues for research have been established.

The BU measure. A group of researchers at Beijing University has completed a preliminary study on developing a CSP measure for China in December 2005. The result of this pioneering study is the proposal of a framework for evaluation of firms, which is disclosed online. Evaluating firm performance, an independent committee, with nominated members, shall use hierarchy analysis to check behavior in three categories. Each category, economic relations, societal relations, and natural relations carries equal weight. The framework has been put to first use in a survey in July 2006. Results of the survey of private firms, SOE, foreign firms registered in China that are in profitable operation for more than 3 years (n = 100) are to be published as a ranking of the top 20 firms. The three categories of the CSP measure include economic relations, societal relations and natural relations. Economic relations, the first category, measures financial performance (value added, growth of total sales, R&D sales ratio and sales ration of new products) and contributions to external society including taxes paid and the number of employees.

The second category, societal relations, includes the protection of employees and external

stakeholders' interests. The protection of employees' interests is measured by training expenses on total salaries paid; level of guaranteed salary payment; level of guaranteed social welfare; average investment in health and safety per employee; and the number of employees suffering from professional diseases or on-duty injuries (negative relation). External stakeholders' interest is measured by three items: quality or safety guarantee of products and services; management of supplier relations and compliance with fair competition.

Natural relations, the third category, assesses the impact on the local environment based on records of environmental pollution, investments in environmental protection related to total sales, quality of environmental management systems, impact of pollution, or complaints by residents. Environmental performance is measured by the ratio of non-clean energy expenditure on total sales and the elimination of greenhouse gas exhaust.

The KLD measure. The KLD data has been widely used in academia and practice to assess CSP (Waddock & Graves, 1997). Based on Waddock and Graves (1997) I briefly outline the KLD Social Screens which KLD utilizes commercially. Screening publicly traded corporations for eight criteria annually, KLD grades the performance on each criterion on a range from major concern to major strength. The eight KLD criteria include positive screens related to community, diversity, employee relations, environment, and product and the three negative screens related to South Africa, military, and nuclear power.

The activities of firms related to the community are screened for areas of concerns such as fines or civil penalties paid, major litigation or controversies relating to the community in which the firm operates. KLD considers as strength: notable philanthropic giving, involvement in public-private partnerships and commitment to raise the educational level in communities.

Diversity related screens (formerly called treatment of women and minorities) include evidence of substantial fines, civil penalties, controversies surrounding affirmative action failures and the lack of minorities in senior management positions count for points of concern. Potential strengths include women in position of the CEO, promotion of minorities to leading positions, outstanding employee benefits, hiring of disabled, and progressive gay, lesbian and bisexual policies. Areas of concern regarding employee relations include poor relations with unions, penalties related to employee safety, the appearance of other major safety controversies, large and recent layoffs, or inadequate pension plans. Indicators of strengths in employee relations include strong union relations, long-term policy of company wide cash profit sharing, worker involvement through ESOP,³ sharing of financial information, strong retirement and benefit schemes.

Notable liabilities for hazardous waste count as areas of concern in the environmental category. Other concerns include civil penalties and regulatory problems, major controversies, large production of dangerous chemicals or other ozone depleting chemicals, high legal emissions and production of agricultural chemicals. KLD measures commitment to the environment counting new products with environmental benefits, revenues from remediation products, company-wide reduction of emissions and use of recycled material revenues.

The KLD category "products" includes areas of concerns such as product safety controversies, liability lawsuits, controversies or fines, consumer fraud, regulatory actions, and fines relating to advertising or antitrust laws. The areas of strengths include long-standing and recognized quality

programs, leadership in R&D, and products/services that benefit the economically disadvantaged.

The three negatives screens employed by KLD focus on areas of concerns related to military and nuclear power, and South Africa (dropped after political change in the country). Involvement in weapons-related contracting is considered a major concern. Ownership of electric utilities that derive electricity from nuclear fuels (in particular uranium) and revenues through the development and sale of parts of equipment of nuclear power plants also count as concerns.

Comparison of Instruments

The following section includes a comparison of the two instruments (BU and KLD) as shown in Table 1. The concerns shared by both instruments (employees, community, environment, consumers) are analyzed first. Then the concerns included by only one instrument are analyzed (women, negative screens and economic relations).

Table 1

Comparison

		BU	KLD
1	Employees	●	●
2	Women		●
3	Economic performance (financial performance, taxes paid, employment)	●	
4	Consumer	●	●
5	Community	●	●
6	Society/ societal relations	●	●
7	Environment/ natural relations	●	●
8	Defense/Military (-)		●
9	South Africa (-)		●
10	Nuclear weapons (-)		●

Employees (BU and KLD). Employee relations include aspects such as unions, employee safety, job security and pension plans or benefits plans that exert influence on a firm's KLD score. In contrast to KLD, BU focuses on related but fundamental issues related to employment (as part of internal societal relations). In the BU study, taking into account the guaranteed salary payment and level of guaranteed social welfare lie at the core of the employment contract. Similarly, employer protection from work related injuries also seems basic compared to KLD measures such as average investment in health and safety per employee and even more training expenses on total salaries paid. Regarding external stakeholders, BU again captures fundamental issues such as quality or safety of products and services (albeit focusing on the existence of a guarantee). Management of supplier relations and compliance with fair competition remain ambiguous. Taken together, BU's measures emphasize the fundamental contract with the employee with operational items.

Community (BU and KLD). Both instruments consider the impact a firm has on its community as an important factor of CSP. The KLD considers some negative influences and the positive effects of philanthropic giving measured in financial terms and other activities that are considered positive in

developing good relationships with and within the community. BU captures some of these aspects within the category environment.

Environment (BU and KLD). The BU measure is focused on the local environment and the community. Quantitative measures such as investments in environmental protection related to total sales, ratio of non-clean energy expenditure on total sales and the elimination of greenhouse gas exhaust are seconded by more qualitative records of environmental pollution, complaints by residents, quality of environmental management systems, and impact of pollution. Specifically focused on the content of environmental policies, the KLD focuses on concerns such as firms producing notable amounts of hazards, pending civil environmental penalties, regulatory problems, major controversies, and being responsible for large production of harmful chemicals. The KLD indicators of strengths include revenues from remediation products and other evidence of environmentally friendly activities. Similar to the measures of economic relations, the BU instrument captures environmental concern on the corporate level by using broader measures than KLD.

Consumer (BU and KLD). BU and KLD include consumers in their measures of CSP. The BU includes product and service safety to capture a firm's responsibility (under external societal relations). Compared to the limited and unspecified concern in BU, KLD emphasizes legal and quality aspects of the customer interface. For instance, KLD specifically includes product safety controversies and product liability lawsuits as negative signals. KLD emphasizes the explicit nature of controversy and thereby also the measurability. Also the criteria chosen by KLD to measure positive activities leverage measurability and capture the possibility for consumers to claim their rights. This aspect is less explicit in BU.

Women and minorities (KLD). The KLD screens for fair treatment of women and minorities. The BU does not specifically address the potential issues related to employment of women and minorities.

Negative Screens (KLD). Only KLD includes negative screens, i.e. criteria negatively linked with CSP. In the past KLD used to screen for support of the apartheid regime in South Africa. Notable involvement in weapons-related contracting or nuclear fuels or the design or construction of nuclear power plants are also considered concerns. No similar negative screens can be found with BU.

Economic relations (BU). "Economic relations" is listed by BU and is not reflected in the items measured by KLD. Measuring financial performance in terms of value added and sales growth reflect a concern for financial performance as part of CSP. Similar to the ratio of R&D to sales and the sales ratio of new products as captured by BU, KLD also screens for leadership in R&D in the category products. Specific contributions to external society including fundamental items such as compliance to legislation (taxes paid) and measure of organizational size (number of employees) as CSP criteria cannot be found with KLD.

DISCUSSION

Our comparison between two CSP measures, one from the US and one from China, shows that two levels of CSP measures exist. On one level consensus exists and on the other level local concepts are important. Consensus concepts are used independent of local contexts to measure CSP in the US and in China. Shared concern for the environment, community, employees and consumers show the acceptance of standard elements of CSP independent of location. The above analysis of BU and KLD measures

shows that for some aspects of CSP a global consensus could be emerging. These consensus concepts do not allow rejecting proposition 1.

Three main factors including knowledge, markets, imitation, and learning, explain how such consensus comes about. One, independent of country differences and contexts include similar groups of strategic stakeholders of firms, such as the employees and the local environment. The current discussion of the importance of knowledge, human and social capital for firms' success addresses this point (Nonaka & Takeuchi, 1995). The tacit knowledge most relevant for competitiveness is embodied in employees and the local environment. Protecting employees who possess knowledge and skill as well as nurturing the local communities where many of the future employees are raised and current employees dwell are key issues on the corporate agenda (Porter & Kramer, 2006).

Two, the nature of social responsibility as a shared issue in market economies (and those in transition) narrows the focus of CSP in a way that makes overlap unavoidable. Putting it differently, the external effects of markets are similar across country borders (e.g. environmental hazards caused by unbounded profit maximization by individual firms). CSP develops remedies for some of these negative external effects (Orlitzky et al., 2003). Consequently the attention paid to specific CSP elements is allocated in similar ways. If socially responsible conduct vis-à-vis stakeholders is required, then employees and the local community are certainly included and need to be addressed as part of CSP. Following an economic rationale, demand for socially responsible action creates specific guidelines on how to evaluate firms. As market economies describe how firms conduct business worldwide, the demand for CSP is similar.

Three, learning through adoption (i.e. imitation or contagion) can explain why CSP measures used in one country are similar to originals after the translation into another country's context. Institutions trying to establish a CSP measure in a country may want to refer to successful implementation of similar measures in other countries. Legitimizing the introduction of new measures with references to traditions or existing practices (DiMaggio & Powell, 1983) explains why local institutions such as CSP are not necessarily constrained by countries. Successful adoption of management practice in one leading country can make adoption in another more likely. Learning from the (negative) experiences of others justifies improvements.

Examples or cases of crisis of individual firms or institutions in a country or the activism of stakeholders or innovations in one country can shape emerging institutions and corporate activities in other countries. Pressure by Nike's stakeholders in the US and other western countries not only convinced Nike to adjust its operations network worldwide, but also other firms learned from Nike's experience. While Nike learned through the pressure of activists, firms and institution builders in other countries learned from Nike's experience and applied the lessons learned to fit their specific environment. Learning from experience, imitation of practices in other countries, the importance of knowledge and the way markets function explain why standardized elements of CSP can be found in China and the US.

Comparing the US and the Chinese CSP measure consensus on one level and local differences on the other level shows that not all elements of CSP are shared. The emphasis on economic performance, equality for women and minorities, and three negative screens are the main sources of differences. Elements of CSP could diverge. This finding does not allow rejecting the second proposition.

Finding partial support for both propositions 1 (adoption of a standard) and 2 (development of local measures), implies support for the development of hybrid measures of local and internationally shared CSP (proposition 3). (The most important difference is the strong emphasis on economic performance in the Chinese measure and the absence of this emphasis in the US measure of CSP.) In what follows three explanations for this difference are discussed, macro-level factors, the origins of CSP measures, and taken-for-granted elements of firm performance in specific contexts. Macro-level factors help sketch the transition of China from a planned to a more market oriented economy and a society in which individual decision making in economic matters increasingly substitutes collective decision making.

Since the early 1980's Chinese firms have assumed new responsibilities for providing employment, financing local, provincial and central governments through their taxes, and fostering economic prosperity by reinvesting profits. Awareness of these responsibilities is unevenly distributed among firms and needs to be shared more widely within society. As taxes did not exist until recently, paying taxes is a new responsibility for managers and leaders of organizations in China. Similarly, employment once guaranteed by collectives now is at risk resulting from a pursuit for profit. Raising awareness of the responsibility of firms to provide employment may be very important. Summarizing these points, in developing economies (or those in transition such as China) where firms need to learn to compete profitably and assume their public responsibilities, CSP measures are likely to include elements of economic performance.

Unlike the macro-level rationale, the background of the CSP measures also explains why BU includes economic performance and KLD does not. The focus of economists on markets and market rationality as well as the stance that the social responsibility of a firm is to generate rents has inspired researchers and practitioners in the US to search for alternative measures of performance. This search consequently has excluded economic performance to emphasize the different responsibilities of firms and measures of firm performance. Where social responsibility of corporations is conceptualized without an opposing perspective as has happened in China, social responsibility more likely includes economics.

The financial performance, number of employees and whether a firm pays taxes or not, is also often taken for granted in the context of advanced economies. Yet, profitability, employment and taxes need to be considered separately. Only when firms survive economically does their CSP matter. The literature on CSP in the West often focuses on theorizing about and empirically testing the relationship between CSP and economic performance (Orlitzky, et al., 2003). The search to understand whether there is a trade-off, correlation or a causal linkage that either explains economic performance with CSP or CSP with economic performance, including profitability in CSP measures does not feature prominently in Western CSP literature.

Finally, BU includes employment prominently and KLD does not. However, recent layoffs (15% in one year and 25% in two years) weigh negatively also with KLD. In other words, employment is a shared issue with the emphasis in China lying on growth and in the US on stability of employment. Fulfilling tax duties is taken for granted in many advanced Western economies but not in all. Consider how the tax discipline differs among the member states within the EU; the considerable size of the black labor market within member states persuades some states to cautiously proceed with EU expansion. Taking values, norms and customs for granted is a way of defining social institutions. Including economic performance among the responsibilities of corporations shows that they cannot be taken for

granted in one country. Excluding them in another country shows that profitability, paying taxes and employment are part of what doing business in this country means.

KLD shows great concern for equality, the employment and career opportunities and advancement of women and minorities in the US. The BU measure does not directly refer to these issues. Unlike in the US, in China the need for such emphasis may not be felt strongly or it may not be voiced. The large percentage of female employment during the last 30 years in China and the successes of women in powerful positions in China illustrates that the need for special emphasis on equal employment opportunities may indeed not be felt as strongly as in the US. Similar to the concern for women's position in society, minorities have enjoyed favorable treatment in China for decades which is said to have strengthened their position within China. Furthermore equality and the status of minorities in China may be considered more a responsibility of the central government than the social responsibility of a firm.

However, if CSP measures abroad influence the BU measure, then adoption or imitation would lead to adding general or shared categories to the locally specific categories of the CSP measure. The exclusion of elements, then, has happened for specific reasons, which may be found in the local context. Assuming that equality of women and minorities in China has not yet been achieved fully, several reasons for the exclusion of the category are plausible. While the need for equal opportunities for women and minorities to rise to top positions and to receive equal pay for similar work may exist, institutional pressures could make it difficult to voice these needs. Emphasizing the need for equality in treatment and opportunities – beyond exceptional cases – may be in vain for political or societal reasons. Politicians may want to stay agnostic or avoid unfavorable developments or issues such as homosexuality or disability. The widely publicized return to more traditional values in China may be effective in similar ways. Moving away from the equality as ordained by communism may keep equality and other issues outside of modern CSP measures.

KLD includes negative screens (military, nuclear power and in the past South Africa). Again the exclusion of these categories shows that adaptation has happened (rather than adoption). This adaptation may have country specific, institutional reasons such as the restriction of firm responsibilities to economic, social and environmental issues so as not to include issues that are considered the responsibility of government at the different levels. This restriction may mirror facts, (i.e. the government is responsible for military policy, energy policy and foreign policy) or it may be symbolic. Reflecting the intended distribution of responsibilities in China, BU may symbolically show where current leadership in China sees the limits of firms' responsibilities in the Chinese society. Our data and analysis are limited to US and Chinese CSP measures which clearly poses limits to generalizing based on our findings.

However, comparing representative measures of CSP in two of the world's largest and distant economies (Ghemawat, 2005) provides insights into the tension of adapting, adopting and integrating CSP measures within and across countries. The Chinese measures seem to emphasize tangible measures (e.g. economic performance) compared to US measures that include specific elements related to political views and values (e.g. military, nuclear power). Both adoption and adaptation are clearly visible in the BU measure. These tensions are particularly relevant for internationally operating firms seeking to optimize localization and global integration.

CONCLUSIONS

The comparison of different CSP constructs in the US and China has shown that some constructs are shared and some are of only local concern. While the overlap between KLD and BU is considerable, the differences are clearly important. The findings that shared elements and locally relevant elements coexist and that CSP measures in different countries can be explained as adopted from other countries and adapted to specific contexts contribute to our understanding of the international landscape of CSP expectations. Showing that CSP measures are composed of shared and specific measures, the findings show that international CSP measures may lay on a continuum of similarity and dissimilarity.

Implications for future research include broadening the scope of the present qualitative comparison by conducting multi-context studies over longer periods of time to capture the full range of measures internationally. Systematic analysis of CSP in many countries could help to map how different measures relate to each other and possibly find dimensions that describe different groups of CSP expectations.

The shared and the locally relevant elements of CSP in China and the US can be used to derive some implications for firms. Based on two measures from two countries, the following framework suggests how to maneuver Chinese and US CSP as measured by KLD and BU. Increased awareness of shared and local elements to CSP and their potential influence on performance in different countries is needed. Regarding internationalization our comparative study suggests – surprisingly – that the entering of CSP in China may require less localization than the entering of CSP into the US because CSP is less dependent on local requirements and demands less specific actions.

Firms that encounter CSP in host countries will more easily conform to requirements that are similar to the domestic understanding of CSP (shared concepts). Firms intending to expand their business internationally need to pay attention to the shared concepts linked to CSP because shared expectations need to be met wherever they intend to do business. Shared expectations related to CSP represent a baseline for remaining legitimate. Managing a multinational firm means to seek competitiveness worldwide. Multinationals can strengthen their competitiveness by increasing CSP. Focusing on shared requirements that are important in several countries as well as focusing on the intensity and high quality of a firm's performance in these areas can increase CSP significantly. However, neglecting the locally important elements of CSP risks forgoing important ways to differentiate a firm in specific markets and raise a firm's CSP.

Firms will be more challenged by locally relevant elements of CSP. Depending on the host country, other concepts need to be considered. Notably for firms active in the US, some of the negative screens are unique. Or to put it differently, firms can use CSP activities related to locally relevant measures to differentiate themselves from competitors. Selective achievement is based on the choice of performance dimension and the quality of performance in that dimension. When firms face locally relevant measures making the right decisions can largely influence CSP in specific countries but also across countries. Across country effects are likely irradiation effects or halos of positive or negative CSP that influence the perceived performance in another country. Low CSP in one country can lead to low CSP in other countries where the corporation is made responsible for all local subsidiaries. Therefore a clear understanding of the trade-offs involved in choosing between four strategic options is required. Firms can have three options. They can ignore local CSP requirements, adopt or adapt them locally or integrate local requirements into firm specific CSP efforts on a global or regional scale.

Rejecting local CSP requirements will decrease local CSP. Keeping the organizational efforts to increase CSP in all markets consistent with the CSP expectations in the home country may maximize CSP at home and simplify efforts and reduce costs related to CSP. However, rejecting local requirements risks CSP abroad. If the differences between requirements abroad and in the domestic market are very large in strategic areas, resulting scandals (e.g. Nike) may even reduce CSP at home through the indirect effects of media reports about low CSP abroad.

Adopting the local CSP requirements abroad aims for increasing CSP in each location. Localization of CSP efforts does increase the complexity of socially responsible behavior of an organization and it raises the costs. This may be overcompensated by the positive effects of increased CSP in the different local markets. Tension may arise where locally desirable behavior contradicts desirable behavior in another location. Consider that the use of nuclear power may be an issue of negative concern (e.g. KLD) but it could be also considered a positive solution to generate energy without increasing global warming through exhaust gas. In such a situation pursuing adoption of local CSP measures may require choices that limit CSP in selected countries.

Adapting CSP behavior to meet requirements in some local markets can help to reduce the complexity of organizational CSP efforts. Adaptation may include changing behavior so that key CSP requirements are met in some important markets. Integrating offers opportunities to meet CSP requirements across countries but it requires firms to reconsider its approach at home and to redesign its CSP behavior to meet the key requirements in strategic markets. For example, applying portfolio techniques to maximize CSP while keeping localization limited can help to balance the costs and benefits of managing CSP internationally. The propositions and the framework above are based on the general assumption that CSP measures co-evolve. New concepts are rejected, adopted, adapted or integrated continuously in connected markets. Therefore the comparison shows one stage in this process. Future research could unveil more of the co-evolution of CSP, dynamics of the measures and firms' CSP strategies.

NOTES

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2. Other measures are the DJSI, GRI and the KLD'S Domini 400 Social Index. DJSI: Dow Jones Sustainability Index. GRI: Global Reporting Initiative.
3. ESOP: Employee Stock Ownership Plan.

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BEAUTY AND THE BEAST: CONSUMER STAKEHOLDERS DEMAND ACTION IN CHINA

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Abstract: Academic conceptualizations of corporate social responsibility rarely take an institutional perspective. Yet, the socially responsible behavior of multinational companies in China cannot exist within an institutional vacuum. We address this gap in the literature by presenting the case of SK-II Cosmetics, manufactured by Procter & Gamble in Japan and exported to China. In 2006, Chinese authorities announced that SK-II contained toxic chemicals despite company denials. Using SK-II as an exemplary case, we argue that dynamic institutional actors, such as the state, media and consumers continually shape and challenge the definition of what is socially responsible behavior, based not just on firm's behavior but on the broader institutional context. We suggest that at least three institutions are important in determining corporate social responsibility for foreign firms in China: first, the market (more precisely competition); second, political/private censorship of information (or the tactical use of misinformation) and corporate governance; third, state protectionism and rent-seeking.

Keywords: corporate social responsibility, institutions, China Procter & Gamble skincare

INTRODUCTION

The overly prominent role moral hazard or opportunism plays in New Institutional Economics¹ has often left students of organizational theory wondering why there are so many firms which actually treat their employees, suppliers or customers fairly or do not harm the environment, even when they know they could get away with it. The call for more corporate social responsibility (CSR) and the recent scandals in multinationals notwithstanding, we know that not all firms lack CSR. Ever since de Soto analyzed whether one can start or run a business (in Peru) by playing by the rules, attention has been drawn to the fact that CSR is a phenomenon that is restricted neither to multinationals nor to the "Western" industrialized world (de Soto, 1989).

In what follows we claim that an institutional perspective is missing in the CSR-literature (Campbell, 2006) which models organizational behavior almost exclusively via the interactions between the firm and its stakeholders. Instead it is assumed in what follows that CSR depends on a set of institutions which reward responsible behavior and mobilize resources for investing in such behavior (Campbell, 2006). We also contest the comparative static view in which institutions are conceptualized

as non-dynamic constraints for individual or collective decision making. Such studies overemphasize the role of (usually exogenously given) cultural norms and state legislation, while neglecting the influence of market forces, such as competition and corporate governance. For example, studies neglect to explore the interaction between the management and share-/stakeholder, and political agencies. The co-existence of firms with high CSR and those with low CSR working in the same country and economic regime asks for an explanation that goes beyond the cultural and political context.

A dynamic perspective promises insights relevant for all transitional economies where political and economic actors still search for institutions that define “defaults” for the range of economic action that obeys nothing but a functioning price mechanism (Meyer & Peng, 2005). To blame either too “liberal” markets or the socialist legacy for the lack of CSR in the new private sector does not do justice to the millions of firms in, for example China, which neither exploit their workforce nor pollute the environment. From a dynamic perspective the question is rather whether these firms can survive in the long run or, more generally, which institutions are needed to make CSR a business strategy which promises positive returns. After a short review of the literature on CSR, we present a much publicized case of SK-II skin care in China before offering an economic interpretation and insights from New Institutional Economics that go beyond the case. The analysis ends with some general conclusions, where we suggest that at least three institutions are important in determining corporate social responsibility of foreign firms in China: first, the market, more precisely competition; second, political/private censorship of information (or the tactical use of misinformation) and corporate governance; third, state protectionism and rent-seeking.

CONSUMERS AND STAKEHOLDER THEORY

Research on corporate social responsibility (CSR) and international firms is growing (Christmann & Taylor, 2001; Dowell et al., 2000; Husted & Allen, 2006; Kolk, 2005; Kolk & Van Tulder, 2004; Schlegelmilch & Robertson, 1995; Strike, Gao & Bansal 2006; Van Tulder & Kolk, 2001). Yet the concept of CSR has been in existence for half a century, when Bowen (1953) first published “Social Responsibilities of the businessman.” Bowen argued that business executives have a strategic role in society, and that managerial decisions have important impacts on the general welfare of citizens and society at large. Since that time, CSR has evolved in a diffusion of corporate codes and programs, yet remains a subject of wide debate. For instance, does CSR encompass only voluntary social or environmental actions (European Commission 2001), or does CSR encompass a wide spectrum of economic, legal, ethical and philanthropic behaviors (Carroll, 2004)? In general, there is much support for the idea that CSR encompasses “actions that appear to further some social good, beyond the interests of the firm that which is required by law” (McWilliams & Siegel, 2001, p. 117). Yet Porter & Kramer (2006) argue that most of the prevailing justifications for CSR focus on the tension between business and society rather than on their interdependence.

Further, typical theories of CSR develop only a generic rationale for the concept not explicitly tied to the strategy and operations of a specific company or the countries in which it operates. Porter & Kramer (2006) reiterate Bowen’s original strategic focus, and caution that a lack of strategic integration will result in CSR practices and initiatives isolated from operating units, leaving the firm vulnerable to strategic threats and externally diffusing the firm’s societal impact.

A lack of strategic integration challenges multinational firms who must deal with both global and local issues within their CSR approach (Husted & Allen, 2006). Global CSR is a response to universal principles (or hypernorms) and “deals with a firm’s obligations based on those ‘standards to which all societies can be held’” (Husted & Allen, 2006, p. 840). Examples of global societal issues may include human rights, environmental protection, and possibly consumer health & safety. In contrast, local CSR “deals with the firm’s obligations based on the standards of the local community” (Husted & Allen, 2006, p. 840). Thus the global and local social context should have relevance to effective firm behavior.

Research indicates that multinational firms face many challenges in developing and implementing effective CSR policies and programs. For instance, a recent McKinsey study concluded that, “Executives around the world overwhelmingly embrace the idea that the social role of a modern corporation goes far beyond meeting its obligations to shareholders...Yet executives, wary of the risks such obligations bring, say that their companies aren’t adept at anticipating or managing social obligations.”² Furthermore, while there is the opportunity for firms to develop a strategic approach to global-local CSR (depending upon the global and local context), research indicates that firms tend to be non-strategic and develop CSR approaches based on internal isomorphic pressures rather than reflect the external social context (Husted & Allen, 2006).

However, other studies indicate that multinational firm behavior can be context-specific in terms of cultural differences and varying stakeholder pressures (Chapple & Moon, 2005; Logsdon et al., 2006). Waldman, et al., (2006) has also illustrated that culture can affect managerial perceptions and CSR behavior. Differences exist within the Anglo-Saxon countries (Maignan & Ralston, 2002) and within Europe (Schlegelmilch & Robertson, 1995). Asian perspectives on CSR also tend to differ. For instance, Wokutch (1990) argued that Japanese firms were more advanced in cooperative labor relations and with occupational safety and health issues than US firms. Welford (2005) shows that a CSR focus has rapidly grown among Asian firms and that Asian firms target different issues than their European or North American counterparts. Asian firms pay less attention to general social or environmental issues when compared with multinationals from Europe or North America, and tend to have a narrow definition of stakeholders as customers and shareholders (Lines, 2004). CSR reporting also has regional differences in both frequency and content (Fortanier & Kolk, 2007; Jose & Lee, 2007; Kolk, 2005). There also appears to be an internationalization effect of CSR practices. For instance, Chambers, et al., (2003) analyzed 350 companies operating in Asia, and found that firms which operate internationally are more likely to engage in CSR and to institutionalize it through codes.

Research also indicates that firms pay attention to social and environmental issues depending upon its relevance to key stakeholders, but may do so in symbolic and/or substantive ways depending upon the degree of monitoring and sanctions for non-compliance (Christmann & Taylor, 2006). Broadly speaking, a stakeholder is “any individual, community or organization that affects, or is affected by, the operations of a company” (Freeman, 1984). However, firms tend to pay attention to a subset of stakeholders, and core stakeholders are those that have measurable salience to managers (Mitchell, et al., 1997). Stakeholder salience depends upon their degree of power, urgency and legitimacy to the firm and/or other powerful actors (Mitchell, et al., 1997). Stakeholders do not act alone; previous research has recognized the powerful networking ability of a vast range of stakeholders (Rowley, 1997). Thus stakeholder groups that may appear to have little direct power can undertake a variety of strategies to

gain greater influence over firm behavior (Frooman, 1999). From a stakeholder perspective, the socially responsible firm recognizes “that day-to-day operating practices affect stakeholders and that it is in those impacts where responsibility lies” (Andriof, et al., 2002).

Consumers are commonly identified as important stakeholders by firms, particularly in consumer package goods sectors. While consumers collectively have significant purchasing power, individually they often lack access to detailed information on social and environmental issues related to the products that they purchase. However, consumer information alone is usually insufficient to safeguard consumer rights and health and welfare (Thorelli, 1978). Thus, consumers typically require intermediary organizations which provide monitoring of firm performance and sanctioning of non-compliance. Consumer support for, and interest in, CSR has been researched in the US and Europe but to date there is little information on Chinese consumer behavior concerning CSR issues. However, we do know that many consumers in the US and Europe say that they prefer to buy from socially responsible firms (Maignan, 2001; Wocester & Dawkins, 2005).

Despite the recognition that CSR is an outcome of societal expectations, there has been little previous use of institutional theory to conceptually or empirically explain how stakeholders and firms interact within larger institutional frameworks and organizational fields (Campbell, 2006). However, recent conceptual and empirical studies (Campbell, 2006; Husted & Allen, 2006) suggest that institutional theory has much to offer in terms of explaining why firms engage in CSR activities. Campbell (2006) argues that institutional theory can provide a conceptual frame to better understand how institutional incentives and constraints result in CSR policies and activities by firms. That is, institutional theory can help explain why some firms behave responsibly (or not) given the organizational field in which they operate. Husted and Allen (2006) apply institutional theory from within the firm’s boundaries in order to see how isomorphic pressures permeate different functional areas. Their empirical study in Mexico demonstrates that the organizational strategy of multinational companies can significantly influence CSR behavior because of institutional processes: that is, firms choose CSR policies and actions that tend to fit with existing firm-behavior in other realms (e.g., product-market activities).

To date, no empirical research examines how external institutional dynamics at the organizational field level may impact firm legitimacy as a socially responsive actor, regardless of actual firm behavior. An intriguing related question is: why do other institutional actors support or challenge the legitimacy of a firm’s CSR reputation and activities? In what follows we suggest that New Institutional Economics (NIE) can identify patterns in the behavior of major economic agents, such as stakeholders, firms, or state agencies. The case that will be described presently focuses on an event (or more precisely, a crisis) that exemplifies the interaction of agents and institutions. This paper examines how institutional dynamics shapes CSR legitimacy when institutional dynamics may not initially trigger changes in firm behavior.

THE CASE

China is a key market for the international cosmetics industry. Faced with a mature or declining European and North American markets, companies are aggressively pursuing the Chinese beauty market. Currently, Chinese women spend less than their Asian counterparts. For example, Euromonitor (2007a) estimates that the “Average annual per capita spending on cosmetics and toiletries in China is just \$8 US dollars (¥65 RMB), five times lower than the global average of \$40 US dollars and far below that of its developed neighbor Japan or the United States of \$248 US dollars (¥26,672).”

However, the annual per capita spending changes dramatically alongside China’s rapid GDP growth. Chinese women are becoming increasingly important consumers in their own right, with average female disposable income increasing by nearly 50% to \$520 US dollars or 52 euros (RMB 4, 264) a year in 2005 (vs. 2001) (Euromonitor, 2007a). Chinese women, like women around the globe, are willing to spend sizeable amounts of their disposable income on premium cosmetics. By 2004, China became one of the global top 10 cosmetics markets, one of the top 5 growth markets, and 2006 estimates of total sales were at \$1.3 billion US dollars (RMB10.5 billion) (Euromonitor, 2007a). Sales are expected to rise by +10% annually until 2010, with an estimated market value of \$17 billion US dollars (RMB139.8 billion). Modern retail distribution has also grown significantly alongside consumer demand. Major Chinese cities like Shanghai have extensive networks of department stores and specialty retailers like Sasa, Sephora and Herborist. (Herborist is a natural cosmetics manufacturer which mixes modernity with Chinese herbal tradition and has been called the Body Shop of Asia (Chinese website www.herborist.com.cn.)

Growing demand for cosmetics in China represents a significant shift in consumer behavior. According to Fortune magazine (Prasso, 2005), “China is a country where barely any women used cosmetics a decade ago. When the authorities stopped discouraging lipstick and other bourgeois displays of beauty in the early 1990s, Chinese women were eager to embrace the aesthetics of the modern world. As a result, the beauty industry has been growing at breathtaking speed ...

Some 90 million urban women in China spend 10% or more of their income on face cream, lipstick, mascara, and the like, particularly in fashionable Shanghai, where women spend 50 times more per capita on cosmetics than women nationwide.” For example, skin care brands, like Procter & Gamble’s SK-II, account for over 70% of China’s premium cosmetics sales. Within this market, Chinese women are interested in brands that can convey “status” and a prestige-image (Zheng, 2003).³ Western brands have thus done well, and many Chinese shoppers are prepared to pay premium prices (above international prices) in order to ensure that they are not buying “knock-offs.” However, Western firms are under increasing pressure by domestic Chinese manufacturers (Euromonitor, 2007b). Table 1 describes skin care companies’ market shares.

Table 1

Skin Care Company Shares by Retail Value 2002-2006

Company	% retail value	2002	2003	2004	2005	2006
Procter & Gamble (Guangzhou) Ltd		12.5	14.8	17.0	17.5	16.3
L'Oréal China		4.5	5.7	10.5	11.3	11.8
Amway (China) Co Ltd		8.0	9.7	13.1	10.7	7.9
Shiseido Liyuan Cosmetics Co Ltd		6.4	6.4	6.6	6.9	7.3
Avon (China) Co Ltd		6.7	6.9	8.3	7.0	6.5
Jiangsu Longliqi Group Co Ltd		5.4	5.0	4.8	4.7	4.7
Unilever China Ltd		4.4	4.2	3.6	4.1	4.2
Beijing San Lu Factory		4.6	4.5	4.2	3.6	3.6
Hangzhou Mary Kay Cosmetics Co		2.4	3.2	4.1	4.5	3.3
Arche Group Co Ltd		2.4	2.4	2.4	2.4	2.3
Elca (Shanghai) Cosmetics Ltd		0.8	0.9	1.4	2.0	2.2

Source: Euromonitor International (2007b)

Procter & Gamble (P&G) has long been the dominant international player in the industry. According to Fortune magazine (Prasso, 2005), Procter and Gamble primarily holds this position because “its Olay whitening skin creams outsell every other brand, and its shampoos (Rejoice, Head & Shoulders, and Pantene) hold the top three hair-care positions in China.”⁴ Globally, P&G positions itself as a leader in CSR, and has been identified as one of Asia’s most socially responsible companies. However, the company has faced international civil society campaigns which challenge its claim of socially responsible behavior. Nevertheless, sales of SK-II, its premium skin care line, have been growing since its introduction into the Chinese market.

The story of the SK-II discovery, available on the P&G website, is fitting for an Asian beauty product: scientists supposedly discovered this beauty secret when they realized that workers at a Japanese sake brewery had remarkably young hands despite their biological age. Testing of sake eventually resulted in discovery of the ingredient Pitera, which the SK-II premium skin care line now contains. SK-II is still manufactured in Japan and imported to China. With strong celebrity endorsements from global stars such as Cate Blanchett, SK-II hit a cord with the Asian and Australian markets. From 2003-2005, SK-II market share grew from 1.1% of the total market to a steady 1.8% (Euromonitor, 2007b). Yet in September of 2006, Procter & Gamble was forced to suspend sales of SK-II, its high-end consumer skin care line following media allegations that government testing had identified that the product contained toxic ingredients which may cause eczema and asthma.

On September 14, Chinese media reported that the Guangdong Center for Inspection and Quarantine had detected banned heavy metals in SK-II products, and that the Chinese General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) had reported this to its Japanese counterpart, since SK-II is manufactured in Japan and then imported to China. The situation

worsened when the Shanghai Municipal Food and Drug Supervision Administration announced state testing had discovered chromium and neodymium in three other Japanese SK-II cosmetic products. The Administration claimed that studies showed that some SK-II products contained traces of neodymium and chromium, substances that above trace levels may pose health risks such as eczema and allergic dermatitis.⁵ Media reports stated that: “In Shanghai the administration called in senior management from Japan-based SK-II producer Procter & Gamble, informing them of the finding and requiring them to take all 12 products off the counter.”⁶ The Shanghai Administration for Industry and Commerce’s website demanded that SK-II products be removed from retail shelves and refunds offered immediately.⁷ In addition to state intervention, angry Chinese consumers also demanded that they be compensated (see Appendix 1).

Initially, P&G offered refunds to consumers in the form of a so-called “safe-product” agreement. However, in order to receive a refund, consumers had to sign a waiver stating that they recognized the products presented no harmful effects. They also were not given a refund immediately even if they had to return their unused product (<http://china.seekingalpha.com/article/20248>.) Later that same month, the media reported that the Chinese Consumer Association (CCA) said that “consumers are entitled by law to demand that substandard products be recalled unconditionally.”⁸

Furthermore, CCA spokesman Wu Gaohan explained that “Any new conditions that the company [P&G] tries to impose are either invalid or illegal...Consumers have to learn to protect their own rights and interests.” P&G later suspended its refund policy as thousands of consumers tried to request refunds. The suspension of the refund policy caused further backlash. According to China Daily, consumers were outraged: “Who should be responsible for our loss?”⁹ The media also reported that “P&G's Chinese website was hacked and clashes broke out at some of its stores.” An internet poll taken by a popular website Sina.com, showed that 98.8% (of nearly 150,000 people) said they would not buy SK-II products in the future. China Daily also reported that consumers were critical of the state’s quality inspection.

The issue spread throughout Asia, with consumers and retailers voicing concern over the safety of SK-II. SK-II consumers in non-Asian countries such as Australia were also debating the safety of the product line (see blog on Vogue Australia website). Throughout the ordeal, the Chinese media consistently focused on the Japanese manufacturing location, not on the location of the US head office, using headlines like “Substandard Japanese cosmetics asked to be recalled.”¹⁰ The Chinese media also suggested that Japanese authorities had admitted that the product had not been subject to quality testing prior to export to China. In contrast, Japanese media speculated that the critical Chinese allegations served as a retaliatory move by the Chinese state following Japan’s strengthened prohibition on toxic chemicals in Chinese food imports (personal interview July 2007; also see http://www.nikkeibp.co.jp/style/biz/feature/risk/061107_sk2/). Throughout the crisis, Procter & Gamble denied that SK-II was unsafe and emphasized the company’s technical expertise as well as the approval by other international safety standards:

“We're completely confident in the safety of SK-II. SK-II products comply with safety standards and regulations set by the FDA, HealthCanada, and the E.U.

The Chinese government recently raised questions about 2 elements found at trace levels in SK-II products. SK-II does not add these elements as ingredients in any of our products. It is common for trace amounts of these minerals to show up in consumer products -- they are naturally occurring elements that can be found in anything from tap water to vitamins. For example, the amount of chromium that you would get from use of SK-II products is 100 times less than what the World Health Organization considers safe in your everyday diet.

P&G product safety scientists conducted analyses of SK-II products and have concluded that the levels reported by the CIQ do not represent a safety concern. Our testing also included other popular skin care brands and showed they, too, contain similar low and safe levels of these trace elements.

SK-II has strict quality control processes in place and consumers around the world can continue to use SK-II products with full confidence. If you have further questions about SK-II products, please contact an SK-II representative at your local retailer.”¹¹

The protests of angry consumers were reported in the Chinese press, as the press also showed pictures of angry consumers. The issue of the protests was “taken up” by state agencies responsible for the health related issues and led to a general discussion about the cosmetic industry, if not health hazards in general. The rapidly increasing use of websites ensured that consumers’ voices could be picked up by consumers outside China as protestors posted their protest on blogs and BBS. In late October 2006, the AQSIQ and the Ministry of Health of China jointly stated that the P&G products were safe although there was no admission of error on their part. The Taiwanese Department of Health, the Hong Kong Custom and Excise and Department of Health, the Singaporean Health Sciences Authority, and the Korean Food and Drug Administration issued statements attesting to the safety of SK-II. Nevertheless, SK-II’s market share collapsed by 50% to only 0.9% in 2006. Procter & Gamble’s website in the UK continues to have questions about SK-II’s safety at the top of the list. Sales of SK-II resumed in China in December 2006.

This case had far reaching effects beyond Procter & Gamble’s drastic fall in revenue and market share. Although the allegations were later rescinded, the case affected the reputation of the industry in Asia. According to Euromonitor (1007b), the entire premium skin care market in China was impacted by the scandal with growth slowing considerably in 2006. In May 2007, a spot-check by China's Ministry of Health found that 10.5% of imported cosmetics and 8.3% domestic products failed to meet quality standards.¹²

DISCUSSION

SK-II is an exemplary case for demonstrating the power of institutional dynamics on foreign firm legitimacy even though the SK-II crisis may, at first glance, appear to be a somewhat trivial case about the ugly side of beauty products (and the possible existence of toxic metals in skin care creams.) We argue that the SK-II case illustrates how Chinese institutions allow state agencies to actively resist “foreign” products by presenting test results in negative ways. Taking a different interpretive lens, the

Chinese authorities could have come up with a different plan of action. However, they chose to go to the media with a negative story about the poor CSR performance of a foreign multinational.

On the surface, the critical issue may appear to be one of science: that is, one must determine the scientific facts of the case -- are skin care products safe for Chinese female consumers? Digging below the surface, we see that the SK-II case is actually a dynamic story of many local Chinese state agencies interpreting test results in a negative way. These testing interpretations may relate to broader issues of international trade and the Chinese reaction to external criticism of China's own reputation concerning consumer health and safety testing. Examples of recently criticized products include Chinese-produced toys and toothpaste. That is, if foreign manufacturers (and foreign countries) are negligent or socially irresponsible with consumer health and safety testing, this provides greater institutional space for China itself to deal with its own internal weaknesses concerning consumer health and safety testing. While Procter & Gamble consistently denied that they had added toxic substances to their product line, these facts are not important (at least for a time) within the Chinese institutional arena. What is more important is the recognition that local agencies can interact to redefine socially (ir)responsible behavior and thus influence a firm's legitimacy regardless of actual firm behavior.

Using SK-II as an exemplary case, we argue that dynamic institutional actors such as the state, media and consumers continually shape and challenge the very definition of what is socially responsible behavior, based not just on firm behavior but on the broader context. The contribution of an institutional analysis is that it draws attention to the fact that CSR is shaped by institutions that have emerged in Western market economies. Seen from the perspective of transitional economies such as China, CSR describes different courses of action within the defaults set by national or international legislation and long-established business practices. Likewise, whether an economic or social actor is a stakeholder is defined by legal "empowerments," that is, the rights to assemble and publish unfavorable data and mobilize support. All this is still missing in transitional economies which are still at the stage of "negotiating" appropriate, socially responsible behavior in market transactions.

In such a situation, any analysis of CSR inevitably asks for a broader contextual analysis acknowledging more actors than the usual stakeholders, and including more courses of actions. In other words, so long as national or international legislation has not yet defined the defaults for socially responsible behavior (and standards of monitoring) within the economy, a very broad organizational field emerges. Indeed, CSR turns into a public policy issue: CSR legitimacy for one firm turns into a problem of "active" trade policy at the state level possibly across many firms or industries; health concerns about a specific consumer product become intertwined with broader issues such as the question of non-tariff trade barriers.

The SK-II case demonstrates how a firm's reputation may become damaged (and perceived as a socially irresponsible company) not because of anything they have done (per se) but rather because P&G did not adequately anticipate, or react to, externally-driven institutional dynamics that arose beyond its immediate organizational field of cosmetics. Thus, the SK-II case also has important implications for the strategic management of CSR in multinational firms.

While Husted and Allen (2006) argue that the key strategic question facing multinational firms is to adequately distinguish between global and local issues and then to strategically respond to these issues, our case highlights an additional strategic element. In the SK-II case, consumer health and safety

concerns appear as a global issue that Procter & Gamble attempts to address strategically in a globally standardized fashion, ensuring that their performance in China, a developing country, is at least as good as in the developed countries/regions of the US, the EU, and Canada. We suggest that firms must distinguish between global and local institutional set ups and respond accordingly.

In the SK-II case, Procter & Gamble consistently tried to react to what it considered a global issue of product testing standards, and ineffectively addressed China's concerns by publicly refuting these concerns and instead using test results issued under other 'foreign' standards. Yet whether these international standards were acknowledged by Chinese institutions was far from clear. A more effective strategy for Procter & Gamble may have been to publicly accept the seriousness of the concern and thus bolster the local legitimacy of the Chinese health agencies while at the same time working (possibly behind the scenes) to change perceptions of the Chinese administration or address procedural errors in testing. Thus a strategic approach to CSR necessitates a differentiation between global and local issues and between global and local institutional set ups which may have the power to shape perceptions of social responsibility or irresponsibility at the local level.

THE INSTITUTIONAL PERSPECTIVE: GENERAL IMPLICATIONS

The case is instructive so far because it shows that institutions matter – a firm's CSR legitimacy is actively shaped by institutional dynamics beyond its control and immediate sphere of reference. We suggest that at least three institutions can be identified which explain the behavior of the major players: first, the market, more precisely competition; second, political/private censorship of information (or the tactical use of misinformation) and corporate governance; third, state protectionism and rent-seeking. Employing market theory and the findings of NIE offers more than an economic interpretation of the SK-II crisis. As will be shown presently, by pointing to the logic behind the behavior of each player, such an analysis allows for the cautious formulation of a hypothesis about the consequences of the institutional set up on the emergence and survival of firms with a high (or low) level of CSR awareness or performance.

Although the economic reforms in China have led to widespread decentralization of decision making power, and the emergence of private ownership, reforms have not directly led to the furtherance of consumers' rights. Typically, the consumer is nowhere to be seen in economic policy, hidden behind statistical categories such as "households," or "peasants." Only recently did the government pay attention to consumers, manifested in the form of residents in the new urban residential areas. These residents express their demands for schools, public traffic, parks, shopping malls and health care, predominantly voicing their demands through their work units which still control the allocation of housing (Li, 2000; Wang, 2001). Thus, from a stakeholder perspective Chinese consumers are at best, emerging stakeholders, and often remain dormant actors because of historical institutional constraints. Yet, that must not mean that they are powerless.

As market theory has shown, one producer with a high level of CSR would already be enough to effectively harm the market share of all producers using toxic substances. The effect will be more drastic the lower the costs for consumers who switch to another brand. The price differential between, say, Procter & Gamble and L'Oreal products, is almost zero in our case. Therefore, enough consumers will change their buying habits to cause damage in sales, market share and profit to Procter and Gamble. In

general, economics defines power as the reciprocal value of the price differential as compared to the next best alternative (the so-called opportunity costs) adjusted for the switching costs (Michael & Becker, 1973). The lower these costs the more influence consumers can exert. In other words: the availability of close substitutes, competition and low switching costs facilitates the emergence and survival of firms with a high CSR.

However, switching costs are not the only constraint on consumer action. In countries such as China where consumer rights have not been historically institutionalized, consumer power is constrained by state control. Thus, newly emerging consumer groups such as those in China may seek to exercise greater institutional power in situations where they have been granted the institutional space to do so: for example, with foreign firms offering consumer package goods products that are not integral to China's economic growth. Unfortunately the same logic points to sectors where one must expect a large number, or high concentration of firms with a low CSR; namely industries where cartels – natural or state-enforced- preclude the emergence of close substitutes and define high (prohibitively high) switching costs. The scandals in China in sectors such as water supply, pharmaceuticals and the health care system offer ample evidence.

Consumers' opportunity costs link to the problem of time and lack of information as consumers seldom have the time and money to test the cosmetics they are thinking of buying. As information and transaction cost theory have shown (Nelson, 1970; Williamson, 1985) asymmetric information allows firms to appropriate a greater part of the consumer rent (the so-called hold-up) to the extent that an active policy of information control might be a worthwhile endeavor. Our case is instructive in so far that the two different players pursued such a policy of information control. On the one hand, Chinese government agencies tried to "rig" the market by a policy of tactical misinformation about the health hazard. On the other hand, Procter & Gamble tried to "silence" protest by offering money.

The point to note here is that the futility of both attempts cannot be explained by changes in technology alone. While, indeed, the Internet keeps general information costs close to zero, the costs for verifying the source of information and its "truthfulness" can be prohibitively high – even without political censorship. The conflict spread worldwide as it is in the interest of all (potential) consumers to see the health hazard in cosmetics controlled. As democratic political regimes turn consumers into voters, the protest cannot be easily dismissed. And indeed, health agencies in the US, Japan, and the European Union tested the products disclosing the Chinese misinformation, while the media reported the Procter & Gamble scheme. Likewise, the US form of corporate governance turns consumers into stakeholders which can exert influence on the management of a firm.

It is also intriguing to speculate how much of the research and political pressure came from competing firms which anticipated the negative external effect when the reputation of the whole cosmetics industry appeared at stake. Thus, for example, L'Oreal published a statement in July 2007 insisting that their sun cream products have passed the tests not only by the US Food and Drugs association but also the Chinese Health inspection agency (www.chinacsr.com/2007/07/05). Competing foreign firms seek to differentiate themselves from the SK-II case and resist isomorphic pressure. In addition, CSR legitimacy is gained not simply by complying with legal standards or through voluntary ethical or philanthropic initiatives (Carroll, 2004), but rather by anticipating and managing institutional dynamics that may not be directly related to actual firm behavior. The analysis expects us to

find more firms with a high CSR in sectors and countries where political and economic institutions such as corporate governance ‘empower’ consumer/voters to influence management decisions either directly or indirectly via political channels and the media.

The last argument points to the role of political actors in the case which needs to be seen as one period in a series of accusations by the Chinese, US, and Japanese governments. Both health concerns and “nationalism” are used for narrowly defined political ends. As the theory of protectionism has shown, health and quality standards are standard tools when governments want to limit imports while paying lip service to “free trade” (Milner & Yoffie, 1989). The attempt of the Chinese administration to prove the health hazard in imported cosmetics can be seen as a strategic move in the ongoing economic conflict with the US, Japan and the EU where the health hazard of Chinese products is regularly reported. In contrast, when the US administration tries to link product safety or piracy with macro-economic issues such as the exchange rate, than nationalism comes into play (The Economist, May 17th, 2007). As the theory of protectionism has shown, such behavior finds its explanation in the vested interest of producers and their link to political agencies. In short, these cases illustrate the impact of an institutional set up that facilitates rent-seeking by producers and firms rather than the influence of consumers or professionals, such as doctors. The number of firms with a high CSR would increase if the issue of CSR, or as in our case health concerns, would not be used for rent-seeking.

To sum up, the SK-II case exemplifies that three institutions matter when an economic system wants to secure a large enough number of firms with a high CSR: functioning markets with low entry and exit costs, an opportunity structure which offers means to consumers for influencing political and firms’ decision makers, and the destruction of rent seeking opportunities.

NOTES

1. New Institutional Economics mostly connected with Douglas North and Oliver Williamson has become a label-all approach that include institutions, whether state enforced, based on inter-active choice, or norms (Williamson 1985; North 2005.)
2. http://www.mckinseyquarterly.com/article_abstract_visitor.aspx?ar=1741&L2=39&L3=29
3. Zheng, T.T. (2003). Consumption, body Image, and Rural–Urban Apartheid in Contemporary China. *City & Society*, 15, (2), 143-163.
4. The strongest competitor in China is L’Oreal which reckons with 15% growth rates for 2005, and 2006, see <http://www.forbes.com/home/feeds/afx/2006/02/23/afx2550236.html>.
5. Banned Substances Found in 3 More SK-II Products. <http://english.cri.cn/2946/2006/09/21/272@142138.htm>.
6. Ibid.
7. Shanghai shops to remove SK-II products September 22, 2006. http://english.peopledaily.com.cn/200609/22/eng20060922_305381.html. Accessed 2006-07-16.
8. Substandard Japanese Cosmetics Asked to be Recalled. 2006-09-22. Xinhua. <http://english.cri.cn/2946/2006/09/22/48@142177.htm>. Accessed 2006-07-16.
9. SK-II gets under consumers' skins September 25, 2006. http://english.peopledaily.com.cn/200609/25/eng20060925_306136.html. Accessed 2007-07-16.
10. http://www.english.peopledaily.com.cn/200609/22/eng20060922_305236.html.

11. Procter & Gamble website for SK-II <http://www.sk2.co.uk/showPage.do?section=faq>.
12. <http://www.chinacsr.com/2007/05/14/1301-over-10-of-imported-cosmetics-fail-quality-test/>.

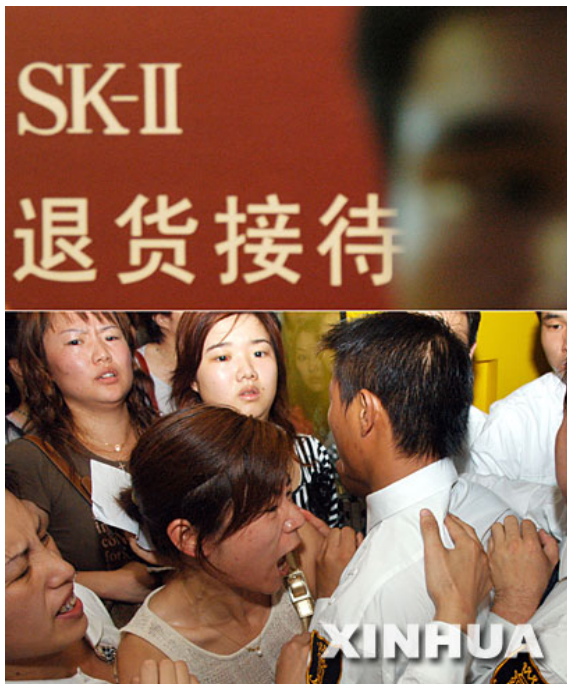
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Appendix 1. Consumer Reactions to SK-II



Appendix 2**P&G Press release to Hong Kong consumers**

(Hong Kong Custom and Excise Department & Department of Health Confirms that SKII Products are Safe and Not Harmful).

Dear Customers,

We are really grateful for your love and support for SK-II all along, we are very pleased to announce that:

1. Hong Kong Custom and Excise Dept & the Department of Health's new testing results confirms that SK-II products are safe and not harmful.
2. With the principle that consumer always come first, SK-II puts safety and quality as our priority, all our products went through vigorous safety evaluation during research and production process, striving to bring the best quality products for our consumers.

For many years, SK-II never stops bringing you the promise of crystal clear skin. In this period of time due to consumers and retailer's support & encouragement, allowing us to confidently stand by the promise from SK-II for our quality of products and services, we continue to create crystal clear's beautiful miracle for you.

SK-II Consumer Hotline:

Yours,

SK-II

2006-09-23

SOCIAL MARKET ENTERPRISES

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Abstract: The emergence of social market enterprises (fair trade importers and retailers, and microfinance institutions) calls for a broadening of our conception of firms that not only strive for profit maximization but also pursue social goals and economic agents (not just driven by “myopic self interest” but also by “enlightened” self-interest, which includes sympathy, commitment, and intrinsic motivation). Social market enterprises are proving to be quite efficient in promoting inclusion of the poorest in globally integrated economies. Beyond their obvious limitations, what seems to be most important is their capacity for being contagious and for giving the market a new role in redressing social imbalances, thanks to consumers’ portfolio votes. Since the social responsibility of social market enterprises includes consumers as target stakeholders, they achieve the joint goal of promoting product quality and safety rights for themselves, as well as those of the most marginalized stakeholders.

Keywords: corporate social responsibility, social enterprises, fairtrade, microfinance

CSR AND THE SOCIAL MARKET ENTERPRISE IN A GLOBALIZED ECONOMY

Picture yourself as the city mayor of your town addressing a speech to your citizens with the primary goal of fighting criminality and actively promoting safety and order in your urban environment. Imagine yourself pronouncing the following words: “Dear citizens, your main goal must be to pursue your own self-interest. If in so doing, you do something which is legal but creates some negative social and environmental externalities (i.e. you perform some clearly non-civic actions such as littering in a park), it is not your fault. The problem lies with the institutions that failed to make their rules more explicit or perhaps did not create the right incentives or sanctions to discourage you from littering.”

Almost all readers would agree that if they were in the mayor’s position, they could never deliver such a speech. Everyone would readily recognize that this is far from the best way to address the problem. Yet, this approach to corporate social responsibility by the majority of economists remains quite common. They argue that firms must only concentrate on their self-interest (creating profits) since the problem of reconciling economic growth with social and environmental sustainability must be left entirely to institutions and policymakers.

In the outline of this economic argument, we can refer to the well-known Friedman (1962) position in which the economist argues that, “Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by the corporate officials of a social responsibility other than to make as much money for their shareholders as possible.” According to the author, managers must strictly limit themselves to act in favor of their shareholders by maximizing profits; any alternative goal must be

considered as a betrayal of their mandate. For the reasons explained above, Friedman's position was already dangerous and unacceptable in "old" closed economies. However, it is far more worrisome in the contemporary globalized economic system. If, in a closed economy, it was possible to conceive of the presence of strong institutions that with their fiscal or regulatory policies ensured coincidence of private and public optimum, it has now become absolutely impossible in a globalized scenario in which international institutions have far less power to avoid the under-provision of global public goods.

Last but not least, and the issue will be dealt with extensively in this paper, it is not in the interest of corporations to ignore external effects of their actions that most often generate future costs for them (higher risk of stakeholders' legal action, reduced confidence in firm brands and products, reduced work motivation, and so on). These are problems that local and national policymakers are now beginning to understand. The authorities in Peking have learned at their own expense that non-economic (environmental) consequences of economic actions have extremely serious consequences on human wellbeing and that neglect of consumer safety standards may seriously undermine the export performance of their growing economy. The arguments set forth in this paper contribute to the emerging and important literature presenting the case that taking care of social and environmental consequences of actions in the globalized economic system is not just something firms should do but also have interest in doing. In this way, firms can reduce an important risk dimension of their actions that may have negative consequences on their own economic results.

This paper focuses on several perspectives in discussion. In discussion of the goal of economic activity: a tri-dimensional approach, we argue that the emerging focus on social responsibility in economics begins with the consideration that, in a globally integrated economy, the target of economic activity can no longer be one-sided (merely the creation of economic value) but must incorporate three important considerations - the creation of economic value in a socially and environmentally sustainable way. This arises from the impossibility of neglecting strictly economic consequences of economic actions. If we want to maximize wellbeing and life satisfaction in current and future generations, our creation of economic value must be socially and environmentally responsible. This new approach necessarily entails amendments to standard indicators (such as GDP growth at aggregate level and profits at corporate levels) which must be adjusted to reflect this three-dimensional perspective.

In discussion of conceptual problems and section follows it, we tackle the problem of the two limits of economic culture that prevent us from seeing the problem in this new perspective: a) functional specialization and extreme segmentation of scientific disciplines and b) anthropological and corporate reductionism of economic thought. The term, "anthropological and corporate reductionism of economic thought" describes a restrictive and narrowly-defined view of humans and of entrepreneurial activity hindering a well-rounded view of sustainable and environmental economic value creation. In discussing the crucial role of social market enterprises, we document the main feature of the new emerging paradigm of the economics of social responsibility and of that of corporate social responsibility.

In the section of reaction of corporations: corporate social responsibility, we focus on the role of contemporary socioeconomic context of a special kind of firm, "social market enterprises" (SME's) and of their alliance with socially concerned consumers. In this section we highlight how social market enterprises are playing a crucial role as catalysts in the social responsibility phenomenon by adopting a straightforward social goal for their economic action, competing with standard profit maximizing

corporations, selling products at a price premium that incorporate social values and so conquering a small but steadily increasing market share value. Their importance lies in the capacity of triggering partial imitation as an optimal reaction in their profit-maximizing competitors and therefore transforming social responsibility from a residual concern into a competitive factor.

THE GOAL OF ECONOMIC ACTIVITY: A TRI-DIMENSIONAL APPROACH

The standard approach in shaping economic goals of corporations and countries is that of adopting a one-sided perspective in which the unique target of all economic actions is the creation of economic value. The one sided perspective is the inevitable cultural product of the principle of “functional specialization” according to which any given discipline has its own field of action and ignores advancements in knowledge occurring in adjoining disciplines. This is the reason why economists have been accustomed to neglecting not only the environmental consequences of economic actions but also the impact of the latter on non-economic dimensions of human beings (such as the quality of relational life) that have a strong influence on human wellbeing and life satisfaction.

The cultural clash generated by such functional specialization can be represented by the conflicting views between economists and experts in the field of natural sciences. According to the former, natural resources are generally not considered a constraint (since their price increases in the presence of scarcity creates the incentive for their more efficient use or for the creation of substitutes). Unfortunately, the argument does not always hold, since standard economic incentives can hardly solve the problem for those environmental resources (such as the climate) that are neither (easily) renewable nor privately appropriable. Furthermore, there is no mechanism to ensure that market solutions conform to time constraints, and there is a serious risk that rebalancing economic mechanisms enter in action after the problem has passed its critical threshold.¹

Traditionally opposing this view is the approach taken by many natural scientists who tend to ignore the fact that the creation of economic value is fundamental in supporting wellbeing. Natural scientists may also overlook the trend of technological progress that (stimulated by market competition) can shift productivity forward and increase the quality of life of a growing population. This is why the two alternative visions risk producing incompatible policy advice, with many natural scientists suggesting that we should consume less and most economists counter-arguing that we must consume more in order to support economic growth.² This simple example illustrates how the problem of functional specialization arises when experts in one field produce policy advice that ignores the accumulated knowledge in another.

A second aspect of the problem is revealed in the clash between economic solutions and non-economic dimensions of existence. In an extension of Baumol’s disease, Becchetti and Santoro (2006) document how affluent societies tend to become richer in income but poorer in the quality of relational goods. This occurs when productivity and competitive pressures increase and push up the opportunity cost of time dedicated to investment in relational life. Time dedicated to relational activities (participation in clubs or associations, in politics, investment in family life or friendships) enters into ever-increasing competition with the increased productivity of our working opportunities and in the growing richness and variety of ways of dedicating our free time to non-relational (or “pseudorelational”) leisure such as watching television, surfing the web and so forth.

Relational goods are local public goods which require coordination of investment among participants in order to be enjoyed (Ulhaner, 1989; Guy, 2000). The problem cannot be solved individually and the long-sightedness of a single individual can be frustrated when another individual takes an opposing course of action. If we also consider that non-relational leisure can be manifested in forms of evasions that do not require any costly investment and which can create forms of addiction, we begin to understand why deterioration in relational goods may be extremely serious. Within this general framework, corporate policies may contribute to limiting the relational good problem since they have important effects on human wellbeing. Policies affect many non-economic dimensions of individual life and may influence life satisfaction in many respects (employment policies, hiring and firing practices, recognizing the effect of commuting on work/life balance, flexibility of part-time opportunities, and so on.).

Economic activity, then, has important consequences in two dimensions that economists have not hitherto been accustomed to consider in their models. As a result, policies that aim to increase human wellbeing cannot use solely the standard quantitative indicators (such as profits at firm level and GDP growth at aggregate levels) but must also take into account the environmental and social consequences of economic action. This is why all targets in future economic analysis ought to be at least three-dimensional. It is not enough, at corporate level, to have information on corporate return on equity; we need to create new measures of socially and environmentally-adjusted profit indicators in which we can also evaluate the net effects of corporate activities on these other two dimensions.³

In the same way, at aggregate level, we cannot just look at standard GDP measures to evaluate our capacity to create private goods; we need to correct them with coefficients that account for the capacity of preserving or enhancing the value of public goods such as health, environment and others that are essential to the promotion of human well-being. It is a commonly held opinion that the adoption and the proper monitoring of advancements in the three-sided approach to the maximization of human wellbeing cannot be solely pursued by adjusting current leading indicators but requires the development of new types of measures ranging from the already well-established human development indicators to the creation of proxies of human capabilities and functionalities or a direct measure of life satisfaction.

When we argue that economists and policymakers should be directly concerned with life satisfaction and the happiness of citizens, we are not saying anything revolutionary, but, rather, we are tracing the origins of the discipline back to the classics of economic thought (Malthus, 1798; Marshall, 1890; Veblen, 1899; Dusenberry, 1949; Hirsch, 1976). A vivid example of how the issue of life satisfaction was important for these writers can be found in this quotation from Malthus (1798) regarding Adam Smith's work: "The professed object of Dr. Adam Smith's inquiry is the nature and the causes of the wealth of nations. There is another inquiry, however, perhaps still more interesting, which he occasionally mixes with it, I mean an inquiry into the causes which affect the happiness of nations."⁴

The great revival of happiness economics in recent years is due to an important novelty, the presence of a large body of empirical data that allows us to explore factors affecting life satisfaction at a world level in depth. With this new set of data, Einstein's well-known saying that "things that matter cannot be measured" begins to be challenged. The recent empirical literature in this developing field has found a surprisingly robust set of results regarding the role of some crucial variables such as income, health, quality of relational life, comparison with peers and hedonic adaptation which have a strong role

on individual life satisfaction. By reflecting on this data which clearly call for an integration of different social disciplines (economics, sociology, psychology and philosophy) it is possible to evaluate which factors are overemphasized and which are neglected in the actual goals of economic action and how they can be readdressed in order to reconcile the creation of economic value with (socially and environmentally sustainable) life satisfaction. Clearly emerging from these studies is the notion that a progression towards a socially and environmentally sustainable economic development may be hindered by the inability to broaden the standard conceptions of human beings and entrepreneurial activity adopted in the traditional economic discipline.

CONCEPTUAL PROBLEMS

Anthropological Reductionism

One major problem preventing economics from effectively pursuing the goal of promoting the human being and its life satisfaction is what we can call “anthropological reductionism.” The issue is very well described by the Nobel Prize-winner Amartya Sen, who, in his famous 1976 paper, argues that the homo economicus (the formalization of the human being, which is at the basis of economic models) is a “rational fool.” Sen explains how a vision of the individual as uniquely driven by “myopically” self-interested motivations has emerged and progressively established itself as the discipline’s benchmark. This process begins with Edgeworth’s conceptualization of economic agents’ characteristics in hostile (or anonymous) contexts (such as those of contracts and war) only to be progressively extended to all realms of human action.

Paradoxically, however, we continue to use a definition of human being (and a structure of its preferences) which, if adopted, would alienate all our friends and make social life impossible. What is missing in the standard “textbook” homo economicus approach is the role of two other fundamental dimensions that drive our actions--sympathy and commitment. Examining our daily behavior further, however, we find that social and moral norms and the desire to please others and to develop close ties with friends or family members influence a large part of our actions. Since the additional dimensions considered above play a crucial role in individual intrinsic motivation (Frey, 1997), and the latter has powerful effects on human action, their neglect prevents economists’ ability to provide optimal policy advice on productivity growth. The broadened vision of the human being we advocate is nothing more than a simple but urgent updating of the long, unmodified premises of economic disciplines in line with the developments in other social sciences.

The conception of homo economicus seems to deny any contributions from the adjoining field of psychology after the end of the 18th century and the essential, anthropological vision of Boetius who defined humans as “individua substantia rationalis.” As a result, it omits any further developments including the incorporation of a broader concept of “persona” where the essence of individual identity derives from its position in relationship to others (Mounier, Levinas, Rosenzweig). This goes further than the needs of social recognition clearly recognized by the sociological concept of reference group whereby the importance of comparing our own performance with that of another works as a means to evaluate the effect of our actions on our wellbeing (amply indicated in recent economics of happiness literature).

While economic textbooks are only tentatively starting to acknowledge the problem (Frank, 2007),

an important part of contemporary economic research is directed towards investigating these overly-neglected and unexplored dimensions. The current “state of play” in economics can be seen as a division between the traditionalists or “Ptolemaics,” who argue that the reductionist approach to defining the human being is necessary and should not be abandoned, and the “Copernicans,” who explore frequent and significant violations of this paradigm in their empirical studies.

Among such empirical studies, we can include a large number of laboratory experiments that show that the desire to please others, inequity aversion, guilt aversion, trust and trustworthiness unequivocally form part of the self-interest observed in human behavior (Fehr-Falk, 2002; Zak & Knack, 2001). To those who criticize laboratory experiments for their lack of “external consistency” (or correspondence between the artificial, experimental situation and real life) it can be shown that similar results are found in many contingent evaluation studies. Evidence from such studies shows that individuals’ willingness to pay for social and environmental features of products is very high and contradicts the hypothesis of *hominis economici*, only in search of a bargain. Against understandable criticism regarding the interview biases that may arise in the contingent evaluation literature (Carson & Mitchell, 1995), we would recall that many “natural” or “quasi-natural” experiments also confirm previous findings. Evidence on the behavior of Fairtrade consumers confirms that those consumers are happy to pay a premium for social and environmental characteristics of their products (Becchetti-Rosati, 2005).

As is well known, Fairtrade products are generally priced above the market prices of equivalent non-Fairtrade products. This is due to their particular value chain in which primary producers are paid a premium and part of the importers’ profits and consumer surplus is used to provide technical assistance and other primary public goods and services to producers. This gives producers a chance to exit from poverty by increasing their marketing competitiveness.⁵

It is now time that this large body of evidence leads towards a new and fundamental formulation of economic theory. What is under discussion is not the basis of the theory of rational choice under (time, technology and budget) constraints but, rather, the too-narrow definition of human preferences, often at the center of constrained maximization problems found in economic models. In other words, if we want to develop our understanding of the socioeconomic reality in which we live, we must abandon the idea that only monetary and material goals matter. We must accept the fact that empathy and moral and social norms play a fundamental role in individuals’ choices and go on to deeply affect their motivation and productive effort.

Corporate Reductionism

Anthropological reductionism meets its commercial manifestation in corporate reductionism whose essence dictates that the desire to accumulate profits is the only motivation of entrepreneurial activity. This commonly held opinion has progressively led to the conception in economic textbooks of only one type of firm: a monolithic entity whose goal is that of maximizing profits or minimizing costs. The Darwinian selection of market competition then reconciles the actions of such self-interested productive units with socially desirable outcomes. Firm market power, asymmetric information and limits to free entry also negatively affect market competition.

However, this view completely negates the fact that a not insignificant share of enterprises have the explicit goal of creating social values (exclusively or combined with economic value). In a tentative

attempt to classify these enterprises, we note at least three distinct groups of firms: cooperative firms, social firms, and social market enterprises. Cooperative firms are historically born with the goal of providing goods to poorer workers at affordable prices. As a result, their target stakeholders are their shareholders/consumers who benefit from them via an increase in their purchasing power rather than a growth in share value. The governance of cooperative firms' non-distribution of profits (and often limits or liquidity constraints to the sale of shares) prevents traditional shareholders' gains, transforming firm gains into accumulated reserves that contribute towards increasing corporate equity. With this respect, the cooperative goal can be re-stated as the provision of services to consumers/shareholders via a governance structure that ensures an intergenerational transfer of the accumulated wealth (Fonteyne, 2007).

Social enterprises are generally defined as those private, non-profit organizations that have become an important means of supplying social initiatives in advanced economies. In times of shrinking government budgets and a strong and increasing demand of welfare, governments in developed economies have found it optimal to delegate the provision of public goods and services to these organizations. According to a principle of subsidiarity, such delegation proves to be cost effective, since small, independent organizations formed by intrinsically motivated workers situated closer to their target customers often provide higher quality and lower-priced services with respect to anonymous and more bureaucratic government entities (Borzaga, 1996). The third type of not-for-profit firms which are emerging as a novel feature in the contemporary corporate environment are social market enterprises. Their role is widely discussed in the following section after some introductory remarks on the economics of social responsibility, important for framing this new phenomenon.

A BOTTOM-UP STIMULUS TO THE ACHIEVEMENT OF THE THREE-SIDED GOAL: THE ECONOMICS OF SOCIAL RESPONSIBILITY

Anthropological and corporate reductionism is not merely a cultural phenomenon. These ways of viewing economics produce important consequences for the general consensus regarding the goals of economic action. They invert the ranking of priorities, an inversion of "substance with accident" (in the Aristotelean sense of the word). The "accidental" shareholder and consumer dimensions of the human beings are privileged with respect to more important dimensions, such as working conditions and relational life. The inversion of values has become a more serious problem for Western countries where economies have turned from domestic reliance to global integration. In the traditional closed economy, equilibrium among institutions, trade unions and corporations, the negative environmental and social externalities created during a firm's struggle for profits were compensated by the action of institutions and trade unions animated by social and redistributing goals. As a result, the crucial role of corporations in the creation of economic value was reconciled with social cohesion thanks to the offsetting bargaining power of the other two pillars of the economic system.

With the revolution of global integration, however, the old equilibrium falls into crisis. Corporations have the opportunity to act on a world scale and to delocalize parts of their activities to countries which provide the most favorable conditions. Meanwhile, trade unions and institutions find it harder to perform in a global context, and therefore, see their bargaining power seriously weakened. If they try to negotiate or impose higher social or environmental standards in a given country, they are

faced with more flexible counterparts that have a greater number of options and an ability to enact the threats of delocalizing production and employment.

It is no wonder, therefore, that bottom-up action promoting corporate responsibility was not born in the old, closed economic system of 1960s Europe with its high regulatory standards and firms focused on domestic markets, but in the globalized western economies of the 1990s.⁶ Our point here is that the alliance between socially-concerned consumers and investors and a special kind of not-for-profit enterprise, which we will call “social market enterprises” (see next section), has been historically crucial in revealing the market power of socially-responsible consumers and investors to traditional for-profit corporations. This revealing of a market niche stimulates the traditional firm to adopt partial socially-responsible practices in order to re-conquer lost market share.

Overall, the era of social responsibility implies a series of crucial novelties in market economies. First, sociopolitical confrontation partially moves “from the streets to the shops” (Forno & Ceccarini, 2006) with consumers using their political power not just through the traditional electoral vote but with their daily portfolio of votes in which they decide to opt for one product or another. In this new perspective, the consumption choice is increasingly driven not just by considerations of price and quality but also by symbolic elements related to the social corporate image and to the degree of social and environmental responsibility of producers. The latter, in turn, find it necessary to signal their level of social responsibility to the market using a variety of instruments.

The new era is changing some traditional and accepted concepts about economic life. In the era of social responsibility, economic agents acknowledge that the old Marxian “external” conflict between firms and workers (or capital and labor) has been turned into an “internal” conflict between their consumer and worker selves. In fact, it is becoming ever clearer that producers do not have the ultimate power and that their survival in a market in which competition is always more aggressive is dependent entirely on consumer “votes.” The era of corporate social responsibility also poses important problems in the relationship between the self-regulation induced by consumer activism and formal regulation. The question is whether the former is an (often weaker) substitute of the latter or merely a complement which contributes to the creation of political support for formal regulation with higher social and environmental standards.

In this perspective, we would make it clear that any regret for the old system of checks and balances is misplaced and that consumers and corporate social responsibility must be a bottom-up bridge that leads us to the creation of new rules in the international scenario. The final passage in this transition still seems far away if we consider that it requires the mutual agreement of a large number of heterogeneous countries in different stages of economic development, and therefore different needs.

THE CRUCIAL ROLE OF SOCIAL MARKET ENTERPRISES

The emergence of social market enterprises (a category in which we include microfinance intermediaries and Fairtrade importers) is an important novelty in the contemporary socioeconomic environment that is helping to fill this vacuum in the era of globalization. As opposed to the traditional cooperative movement, this new cooperative movement does not identify workers/consumers as the main target stakeholders and does not operate only in a domestic environment.

Social market enterprises mark the emergence of a new cooperative approach that starts with the

initiative of European importer associations (conventionally defined as Alternative Trade Organizations or ATOs) which decide to create a new value chain in standard commodities. In this new-value chain, marginalized commodity producers receive a price premium, as well as opportunities for advancement and inclusion. For example, these producers receive technical assistance, financial services, and local public good financing.⁷ The four pillars of the Fairtrade movement are consequently importers, retailers, marginalized producers and concerned consumers. The latter agree to pay a premium on the consumer price in exchange for the opportunity to contribute to the promotion of marginalized producers.⁸ ATOs compete with traditional for-profit enterprises on the market but aim for not simply profit maximization but for market inclusion and promotion of the poor.

Fairtrade started as a niche phenomenon but is progressively approaching the center of the stage. Fairtrade sales reached \$1,614 million worldwide in 2005, and \$1,020 million in Europe (Raynolds, Murray & Wilkinson, 2007) with around 40 % yearly rates of growth from 2000 to 2005; market shares range from 1 or 2% for several products up to 20% for coffee in the UK and even 50% for bananas in Switzerland (Krier, 2005). There are many similarities with microfinance associations (MFIs) that compete with the traditional banking system (even though the latter is not very active in the market niche in which MFIs operate) and have the primary social goal of providing access to credit for non-collateralized poor borrowers. For example, the founder of Grameen Bank, Muhammad Yunus, defines Grameen as a social market enterprise. As in the case of Fairtrade importers, the activity of microfinance institutions is backed by the support of socially concerned investors willing to forgo part of their returns in order to subsidize the start-up of MFIs.

The origin of modern microfinance can be traced back to the creation of Grameen Bank in 1983 after the pioneering activity of Muhammad Yunus. In 1976 Yunus started to experiment with the effects of lending small sums to poor borrowers without asking for collateral. Since then, the development of microfinance has been astounding. The Grameen Bank now has six million borrowers and the Microcredit Summit Campaign at the end of 2006 documents the existence of 3,133 microfinance programs around the world reaching approximately 113 million borrowers among whom there are some 82 million in severe conditions of poverty. A lively debate exists on the reasons why microfinance has such a low rate of non-performing loans (around 1 percent on average) on a representative sample of 200 MFIs according to the most reputed information source (the MicroBanking Bulletin). The most likely explanations are: 1) the assortative matching and peer monitoring effects of group lending with joint liability mechanism; (Ghatak, 2000; Stiglitz, 1990; Ghatak, et al., 1999); 2) the ability of loan officers to collect soft information on borrowers (Berger-Udell, 2002); 3) the social norm pressure that increases costs for non-performing borrowers. One of the most original and graphic explanations of this performance, however, is provided by Yunus himself, "The rich can evade the consequences of non-payment; the poor cannot. They value access to credit so highly, and dislike the loan sharks so much, that they are only too grateful for a once-in-a-lifetime opportunity to improve themselves."

A fundamental characteristic of SMEs is their propensity to spread, to be contagious. Their market shares reveal the existence of a significant share of "socially concerned" consumers and investors to competitors. These consumers and investors are willing to pay a premium for the socially responsible characteristics of the products they buy. In doing so, they trigger a reaction in the traditional, profit-maximizing competitor who now finds it optimal to introduce socially-responsible products into

their product range as a way of re-conquering the market share lost.

The rise of social market enterprises has important consequences on the way we conceive the concepts of economic agents and the market. For example, the “portfolio vote” of Fairtrade consumers is a challenge to the standard reductionist definition of homo economicus preferences. Their willingness to pay in excess for the social characteristics of the products (expressed with their purchases) provides empirical support to a new set of theories that see fairness (Fehr & Schmidt, 1999), inequity aversion, sympathy and commitment (Sen, 1976) as additional important motivations of economic choices. A relevant novel feature of FT consumption is that, for the first time, fairness and inequity aversion do not refer to neighbors or co-workers but to distant producers thereby documenting a significant enlargement of the reference group which individuals consider in their choice.

Against a possible critique that Fairtrade goes against standard market practice, it is worthwhile to emphasize that Fairtrade is, in some sense, contributing to an improvement in the reputation of the market. The benefits of markets are in their capacity to promote efficient bargains in which both sides (sellers and purchasers) realize a surplus. A surplus in this case means the difference between the maximum willingness to pay and the equilibrium market price for consumers and the minimum price and the equilibrium market price for sellers. Markets achieve such goals with a very simple decentralized mechanism in which prices have the fundamental role of conveying information on demand tastes and purchasing power, on supply productive potential and on the scarcity of the good. The limitation of markets is that they cannot address social imbalances and, more specifically, they cannot affect the endowment of agents who buy or sell in them. In the extreme case of organ trafficking, an individual could decide to sell their kidney and find a needy buyer to purchase it. The market creates conditions for an “efficient” exchange between the two counterparts but has no voice for addressing social and economic imbalances beyond it. It is extremely interesting to note that with the emergence of socially responsible consumption, this market limitation may be overcome.

The rise of Fairtrade makes it not just the place in which exchanges purely reflect (often) imbalanced bargaining powers and the endowments of buyers and sellers, but also the place in which it is possible to contribute to reduce such imbalances by “exchanging values” and voting for the production of global public goods (Becchetti-Huybrechts, 2007). The crucial feature of Fairtrade is, therefore, that of “creating (economic) value with values.” In fact, Fairtrade reduces the dichotomy between neutral production circumstances and negative externalities and market features.

In a very famous, stimulating and provocative quotation, Keynes said in 1931 that, “For at least another hundred years we must pretend to ourselves and to every one that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.”⁹ This sentence highlights the paradox of the market economy that does not require virtues but simply self interest in order to work since it is the market itself that transforms actions induced by private interest into socially good outcomes. The problem is that, at the same time, self-interest may crowd out traditional virtues (such as fairness) in the scale of social and moral values since “foul is useful and fair is not.” In spite of its imperfections and limitations, Fairtrade and, more generally, the economics of social responsibility seem to mark a step forward as it provides a market for value-based commerce.

THE REACTION OF CORPORATIONS: CORPORATE SOCIAL RESPONSIBILITY

As has been shown in the previous section, corporate social responsibility can be conceived as the reaction of profit-maximizing multinational companies to the increasing bottom-up pressure of consumer activism. On a practical level, this activism is translated into small but constantly growing market shares of the “pioneering” social market enterprises (such as Fairtrade importers and retailers and microfinance institutions) that create products to satisfy the concern of this special kind of consumer for social and environmental sustainability. To illustrate the proportions of the importance of corporate social responsibility consider that:

1) Recent reports show that one of every nine dollars invested in market funds is invested in so-called “socially responsible” investment portfolios.¹⁰

2) KPMG (2005) reports that in 2005, 52 percent of the top 100 corporations in the 16 most industrialized countries published a CSR report.

By definition, corporate social responsibility involves a change of focus from the maximization of shareholders’ wealth to the maximization of a more complex objective function in which the interests of different stakeholders are taken into account according to given weights. In this respect, we may conceive of an ethical segment in which, in a continuum of increasing CSR-oriented strategic choices, social market enterprises are at the (right) ethical extreme, traditional profit-maximizing enterprises are at the left extreme and for-profit corporations that choose to adopt CSR practices ideally move rightward from the left-hand side.

When talking about CSR to CEOs of listed companies concerned with the potential reaction of CSR on their stock price or to managers who struggle for survival in highly competitive markets, the crucial question becomes whether this change of focus is compatible with firm survival and growth in a highly competitive environment. By way of example from the field of biology, we wonder whether this new species of corporation is going to coexist or to be eliminated by traditional corporations in the Darwinian selection of market competition. To explore this point in depth, we need to break down CSR into specific fields of action and to examine whether CSR behavior enhances profit or not in the differing circumstances of these fields of action.

One common misconception about CSR is that it is limited to cost-enhancing philanthropic activities and relate to corporate performance. On the contrary, when we look at a standard definition of CSR domains from the screening criteria adopted by the most important social rating agencies, we find that this misconception is proven false. If we consider KLD¹¹ criteria as a benchmark, we find seven broad criteria (community, environment, employees, human rights, corporate governance, product quality, controversial industries) that confirm that CSR is not mere philanthropy since it involves the satisfaction of a more complex multi-stakeholder welfare target. These stakeholders include workers, local communities, subcontractors, future generations and, obviously, consumers.

By evaluating the specific suggested actions in the areas in which CSR is practiced, we can conclude that SR practices are more likely to induce negative effects on equity value than on productive efficiency. This occurs because, with the shift of goals implied by CSR, the shareholder’s slice of the cake is no longer the primary goal. It is, therefore, possible that CSR generates larger cakes even if the shareholders’ part does not increase in size. In evaluating the effects of CSR on corporate performance, the final outcome depends on comparing the costs (certain and relatively easy to predict) with the

benefits. On the cost side, the enhanced care for stakeholders is provided by the delivery of monetary and non-monetary benefits to them. Beyond a stronger emphasis on charitable contributions and investment in public goods for local communities, we find higher self-imposed safety standards for consumers and employees in the working environments, the adoption of more environmentally sustainable productive processes, various form of benefits for workers concerning retirement rules, reconciliation of family and working time, profit participation and involvement in firm decisions amongst some of the benefits of a CSR policy.

Looking again at the KLD criteria, we find only one CSR item that might potentially reduce rather than increase costs: reducing the gap between manager and worker remuneration (assuming that the costs associated with the manager are lowered). In terms of potential benefits, there are at least five reasonable arguments to be considered. First, in a framework of asymmetric information on product quality between seller and customer, the adoption of CSR practices may be an efficient signal, provided that a negative correlation exists between CSR and the likelihood that the firms will sell “lemons” to their customers. This hypothesis stems directly from the fact that product quality and attention to consumers is one of the qualifying dimensions of CSR. It is not the case that CSR practices are widely adopted in industries in which low quality products may generate more negative consequences for consumers (i.e. food and banking industries.)

Second, in the Freeman’s (1984) perspective, CSR may be the optimal way to minimize transaction costs with stakeholders and the “ethical risk” of corporations. For ethical risk, we mean the probability that the firm incur severe losses for being sued by stakeholders. Aggregate figures of these costs every year for listed companies are impressive. Therefore, “ethical risk” has become one of the main topics in risk management courses taught to corporate employees.

Third, the adoption of more environmentally friendly productive processes may entail relatively higher costs with respect to competitors in the short run but significant gains in the medium and long one. More environmentally friendly productive processes should create leadership in the adoption of more energy saving productive processes in anticipation of stricter pro- environment regulatory changes.

Fourth, CSR may stimulate on workers’ productivity for two main reasons: 1) higher monetary and nonmonetary benefits may positively affect productivity as well discussed in the efficiency wage (Shapiro and Stiglitz, 1984) and gift exchange literature (Akerlof, 1982); 2) the corporate choice may positively affect intrinsic motivations of workers, which have been demonstrated to be a significant determinant of their productivity.

Fifth, the CSR option becomes more rewarding as more and more concerned consumers vote with their portfolio for corporations more actively engaged in social and environmental sustainability. This last point explains why, in empirical analyses on the effects of CSR on corporate performance, it is impossible to have clear cut (and historically robust) evidence in one direction or another. The Eisenberg law of indeterminacy tells us that experimental results are unstable when the object of our analysis evolves and is all the more applicable in this context. The final outcome in the CSR-corporate performance nexus depends on many factors, but it is ultimately strongly conditioned by our behavior as consumers.

CONCLUSION

In recent times, we discussed the rise of new type of firms, which we define as “social market enterprises” (microfinance institutions, fair trade producers, corporations which incorporate social goals and produce both social and economic values.) Social market enterprises decrease the gap between the negative social and environmental externalities of economic creation and corrective policies of inclusion or redistribution. A social market enterprise performs both activities as it is not merely a supplier of social services. Quite to the contrary, it competes on the market, creates economic value but in a socially and environmentally responsible way, and promotes inclusion and social justice as goals. An important property of social market enterprises is that, despite their limited size and role in the market, they can be highly contagious. The existence and positive market shares of these types of firms selling products which incorporate social and environmental sustainability features can reveal to the rest of the market the apparent paradox of consumers and investors that were not behaving as in the standard stylized textbook representations. Microfinance and socially responsible investment fund investors and fair trade product consumers are an open contradiction of the homo economicus behavior. When SME’s started offering products in which a social value accompanied a higher price, SMEs surprisingly conquered consumers and investors, thereby revealing to bigger market players that economic choices are not only driven by self interest but also by sympathy and commitment, as Sen suggested in his famous 1975 “rational fools” paper.

In this paper, we have seen that after the entry of small, contagious firms in the market, profit maximizing corporations realized that incorporating social value in their products or in their activity was useful to attract new customers. After that moment, corporate social responsibility became an important part of their competitive strategy. Small contagious firms (social market enterprises) are succeeding with the help of concerned consumers in the difficult task of transforming solidarity, inclusion and social justice from values into competitive factors by creating economic return with values. When solidarity, inclusion, and social justice take prominent places in the economic strategies of social market enterprises, these values no longer take a marginal role in the conduct of business but shape both value creation and social inclusion and redistribution in every commercial phase.

NOTES

1. From this perspective, the well known optimism induced by the inverse U-shape of the environmental Kutznets curve does not ensure that the forces leading to a reduction of per capita CO2 emissions may prevent that total emissions from continuing to grow as far as population grows and some rapidly industrializing countries are still below the maximum emission intensity point (Stern, 2004; Auci and Becchetti, 2007).
2. When attempting to integrate the two disciplines, it becomes clear that the only possible synthesis lies in the improvement of energy efficiency, creating an environmentally sustainable growth in which the creation of economic value is made conditional on the non-deterioration of (non renewable) natural resources.
3. To some extent this is exactly what ethically managed funds already do when they select their stocks by looking not just at their performance but also by considering positive or negative selection criteria based on social and environmental responsibility.

4. T. R. Malthus, *An Essay on the Principle of Population*, first edition, 1798: Chapter 16, par. XVI.1.
5. For the theoretical debate concerning the role and impact of Fair Trade at micro and aggregate level see Maseland & De Vaal (2002), Moore (2004), Hayes (2004) and Leclair (2002).
6. It is important to note that social market enterprise action remains very separate from “anti-globalization” as it concretely proposes approaches which can also make the globalization process smoother for those who are marginalized. The process of globalization in a competitive scenario should slowly contribute to a narrowing of the wage and income gap between poor and rich countries thanks to the growing demand for unskilled labor and the relatively higher per capita growth of poorer countries which are open to international trade. However, there remains a problem in the form of the many obstacles to this process (leading many economists to speak about persisting divergences and convergence clubs instead of full convergence) and transition is very long and can create “economic victims” in the interim phase. Social market enterprises can contribute to improving access to markets and credit for the most marginalized, thereby allowing them to enjoy the opportunities created by globalization.
7. The distribution channel offered to marginalized producers by Fairtrade importers does not intend to be exclusive, since one of the movement’s goals is to strengthen these producers’ positions in international markets. Scaling up and phasing out are therefore two of the most delicate issues in the relationship between Fairtraders and marginalized producers (Becchetti-Costantino, 2007).
8. For the theoretical debate of the role and impact of Fair Trade at micro and aggregate level see Maseland and De Vaal (2002), Moore (2004), Hayes (2004) and Leclair (2002).
9. John Maynard Keynes "The Future", *Essays in Persuasion* (1931) Chapter. 5
10. See Report on Socially Responsible Investing Trends in the United States, 2003 and Cerulli Associate’s European SRI Reports respectively for further details.
11. KLD Research & Analytics, Inc. is an independent investment research firm providing management tools to professionals integrating environmental, social and governance factors (ESG) into their investment decisions. KLD Research & Analytics, Inc. is the leading authority on social research and indexes for institutional investors. Since 1988, institutional investors, managers, trustees, consultants and advisors have depended on the quality and expertise of KLD. Today, 31 of the top 50 institutional money managers worldwide use KLD’s research to integrate environmental, social and governance factors into their investment decisions.

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ESSAY: CHINESE FEMALE ENTREPRENEURS VERSUS THE SOCIAL RESPONSIBILITY OF SUSTAINABLE DEVELOPMENT

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Abstract: An enterprise's primary responsibility is enabling the enterprise itself, the local community, the region, and even the world community to pursue sustainable development. Each enterprise acts as a member of the world community. Once humanity lacks "sustainable resources" and a healthy environment, no enterprise will be able to develop or survive. Therefore, an enterprise must undertake its own responsibilities in economic, social, and environmental terms and fulfill its social responsibilities. Most Chinese female entrepreneurs, from the first time they stepped into the business world, have had to overcome a thicket of problems and compete against rivals of great competence. Women entrepreneurs must, also, shoulder such heavy tasks as saving resources, environmental protection, upgrading of the industrial mix, job placement, and social security in spite of great fluctuations in the wake of industrial restructuring initiatives. In the past 20-odd years since China's adoption of her world-acclaimed policy of opening and reform, Chinese female entrepreneurs have made great efforts, received generous support from the government and society, undertaken the task of pursuing sustainable development, and accumulated a great deal of valuable experience.

Keywords: enterprise, social responsibility, female entrepreneurs, sustainable development

An enterprise's primary responsibility is enabling the enterprise itself, the local community, the region and even the entire world community to pursue sustainable development. Each enterprise acts as a member of the world community. Once humanity lacks "sustainable resources" and a healthy environment, no enterprise will be able to develop or survive. Therefore, an enterprise must undertake its own responsibilities in economic, social, and environmental terms to fulfill its social responsibilities. Otherwise, an enterprise will gradually lose its vitality and, even, sink into a disadvantaged position when unaware of the necessity of corporate social responsibilities.

THE RELATIONSHIP BETWEEN ENTERPRISES AND SUSTAINABLE DEVELOPMENT

Enterprises' Intrinsic Role in the Pursuit of Sustainable Development

Enterprises create wealth, pay taxes to national governments, and provide job opportunities, thus contributing to the advancement of humanity. In light of today's circumstances in China, enterprises constitute a major force that helps build up a well-off society in a well-rounded way in order to realize a

new form of industrialization. Economically speaking, enterprises are the microcosmic foundation and serve as the cells of the larger, national economy. Besides, enterprises are the subjects of economic growth and technological advancement. Speaking from the perspective of sociology, enterprises shall, in the capacity of social citizens, bear the social responsibility of pursuing sustainable development. Furthermore, each enterprise is like a value chain that relates to the interests of a series of people living in the society. The enterprise brings value to its employees as well as those people living in its local community, city, and region. Therefore, speaking in spatial terms, a successful enterprise propels the development of many regions and many people.

According to the major aspects of sustainable development determined in the Johannesburg Conference, all national governments on the earth bear joint responsibility for water, energy, healthcare, agriculture, and biological diversity. However, when it comes to promoting sustainable development in all these domains, enterprises need to be mobilized in order to take an active part in the pursuit of sustainable development. In other words, it is necessary for enterprises, with support granted by government, to operate in an industrialized and market-oriented manner that embraces sustainable development. In this new economy, each enterprise is also like a big school, as a corporate culture requires people to constantly learn new knowledge and create new things. Ultimately, as evident from globalization and the characteristics of this new economic era, today's world features development of all parties in company with one another.

Competing tit-for-tat becomes an irrelevant business method. Instead, a newly emerging mode of corporate operations features co-existence, mutual assistance, and the phenomenon of the strong helping the weak. This method leads to more intelligent and efficient environmental resource management and also establishes an important foundation for constructing a new, market-oriented, socialized system. Only by using this new business method does it become possible to construct a new scene characterized by harmony amongst enterprises, harmony between enterprises and society, and harmony between humans and nature. It thus follows that enterprises occupy an important position and also play an indispensable role in the pursuit of sustainable development.

Enterprises' Negative Influences in the Pursuit of Sustainable Development

As some enterprises observe that the mode of production and consumption of the rich prevail in the world, some enterprises fling caution to the winds by increasing their production volumes. These enterprises may also advocate modes of consumption that lead to wasted resources. Enterprises' ineffective use of resources has, thus, faced opposition by the entire world. Meanwhile, pollutants generated by enterprises have caused the health conditions of humans to deteriorate and decreased biological diversification. According to a report released by the UN in 2006, pollution of indoor and outdoor air has caused over 3 million persons, mostly women and children, to die too early. In addition, enterprises' production and developments have resulted in the exhaustion of non-recyclable resources. The current efforts to utilize recyclable resources, clean energy, and natural resources necessary to human survival, such as drinkable water, are far from enough. Especially of note is the fact that poverty is the core issue in regard to sustainable development. With the tide of globalization and growth of the new economy, a few consortiums in developed countries grasp an increasing amount of humankind's wealth. Very serious competitive forces impede the entry of products and services of developing

countries (and especially under-developed countries) into the world market. These economic phenomena result in a relative surplus of products and low level of service skills in developing countries, causing the poor to become poorer and the rich to become even richer.

THE SOCIAL RESPONSIBILITY OF ENTERPRISES

Enterprises shall bear the following social responsibilities in the pursuit of sustainable development:

1. Enterprises must constantly pursue innovation, enhance their productivity, foster new points of economic growth, and keep up with the latest economic developments resulting from globalization. Meanwhile, enterprises shall establish a good reputation, help propel the sustainable development of China's economy, pay more taxes to national governments, and create more job opportunities for society, (especially for women) to alleviate or eliminate the worldwide prevalence of poverty.

2. Enterprises shall meet the requirements of environmental protection, resource conservation, and stewardship while emphasizing survival and sustainable development of humankind in all stages. Important considerations must be given to safeguard and develop education, scientific research, design, manufacturing, transportation, sales, and after-sales service. Other responsibilities include taking good care of the workforce, creating production and operating environments that meet national and international standards, and working to enable workers and staff members to enjoy adequate social security services. Enterprises shall pursue and advocate efficient modes of production and consumption that are conducive for sustainable development. They should use their best endeavors to meet consumers' rational demands. Enterprises should also strive to reduce their use of energy and materials, as well as provide low-cost, non-polluting, high-quality, and eco-friendly products and services.

3. It is required to pay extra heed to those major domains that relate to sustainable development determined in the Johannesburg Conference, such as energy, water, healthcare, agriculture, and biological diversity. Discussion of these issues brings into full play the distinctive advantages of entrepreneurs and mobilizes them to help develop operations in an industrialized and market-oriented manner, and intensify the efforts in research and development of products and services while considering intellectual property rights. Entrepreneurs paying attention to environmental preservation accelerate the transformation of scientific and technological results into productive forces, and, meanwhile, learn and usher in state-of-the-art technologies, seek partners worldwide, and emphasize sustainability.

4. In the new era of economic globalization, enterprises shall seek common development while co-existing with others, avoiding waste of resources as a result of destructive rivalry and constructing harmony among enterprises, society, and the world. Meanwhile, all enterprises shall strive to become "schools" because efficient and innovative thinking and a high caliber of human talents are the key elements for the pursuit of sustainable development. Therefore, entrepreneurs shall intensify their efforts in educating and training their workers and staff members. Entrepreneurs should also be aware of what is going on in the world, as well as focusing on enhancing their personal competitiveness. This keen focus on human resources and world current events will develop managers in technical, operational, and managerial fields for good, sustainable development.

5. Elimination of poverty remains the core task of sustainable development. Entrepreneurs shall pay close attention to the need of poverty elimination, and endeavor to raise to new heights humanity's

standard of living, conditions of health, levels of education, and overall development. In order to create a bright future for their offspring, entrepreneurs need to take an active part in trans-regional and cross-cultural communications and cooperation, pursue sharing and sustainable development of economic and social resources, and protect the common homestead of humanity – the earth.

In sum, in today's world featuring extreme inequalities in both economic and social terms, enterprises in all countries, big or small and rich or poor, should actively follow the United Nations' "World Summit on Sustainable Development Plan of Implementation." Enterprises should value the United Nations' "Agenda 21" in accordance with the principles of equality and fairness to realize the hope that the earth might allow us to reach the ideals of humankind.

The social responsibility of the above-said enterprises has enabled enterprises to enjoy a wider space in the course of pursuing sustainable development. On the other hand, enterprises have furnished themselves with an awareness of sustainable development and a sense of social responsibility. Enterprises' social awareness beneficially enhances the social images of enterprises as citizens in society and changes the general public's view of enterprises, thus making consumers willing to accept enterprises' products and services. Otherwise, enterprises do not develop into stronger companies. Therefore, enterprises are closely associated with sustainable development. In this way, even micro-enterprises might make heavy contributions to the pursuit of sustainable development.

CHINESE FEMALE ENTREPRENEURS' SUSTAINABLE DEVELOPMENT INITIATIVES

Different from their counterparts in developed countries, Chinese female entrepreneurs stepped onto the stage and have been seeking development in an era in which China underwent the middle phase of industrialization. At that time, developed world countries had long before gone through their respective phases of industrialization and post-industrialization and even embraced a new economic era. The negative influences brought forth by humanity's modern civilization accelerated consumption of resources, deteriorating pollution of natural environments, global warming, deserts' intrusion into mountains and grasslands, and a fast-growing population, have worked together to jeopardize the survival and development of humanity.

Unlike their counterparts in developed countries, Chinese female entrepreneurs working in the mid-phase of industrialization have had no opportunity to cause pollution in the course of industrialization and later work out solutions. Instead, very early in the process of industrialization, these women have needed and continue to need to measure up to the world's environmental standards at huge prices. Second, due to the tide of globalization, all players interact with the world market. Multinationals hailing from developed countries have managed, by virtue of their gigantic competitive forces, to occupy most of the Chinese market and the rest of the world market. In contrast, Chinese industrial products have remained in the dry tree in the market, which has directly given rise to a relative surplus of inferior Chinese industrial products.

This phenomenon has further impeded the integration of rural laborers into industrial sectors in China and has resulted in greater fluctuations in China during her course of industrial restructuring and upgrading. Third, with the tide of globalization and growth of the new economy, knowledge has been updated at an increasingly fast pace. Each and every enterprise must adapt itself to the latest market conditions to meet the demands of the world market. Often, this reorganization requires that women

entrepreneurs rethink the flow of corporate operations by means of information technology. Therefore, most Chinese female entrepreneurs have had to overcome a thicket of problems and compete against rivals of great competence from the rest of the world.

Women entrepreneurs have also had to shoulder such heavy tasks as resources saving, environmental protection, upgrading of the industrial mix, job placement, and social security in spite of great fluctuations in the wake of industrial restructuring initiatives. In the past 20-odd years since China’s adoption of her world-acclaimed policy of opening and reform, Chinese female entrepreneurs have made great efforts, received generous support from the government and society, undertaken the task of pursuing sustainable development, and accumulated a great deal of valuable experience in this regard.

Chinese Female Entrepreneurs and the Natural Resources Environment

Female entrepreneurs have now stood at the forefront of sustainable development by means of transforming technologies and upgrading traditional industries. For example, the Haier Group succeeded in re-designing the flow of its corporate operations to catch up with the tide of globalization and the development of the new economy. A number of enterprises have now met world standards and China’s national standards in regards to environmental protection. Some enterprises have made their technical standards measure up to world standards; some other enterprises have been producing products with China’s unique competitive edges. For instance, the Haier Group and the Tasly Group are participating in the formulation of world standards in the industries in which they operate.

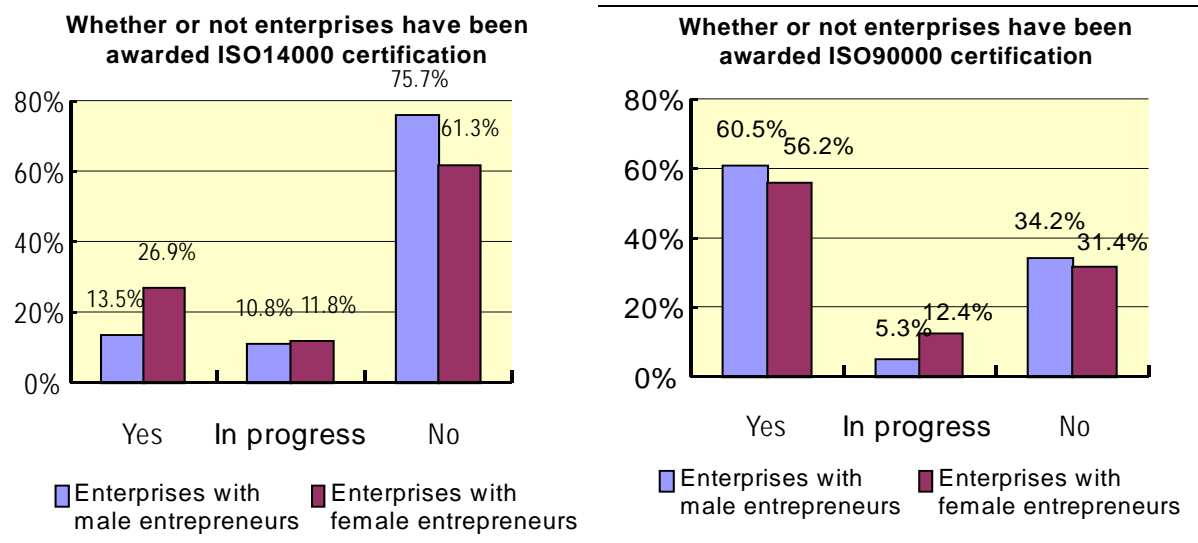


Figure 1. Endeavors made by Chinese enterprises led by female entrepreneurs in meeting world standards.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

Quite a few female entrepreneurs are working intensively to disseminate and apply eco-friendly energy strategies. Some of them use waste in energy production. To cite an example, the Liaoning Gongyuan Cement Group has utilized advanced technology to use solid waste, such as fly ash, tailings and ardealite

phosphogypsum, in energy production to help alleviate pollution of the natural environment.

Chinese Female Entrepreneurs and the Construction of New Rural Villages

The “three-dimensional rural issues” from 17th CPC have been among those key issues concerning China’s socio-economical development, poverty elimination, and holistic build-up of a prosperous, well-rounded society. In today’s China, agriculture still takes up a relatively huge percentage of China’s GDP. This indicates that Chinese female entrepreneurs may bring their own potentialities into play in the agricultural domain. In reality, Chinese female entrepreneurs have already made solid efforts in this domain, and achieved amazing effects.

China New Cooperation Group mobilized women to set up one-hundred stores in counties within China. These efforts not only promoted the emergence of small-sized enterprises led by women, but also helped construct a new distribution network for rural areas, which allows the enterprises to distribute their goods nationally. At present, the China Association of Women Entrepreneurs is expanding on this original project, which is titled “New Ventures by Female Entrepreneurs.” Another example of an extraordinary initiative of Chinese women entrepreneurs is the Shandong Rizhao Huatai Food Co., Ltd., a company regarded as a role-model exporter. Apart from helping local peasants get wealthy, this enterprise has enabled its aquatic products to measure up to the world’s advanced levels. This company’s products occupy overseas markets in Japan, South Korea, and Southeast Asia.

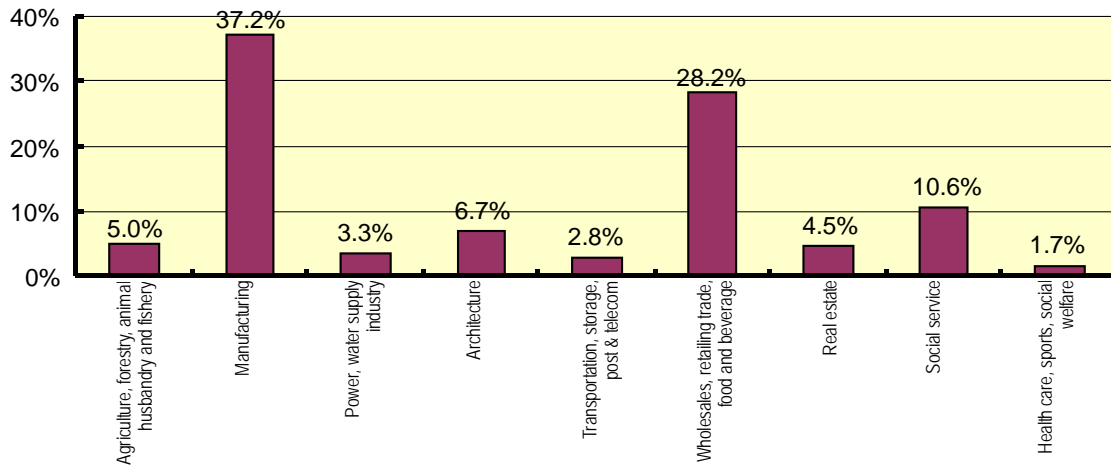
The Work of Female Entrepreneurs in Human Services

Many female entrepreneurs have been operating those enterprises engaged in such businesses as human life, healthcare, entertainment, beauty care, and education. Many female entrepreneurs work to improve the reproductive health of humans and care for the elderly, children, and women. Involved in this work of preserving and improving life, women enhance their personal qualities, image, and well being. Some people reckon that women can demonstrate their God-given advantages over men very clearly in these domains. For example, many people credit women as possessing the traits of tenderness, consideration, and conscientiousness, as well as great motherly love. Although female entrepreneurs have operated enterprises of different sizes and have varying personal qualifications, almost all entrepreneurs have kind hearts and dedicate themselves to the pursuit of sustainable development.

With the growth, upgrading, and restructuring of China’s economy, China’s service industry will grow even stronger. A majority of service sectors are rather suitable for women to embrace opportunities. As long as the government and general public grant women further support, certain women desirous of launching their own businesses or finding employment in service sectors are expected to contribute immeasurably to China’s pursuit of sustainable development in the years to come.

A Research Demonstration of Female Businesswomen’s Social Commitments

Female entrepreneurs work in diversified industries. Female-led enterprises are engaged in all industries and trades within China. They are mainly in manufacturing (37.2%), wholesale, retail, trade, and catering industries (28.2%) and social services (10.6%) (see Figure 2).



Figures 2. Proportion of female-led-Chinese enterprises in various industries.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

Female entrepreneurs and the employment of women. Figure 3 shows that in large corporations of over 1,000 people in female led-enterprises, the female proportion of the workforce is 50% higher than male-led enterprises.

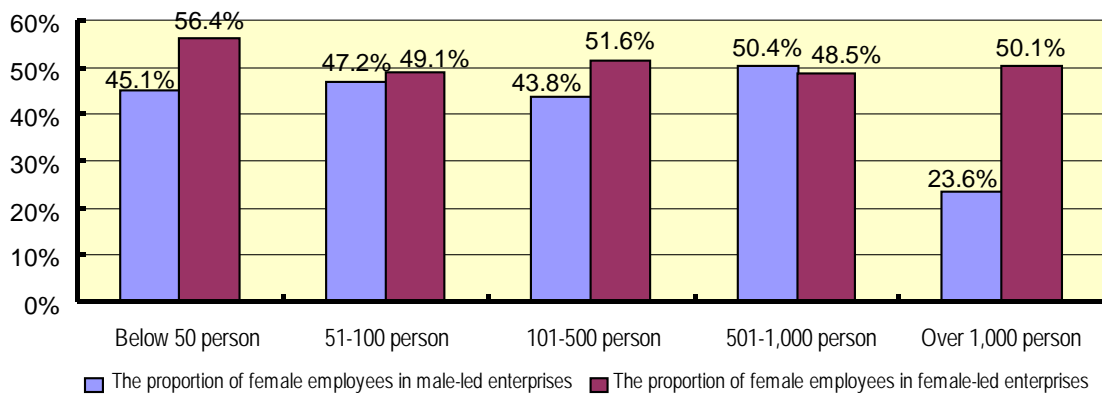


Figure 3. Comparison of the proportion of female employees in both male-led and female-led enterprises in 2005.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

Female entrepreneurs and the international market. In over 53% of female-led enterprises, exports account for over 30% of sales income.

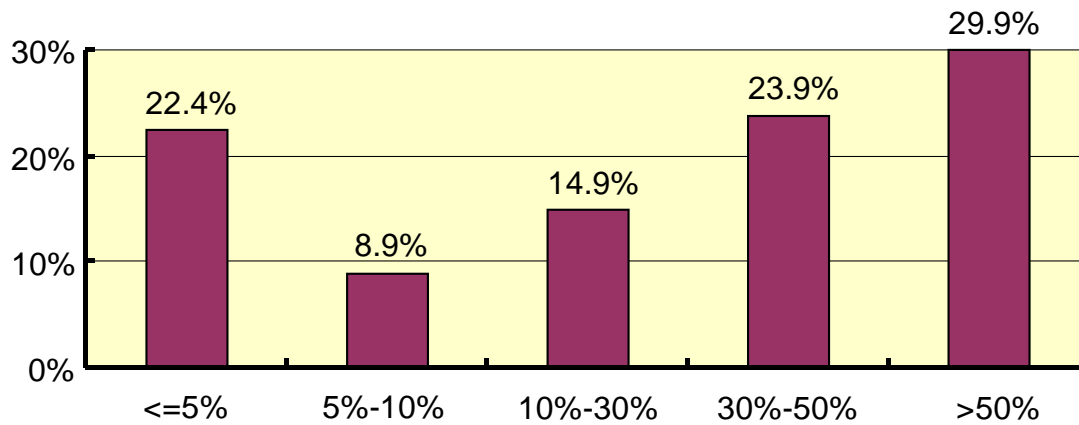
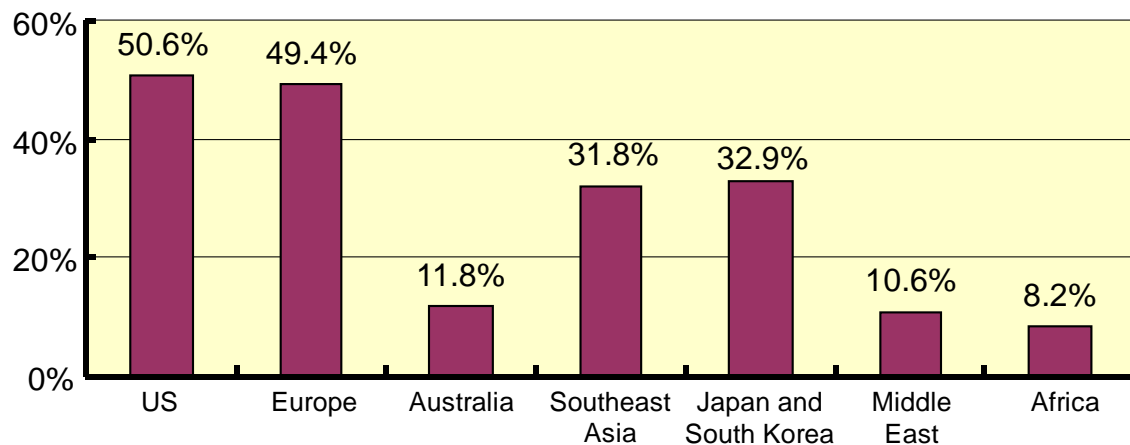


Figure 4. Proportion of exports in sales income in female-led enterprises.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

As displayed in Figure 5, America and Europe have become the main countries and regions where female-led enterprises export their products. Compared with 2003, the main exporting regions for China's female-led enterprises are not confined to Asia. Rather, America, Europe, and other developed countries have become Chinese women entrepreneurs' main trading partners.



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Figure 5. Female-led enterprises main export destinations.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

Education Level of Female Entrepreneurs

Figure 6 shows that female entrepreneurs are slightly better educated than male entrepreneurs.

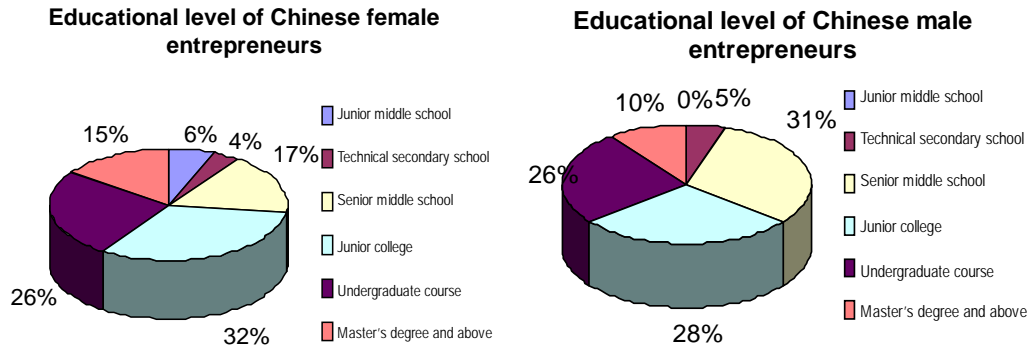


Figure 6. Gender comparison of educational level of Chinese entrepreneurs.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

The Developmental Trends of Female Entrepreneurs

Mirroring the investigation conducted in 2003, nearly 80% of female entrepreneurs are registered after 1995. After 1995, more and more female entrepreneurs started businesses in China. This growth trend continues today.

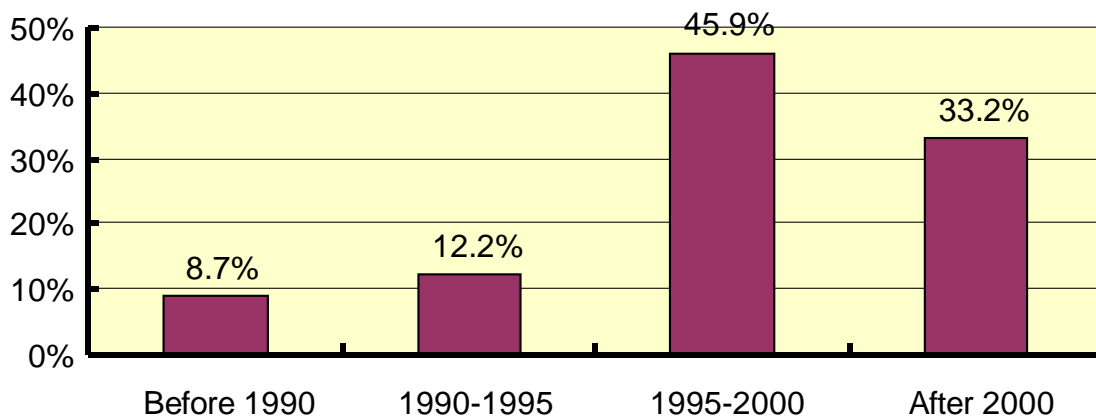


Figure 7. Categorization of female-led Chinese enterprises according to the time of incorporation.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

Female Entrepreneurs' Future-Oriented Approach

Most entrepreneurs have an optimistic attitude towards future enterprise development. Nearly 2/3 of female entrepreneurs are optimistic or very optimistic about the prospect of enterprise development in the future. More than 1/3 of entrepreneurs think the prospect is just so-so, and 4.3% of female entrepreneurs take a pessimistic or very pessimistic view of the future of enterprises.

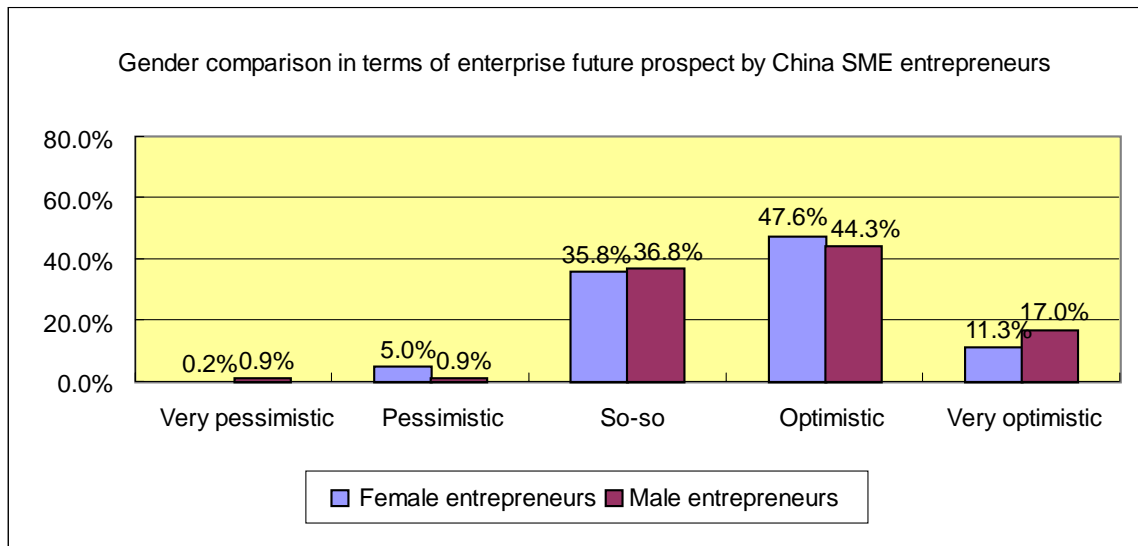


Figure 8. Gender comparison of entrepreneurs (in SMB) attitudes towards future enterprise development.

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

Female entrepreneurs' endeavors to conserve natural resources

Chinese enterprises have employed technologically backwards equipment and remained at relatively low levels in the industrial mix. Enterprises' adoption of immature technologies have caused the waste of resources (especially energy sources) and environmental pollution. Therefore, China has failed to accomplish her goal in terms of energy-saving, waste and emissions reduction under her 10th Five-Year-Long National Development Program. In 2006, the initial year of China's 11th Five-Year-Long National Development Program, China has failed, once again, to attain her goal in terms of energy saving, waste and emission reduction. In the final analysis, the coarse mode of economic growth stands as a principal barrier against China's move toward poverty elimination.

1. In 2006, CAWE fielded a sample survey of 120 Chinese enterprises led by female leaders, and reached some negative and discouraging findings. From 2001 to 2005, that is, the period of China's 10th Five-Year-Long National Development Program, 60.3% of the surveyed Chinese enterprises led by female leaders have registered a savings ratio of raw materials per unit of production that is below 10%. Among others, 45% of these surveyed female-led enterprises have not only failed to save raw materials, but also made heavier input in each unit of production, thus resulting in the waste of raw materials.

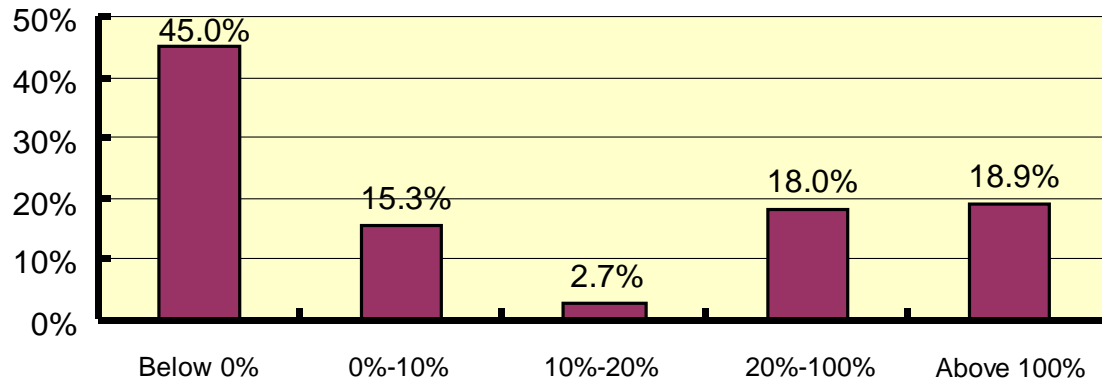


Figure 9. Saving ratio of raw materials in Chinese enterprises led by female leaders (2000-2005).

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

2. Meanwhile, CAWE has conducted an energy saving survey with these same 120 female-led enterprises. Figure 10 shows the findings of this survey. As shown in Figure 10, during the period of China's 10th Five-Year-Long National Development Program, 56% of surveyed enterprises have failed to meet the energy-saving requirement (i.e. a 20% reduction in energy consumption per unit of production); 42% of these enterprises have seen their efficiency in energy utilization drop, thus increasing the waste of energy resources.

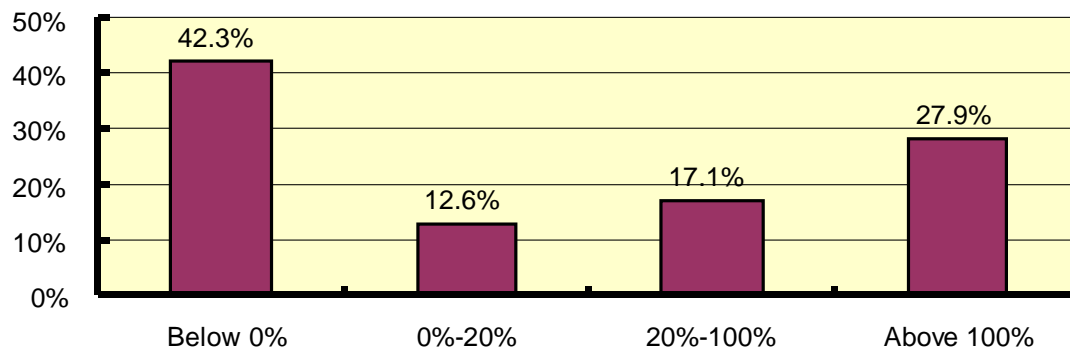


Figure 10. Energy saving practices of Chinese enterprises led by female leaders (2000-2005)

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

3. The findings of the survey also indicate that the emission reduction movement in the surveyed Chinese enterprises reflects the situation of Chinese enterprises as a whole and show a failure in meeting the national requirement. Figure 11 sets out the findings of a sample survey given to female-led enterprises. The survey examined the businesses' efforts to reduce their emissions (including water, gas, and solid wastes). One group of 53 companies was selected for an analysis of emitted water waste, 37 enterprises were selected for an analysis of waste gas, and 40 companies selected for an analysis of solid waste levels. According to the findings, 57%, 77%, and 66% of these surveyed Chinese enterprises led

by female leaders have reached only a less-than-10% reduction in their emissions (including waste water, waste gas, and solid wastes.) In fact, some of the surveyed Chinese enterprises led by female leaders have not only failed to reduce their emissions of the three types of pollution mentioned, but have increased their emissions. To be more specific, 18.9%, 54.3% and 41.4% of these surveyed enterprises led by female leaders have increased their emission of water, gas, and solid wastes. In particular, a rather high percentage of these surveyed enterprises have increased their emissions in waste gas and solid wastes.

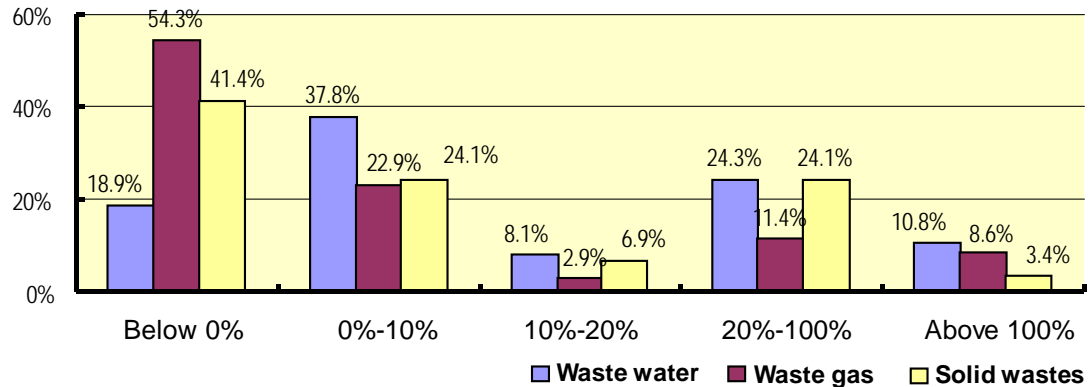


Figure 11. Reductions of Chinese enterprises led by female leaders in three wastes (2000-2005).

Source: Findings of a survey fielded by the Research and Consultation Center of China Association of Women Entrepreneurs in 2006.

In 2002, a delegation of 16 Chinese female entrepreneurs attended the World Summit on Sustainable Development held in Johannesburg, and were interviewed by the former Chinese premier, Zhu Rongji. After this delegation returned to China, the China Association of Women Entrepreneurs organized the International Forum on Sustainable Development and Chinese Female Entrepreneurs. During this forum, the 16 representative Chinese female entrepreneurs who had attended the Johannesburg Conference voiced a proposal to the business circle with regard to the necessity of enterprises' taking prompt actions to pursue sustainable development. At the moment, efforts are being made in this regard.

GREEN GDP STRATEGY AND CORPORATE RESPONSIBILITY

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Abstract: By most measures, the environmental challenges confronting China are at least as serious as those confronting many other nations in the world. A measure of Green GDP will almost certainly give policy-makers and the interested public a more defensible estimate for the extent and scope of environmental challenges. Based on a review of the two strategies in combating pollution, this paper suggests that a combination of governmental intervention and free-market operation could be a better strategy to reverse China's heightening environmental challenge. The thrust of this article is to suggest that while a better macroeconomic estimate may be helpful in motivating governments to act, a more microeconomic approach at the corporate level may yield more useful results both in terms of understanding the problem and in planning the steps that are likely to be needed in achieving a more acceptable solution.

Keywords: GDP (Gross Domestic Product,) free-market school, government intervention school, Green GDP auditing, TEV model (Total economic value model)

The measures of Green GDP (Gross Domestic Product) have long been the subject of research in western countries since the 1960's, but it has never been practically used in measuring economic outputs. Since the fall of 2005, Green GDP has swiftly become a hot policy and research topic in China. The research issues involve how to apply the concept of Green GDP to measure economic outputs and how to use Green GDP to support the government's objective of improving the balance between growth and equity. After close to thirty years of narrowly focusing on the growth of corporate outputs, the concerns for corporate environmental consequences and environmental sustainability have finally prevailed. The Chinese government started in 2006 to use Green GDP measures to account for environmental costs in corporate outputs and GDP calculation. While it has never been entirely clear what practical use would eventually be made of the studies in the West, the emergence of this Green GDP methodology in China will draw policy attention to the quality and sustainability of economic growth and will hopefully lead to better environmental outcomes.

Green GDP methodology is an adjustment to traditional measures of a country's output of goods and services taking pollution and waste of resources into account. This method refers to an accounting system in which environmental degradation costs and natural resource depletion costs are factored into the calculation of GDP growth. The goal of this methodology is presumably to provide a better measure for guiding public economic policy and thereby contributing to a more welfare-rich outcome than could be achieved using traditional measures.

The concept of Green GDP was initially developed in the West in the 1960's (Pearce, Markandya,

& Barbier, 1989). This concept is a relatively new idea in China and there is controversy over how to implement a financial accounting approach to measure the costs of environmental damage and degradation caused by pollution and resource exploitation. In spite of these difficulties, two Chinese government agencies, the National Bureau of Statistics (NBS) and the State Environmental Protection Agency (SEPA), were designated to research and develop the Green GDP index and use it as a standard measure of China's environmental sustainability. These two government agencies measure environmental costs in terms of economic growth. By so doing, China will be the first country in the world actually implementing the Green GDP concept in the measurement of its economic activities. To better understand the background for the issues involved in China's recent request for Green GDP, it is necessary for a historical review of human activities and environmental protection.

HISTORICAL REVIEW

Reckless usage of land and other natural resources which caused severe damage to the human living environment can be traced back to the Roman Empire and Middle-Ages in western civilization. For instance, the Libyan coast had been covered with vineyards and the hinterland was covered with dense forests before its conquest by Romans. The deforestation, land contamination, and land erosion during and after Roman times turned Libya and other parts of northern Africa into desert (Kala, 1998). Excessive Roman commercial transactions for timber and agricultural produce deforested and salinized large areas in Palestine and Mesopotamia. In the Middle Ages (about a thousand years between the fifth century and fifteenth century), the power of the Church grew rapidly and the Church gradually became the major landowner. Unfortunately, the growing church power helped neither economic growth nor environmental protection. Diminished natural resources and environmental degradation subsequently led to the stagnation of economic activities in Europe in the seventeenth century.

Environmental protection did not receive enough attention in classical economic studies and business practice of the eighteenth century. In *The Wealth of Nations*, Adam Smith (1776) contended that expansion and improvement in the agricultural sector would lead to greater prosperity. He argued that the pursuit of self-interest based upon free enterprise and free market economy was the key to economic growth and human well-being. He was optimistic regarding the adequacy of natural resources because at his time much good land still remained uncultivated and the greater part of cultivated land was not improved to reach its full potential. With the abundance of land and improved farming methods, Smith believed that agriculture posed no problem. Problems such as population growth, rapid urbanization, poverty and urban squalor became noticeable in Smith's time but were not yet a serious cause of concerns as in later years.

In the last hundred years of industrialization, acid rain, the greenhouse effect, O-zone depletion, deforestation, land and water contamination, soil erosion, accumulation of vast quantities of highly toxic chemicals, nuclear and other wastes have gradually created an environmental nightmare. Pollution began to cause serious harm human health, endanger aquatic life, reduce agricultural yields, and pollute drinking water. These environmental problems were closely linked to business activities. Business people were more concerned about corporate-level profit than negative environmental externalities at the societal level.

The Concept of Externality

Externality refers to the costs emanating from production or consumption processes by economic units, such as firms and consumers, which are passed on to outsiders by way of air and water pollution and soil contamination. In other words, in the absence of property rights to air space and water courses, the economic activities of individuals and organizations may abuse these resources for their gains and benefits at the price of production and consumption of other economic units (extra losses or costs). However those gains and losses were absent from the financial calculations for the gainers and the losers before the concept of externality came into the picture. This concept of externality built the foundation for environmental economics by relating economic analysis to environmental problems. The first substantial treatment of externalities was by Kapp (1950; 1963) with anticipation that economic growth has far-reaching adverse consequences affecting the environment.

STRATEGIES TO COMBAT POLLUTION

Employing the concept of Green GDP will help provide a better picture of the pollution problem at both national and corporate business levels. Pinning down the corporate polluters and the related financial costs at micro-level might help combat pollution. This information is essential in finding ways to cope with environmental challenges (Adlemann, Fetini, & Golan, 1997). The debates on how to deal with the adverse consequences on the environment lead to the creation of two major schools: free-market school and government intervention school.

Free-Market School

The free-market school maintains that the environment will be better served through the exchange of well-defined and enforceable property rights in which there is a role for government as enforcer (Kula, 1998). According to Coase (1960), if a system of property rights is properly instituted and guaranteed by legal force, there would be no need for intervention on pollution disputes. The polluters and those affected can achieve a satisfactory solution through negotiation. The self-interested parties will engage in a voluntary exchange of property rights in a free-market environment. Ronald Coase (1960) does not believe that the government has articulated knowledge on all aspects of environmental externalities and is capable to internalize the externalities. He argues that the imposition of a pollution tax can itself introduce a set of externalities. The environmental problems will be better resolved through the exchange of well-defined and enforceable property rights. The government will serve the role of regulator and enforcer to facilitate economic growth without compromising environmental quality.

However, the market environmentalists believe that individuals, not the government, are the best judges of their own welfare. With a well defined free-market structure, individuals should be capable to find the optimal solutions for themselves and the society as a whole (Kula, 1998). However, it seems that this property rights approach would work better when a small number of individuals are involved in external effects. Interested parties could effectively negotiate a payment scheme to induce those who generate externalities to adjust their behavior to acceptable levels. But when the number of interested individuals is large, this free-market model may be not practical due to the undoubtedly high cost of negotiation, implementation and enforcement (Kula, 1998).

Intervention School

In contrast to the free-market school, the school of government intervention argues that market forces are not always conducive to either prevention or creation of natural resource-based capital. For instance, the development of forestation and water resources would benefit environmental preservation and social welfare promotion in the long-term but would not necessarily generate satisfactory short-term returns to non-governmental private interest groups. According to Pigou (1929), the government categorically is the trustee for public interests to watch over and act to defend the exhaustible natural resources of the nation from rash and reckless exploitation. Pigou suggests three policy instruments for the rational use of exhaustible natural resources protection of environmental quality, curbing wasteful consumption: (1) state subsidies, (2) taxation, and (3) legislation. The objective of government intervention through policy instruments is to optimize resource allocation on behalf of the society and to correct the shortcomings of the free-market. The underlying assumption is that governments are efficient and capable to work out solutions to problems (Demsetz, 1969).

In brief, the debate between the two schools is about how to find the optimal environmental strategy to achieve the goals of sustainable economic and social development (Turner, 1988). The core of the debate is to find efficient ways to discourage or penalize the reckless use of environmental resources in order to support and improve current living standards. The depletion of natural resources will in turn compromise the ability to sustain future development or impede future generations from meeting their own needs.

WORSENING POLLUTION PROBLEM IN CHINA

Before discussion of how to formulate the right strategy to achieve green GDP goals, let us briefly review the environmental crisis China now confronts. In the 1960s and early 1970s, when the international community started to pay serious attention to environmental issues, China was experiencing chaos because of the Cultural Revolution. With ignorance, the Chinese government chose to deny its pollution problems and refused to participate in the international conference on human environment by claiming “[t]here is no need to participate in a global conference to address the environmental protection. A socialist nation does not suffer from the environmental ills of capitalism” (Ferris & Zhang, 2002).

Unfortunately and ironically, forty years later, China became one of the most polluted nations in the world. The air and water were badly polluted and much of China’s land was contaminated, salinized or deforested. According to the World Bank, in 2000 China had 16 of the world’s 20 most polluted cities. According to the International Energy Agency (IEA) forecasts, the increase of greenhouse emissions from 2000-2030 from China alone will nearly equal the increase from the entire industrialized world.¹ China’s emissions of sulfur dioxide were the highest in the world in 2004. Acid rain caused by coal-burning plants caused “striking damage to agriculture, buildings, and public health.” (SEPA, 2006).

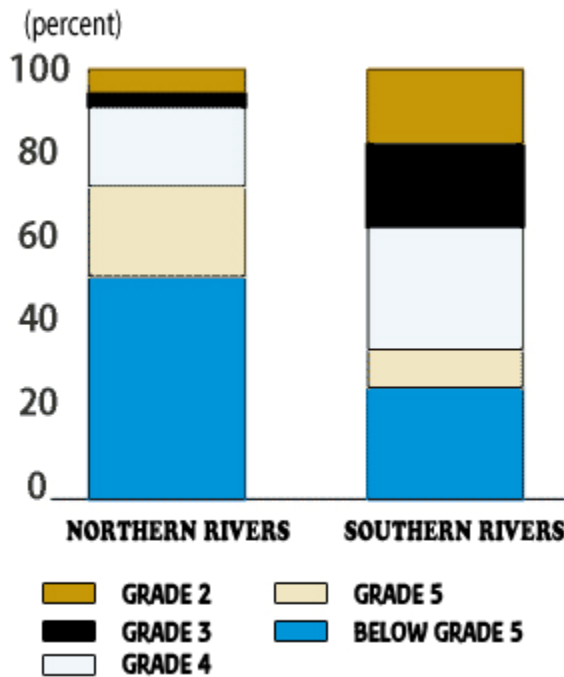


Figure 1. River pollution in China.

Source: www.carbon.cfr.washington.edu

Besides severe air pollution, water pollution is another dimension of the environmental crisis. According to the SEPA report (2006), the water in five of the seven largest rivers has been badly polluted. The Yellow River, Songhua River and Huai River regions have less than 10 % Grades I and II water suitable for human conduct; seriously contaminated by industrial discharges, many of these waterways are largely unfit for direct human use. Overall, 70% of the water was unsuitable for human use. Some rivers and lakes had dried up from overuse by factories and farms. Those that did not dry up have become open sewers while pollutants and fertilizer runoff cause algae blooms—red tides—along the river and the coastlines, devastating the fishing industry. In addition to the damage to the waterways, nearly 1,000 lakes have disappeared over the past 50 years. 75 percent of China's 20,000 natural lakes and thousands of artificial lakes suffered from algae pollution caused by an influx of waste water containing nitrogen, phosphorus and other harmful substances, according to Zhu Guangyao, Vice Minister of SEPA.²

Subsequent to the deterioration of inland water, Chinese coastal water also suffers from pollution. Sewage, inorganic nitrogen, phosphate, oil hydrocarbons, organic matters, pesticides, and heavy metals from land-based sources contaminate coastal ocean water. Large amounts of pollutants are discharged and dumped directly into the ocean. Sewage discharged into the ocean from factories and cities along the coastal line account for more than 10 billion tons and 146 million tons of toxic materials were discharged per year by 2000 (Li & Daler, 2004).

Elizabeth Economy (2004) wrote a book, *River Runs Black: The Environmental Challenge to China's Future*. Her first hand investigation of the Huai River region and China's growing pollution problems elicited serious public and research attention from the West concerning China's environmental

crisis. Land in China has also badly suffered from pollution. China has about 120 million hectares of arable land. About one tenth of the arable land has been damaged. Much of its land has been deforested, leading to erosion and flooding. By 2020, according to predictions, 25 percent of China's arable land will be gone (Economy, 2004). According to SEPA, "grave" soil pollution that jeopardizes ecology, food safety, people's health and the sustainability of agricultural growth. It is estimated that 12 million tons of grain are contaminated by heavy metals in the soil each year, which incur direct economic losses of around \$2.5 billion.³

In addition, the acreage of farmland irrigated with polluted water is also growing. About 7.3 percent of the country's irrigated farmland was harmed by polluted water, an increase of 1.6 times of the figure in the 1980's, and 93 million hectares of farmland were polluted by pesticides. Desertification poses another threat. Due to over-development, large areas of the country's grassland and farmland are turning into sandy land. The acreage of desert land in China reached 2.62 million square kilometers in 2000 and is expected to increase at a speed of more than 2,400 square kilometers each year.⁴ With such badly polluted air, water and land, it becomes imperative for China to take decisive actions to turn around this crisis before it is too late to reverse the course. Clearly, without decisive actions taken, the worsening pollution will make Chinese economic growth environmentally unsustainable.

ENVIRONMENTAL SUSTAINABILITY

It is almost impossible to accurately figure out the pollution costs of China's GDP because of the lack of standards for measurement and the difficulties in collecting relevant data on pollution damage. The World Bank estimated that pollution costs China 5% of its GDP, including health care and lost productivity. In 2004, the Economist estimated that pollution decreases China's GDP by 12%. In September 2006 China (for the first time ever) published a Green GDP Auditing Report for 2004.⁵ According to this report, Pollution caused direct economic losses of RMB 511.8 billion Yuan (\$64.2 billion). Water, air and solid material pollutions accounted for 55.9%, 42.9% and 1.2 % respectively. It would take RMB 1080 billion Yuan (\$135.8 billion) of direct investment and RMB 287.4 billion Yuan (\$34.2 billion) of operating costs to clean up the pollution hazard, which is about 8.6% of total GDP. Unfortunately, the total investment in environmental control was 1.18% in China's tenth Five-year economic development period (2001-2005), which was far less than what is needed to offset the environmental damage.

Green GDP auditing examines the costs of over twenty items while the current Chinese Green GDP auditing only cover the costs of ten items. The costs measured were: health, agricultural and materials losses caused by air pollution; health, industrial and agricultural production losses and water shortage caused by water pollution; and economic loss by land occupation of solid wastes. According to China's SEPA, underestimation occurred due to missing information in the calculated costs of the ten items. In addition, in this Green GDP auditing, another ten items such as the costs of damages to natural resources and biological environment, the costs of ground and underground water, soil contamination and in-house air pollution were also excluded (SEPA, 2006).⁶ Those exclusions were due to lack of a fundamental research work which would provide the basis for auditing estimation.

Therefore, the accounting results reflect only a fraction of ultimate Green GDP. Even so, the environmental pollution costs and treatment costs (8.6% of GDP) were about to offset the total

economic growth of 2004 (9.5%). In other words, discounting the environmental costs, the net GDP growth would be less than 1% for 2004. If we take the twenty pollution items into account, China would have a negative GDP growth. The report indicates that the high economic growth over the years damaged the quality of life and long-term growth potential of future generations. Clearly, without taking serious corrective actions, China's long-term development plan would not be environmentally sustainable. Thus, the worsening environmental pollution problems have raised serious concerns about the sustainability of Chinese economic growth. China's miracle of economic growth might end soon because it will be overwhelmed by environmental problems. Regardless, the Green GDP estimates provide a better understanding as to the serious extent of the environmental challenge. The Green GDP report serves as a wake-up call for China to undertake the challenge seriously and immediately.

THE DILEMMA AND THE POLICY OPTIONS

China essentially is depleting its own natural resources for rapid economic growth, sacrificing long-term interest for the short-term gains. Ironically, the Chinese decision makers were not unaware of the worsening environmental situations, but they failed to respond adequately and efficiently because they have been facing a daunting challenge in balancing economic growth and environmental protection. Unfortunately, the push for growth has always superseded environmental considerations in the past decades. Until now, no clearly defined strategies have been formulated in combating the environmental crisis.

As mentioned earlier, the debate on strategies to cope with environmental challenges can be put into two categories: either free market operation or governmental intervention. Recent policy studies on China's environment suggest that governmental intervention is the key to a clean future, including stricter governmental industrial regulation and pollution levy reform. (Dasgupta, Wang, & Wheeler, 1997; Dasgupta, Laplante, Namingi, & Wang, 2000; Ferris & Zhang, 2002; Li & Daler, 2004). How to use a market approach for environmental control is much less explored. This paper intends to argue that combination of both free market operation and governmental intervention might provide better solutions.

Government Intervention

According to World Bank policy research on policy reform and industrial pollution in China, the damage of industrial discharge can be substantially reduced at modest costs if a stricter regulation is enforced. The research project also found that adopting an economically feasible policy of much stricter regulation will restore the health of many waterways (Dasgupta, Wang, & Wheeler, 1997). China's current environmental problems stem, in large measure, from weak pollution control. The weak pollution control stems from the failure to prioritize the economic and social development activities and formulate a cohesive strategy to take care of growth and equity simultaneously. For a long time, Chinese decision makers have tried to solve the puzzle of enforcing environmental standards without crippling economic growth. In practice, they have sacrificed the environment for economic growth. In the environmental protection community, the Chinese government has been labeled environmentally unfriendly.

To intervene properly, this paper suggests that the Chinese government needs to take measures in the following three dimensions. First of all, China needs to create an environmentally friendly

government from central administration to local authorities. The actions to be taken include:

- Creation of a legal framework of environmental protection and enforcement
- Green Accounting Reform: To deduct the cost of environmental damage from total outputs
- Green Tax Reform to impose excise tax on polluters and make the polluters pay
- To create and grow an environmental Industry--- regulated markets for technology to provide advanced air, water treatment facilities
- To increase environmental investment, China's Eleventh Five-Year Plan- 2006-2011 budgets \$169 billion for environmental spending (1.6% of GDP), an increase of .8% from the budgeted allocation in the 1990's (.8%of GDP)
- To break the various problems into manageable projects
- To give tax credits for R&D on pollution control

Secondly, China needs to engage and cooperate with the international community. For example:

- Learn from the lessons of developed economies: seek answers about how to fix the pollution problem in terms of policy, economic priorities, technology and education/culture
- Combine macro economics and micro economics to identify problems and develop solutions such as steps to address urban air quality through sensible pricing of energy

Thirdly, non-governmental organizations: Green activists, entrepreneurship and NGO should play a more active role in environmental protection.

Free Market Operation

Like in any other nation, corporations in China are measured by their performance revenue and profitability at the firm level. Ultimately these corporations focus on productivity and quality management but neglect environmental management. This is simply because environmental management involves higher costs and lower profits than if they were managed jointly. Therefore, efforts must be made to link all of the main aspects of performance/efficiency measurement including environmental protection at the firm level (Giancarlo, 2005).

An important instrument to ensure sustainable development is to price and provide incentives for environmental development by making the polluter pay the marginal pollution damage expressed in monetary terms as "marginal external cost" (MEC). This instrument is also known as Polluter Pays Principle (PPP) which was developed by the OECD in 1974.⁷ The purpose of the PPP approach is to prevent or offset the negative externalities of economic activities through charging the polluters the marginal external costs. At the micro-level, polluters violate the property rights of others, according to Coase (1960). To apply the PPP model, one needs to first define property rights and enforce them as laid out by Ronald Coase (1960). Without establishing well-defined and instituted property rights, there will be no legal basis to implement the PPP model. The basic mechanisms for the Making the Polluter Pay methods include:

- 1) Setting the standards, the cost of achieving which is initially borne by the producer;
- 2) Setting charges or taxes on the polluting product or input;
- 3) Setting a standard and issuing pollution permits in amounts consistent with the standard, and allowing those permits to be traded.

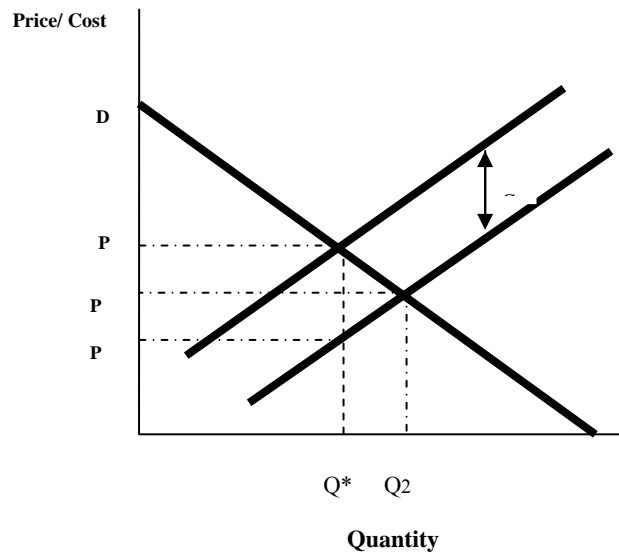


Figure 2. Sharing the cost of pollution control by both producers and Consumers.

As shown in Figure 2, without imposing a pollution charge, the consumers will buy Q_1 and pay a price of P_1 to producers. With a pollution charge, C , is put into effect, the total consumption is reduced from Q_1 to Q^* . The supply curve shifts from S to S' with a new market price, P^* and consumers pay this price in the market. Since producers must pay the charge component C , the price received by the producers is actually P_2 . In this scenario, both producers and consumers share the burden of the pollution surcharge. In effect, the more competition in the market between producers, the less consumers will bear the burden of a pollution charge.

This is a market-based model of incentives for pollution control as it sets the prices for environmental services through the market. It can be carried out in the form of pollution charges. Ideally, the charge should be equal to the value of marginal external cost (MEC). This charge can be carried out more efficiently through market negotiation than levy taxes in certain circumstances. For instance, a local coal miner may create air and water pollution, affecting local residents. The coal miner can negotiate to pay the residents the cost for reallocation. This might be a better or more efficient solution than charging the miner a penalty. However, this approach will become too complicated and too impractical if it involves a large interest group of individuals and institutions. Government intervention might be a better solution.

OVERALL GUIDING PRINCIPLE

Whether using free market or interventionist approaches to establish the environmental control system, as a first step, it is critical to realize that a proper valuation of the environment is a major feature of sustainable development. There must also be a strong awareness and integration of sustainability into project appraisal. According to Pearce, Markandya, and Barbier (1989), a total economic value (TEV) model can be employed for project appraisal as to an environmentally related project.

- 1) Proceed with a development project
if $B_d - C_d > B_p$ and
- 2) Do not proceed with development project
if $B_d - C_d < B_p$

Where

B_d refers to the benefits of the development.

C_d refers to the costs of the development.

B_p refers to the benefits if preserving the environment by not proceeding with the development project.

In this TEV model, we intend to relate the benefits or the total value of the assets left as a natural state to the benefits and costs of a development project. The evaluation for costs and benefits for the project is relatively simple because they can be measured based on the marketed inputs and outputs which have observable prices. But it is more difficult to measure B_p , the benefits of preserving the environment for not developing the project.

In practice, a few methods have been developed for directly measuring the monetary value of those gains for environmental preservation, such as using a surrogate market or using experimental techniques (Pearce & Markandya, 1989). The Green GDP calculation at a disaggregated level may help provide financial information in determining the feasibility of a project. Consistent with Green GDP, this TEV approach is to ensure that project appraisal within a sector or agency is carried out by properly taking environmental values into calculation to ensure that overall economic development is sustainable.

CONCLUSIONS

By most measures, the environmental challenges confronting China are real and serious. A measure of Green GDP will almost certainly give policy makers and the interested public a more defensible estimate of the large extent of these challenges. Green GDP also serves as a starting point in formulating strategies to cope with the environmental challenge. Based on a review of the two strategies in combating pollutions, this paper suggests that a combination of governmental intervention and free-market operation could be a better strategy to turnaround China's continuously worsening environment. The paper suggests that while a better macroeconomic estimate may be helpful in motivating the governments to act, a more microeconomic approach such as TEV may yield more useful results both in terms of understanding the problem and in planning the steps that are likely to be needed in achieving a more acceptable solution.

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WHY SHOULD WE CARE? THE ETHICAL FOUNDATION OF THE RESPONSIBILITY OF PRODUCERS AND CONSUMERS

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Abstract: The "ethics of responsibility" is developed on the basis of reflections about anthropology, different motivations for responsibility, responsibility of individuals compared to responsibility of institutions and limitations and "de-limitations" (Entgrenzung) of responsibility of producers, traders, consumers and the state in a globalized economy.

Keywords: responsibility of institutions, delimitation, globalized economy, anthropology

DIMENSIONS OF POWER AND RESPONSIBILITY

Power is the ability to decide between different options and to implement the decision. This is a broadly accepted definition of power based on Max Weber's definition of power. Each person has a certain amount of power, from very little to very extensive, from power and scope over self to influence and direction over the lives of millions of people. Different forms of power can be distinguished: competence (technical and social competence), capital (money, in general material possessions), communication and information (very important in the modern information society), experience (including the power of history), innovation (creative power), physical strength (physical power, arms), credibility (power of reputation), conviction (power of arguments), decision-making (power of taking and implementing decisions), monopoly (power without counter-power), cooperation (power to form coalitions), time (time and speed as an important power in modern economy) and so on.

Owing to the fact that power often is abused, power tends to have a negative connotation. Can power be ethical? According to the sociologist Max Weber, power is the possibility of enforcing one's own will. The possession of power allows an individual to realize and implement ethical values which one recognizes as "good" and avoid the implementation of "evil."

Generally speaking, responsible behavior is the response to power (for more on this value please see Jonas, 1979, and Stückelberger & Mathwig, 2007). Responsibility means the responsible use of power in its different forms. In ethical terms the level of responsibility inextricably links to the level of power. The more power a person has, the greater his or her responsibility. Somebody who has no power cannot assume responsibility, and anybody who exercises power without responsibility abuses it. A newborn baby cannot as yet be held responsible, because it does not have the will and the skills to decide between options. In contrast, a father of a family, an entrepreneur or the president of a government has the responsibility to use their power for the benefit of the people. An excellent speaker has the responsibility to use his/her eloquence and argumentations in a way which empowers and supports, but does not oppress people.

THE ANTHROPOLOGICAL FOUNDATION OF POWER AND RESPONSIBILITY

The understanding of power and responsibility depends to a great extent on the image one has of man. A pessimistic view emphasizes that man is always in danger of abusing power and neglecting his or her responsibility. The weakness and sinfulness of human beings leads to the necessity to control power of each human being by techniques of sharing and limiting. Responsibly using power means controlling, sharing, and limiting power. This is the most important way to responsibly use power. With an optimistic image of man one sees the opportunity of persons to assume responsibility by self-education and self-discipline. Looking at power from an optimistic view, optimists believe in the ability for self-responsibility, without emphasizing the need to control and share power.

All value systems stress the importance of responsibility. Yet, its understanding (what kind of responsibility?), range (responsible toward whom?), and motivation (why?) are very different. In the perspective of Christian anthropology and ethics, power and responsibility are rooted in God and are derived from him. According to the theological definition of the Ecumenical Council of Churches, power represents man's ability to participate in God's creation. The accumulation of power assumes a lesser role than the priority to properly use the appropriate power as needed according to each step of the task as well as the overall objective and level of action. In the Christian perspective, power is given by God and taken away by God in the case of abuse of power as occurs in many biblical stories, especially concerning the conduct of the kings in the Old Testament.

Therefore, to share and to limit power is a valid and important way to avoid its abuse. Power is a loan in the service of the community. The measure of responsibility must be adequate to the measure of power invested in a person or institution, and vice versa. Not only power, but also the burden of responsibilities has to be shared. If people do not share the burden of responsibility, many people tend to become selfish, autocratic or feel responsible for everything, even for matters they are unable to influence. Thus, the phenomenon of divided power rivals the destruction of undivided power. Power is tamed by responsibility toward an authority above the holder of the power, thereby putting power at the service of humanity. Conversely, it is irresponsible to demand responsibility from somebody without granting him or her the corresponding power.

WHY SHOULD WE CARE? MOTIVATIONS FOR RESPONSIBILITY

The motivation for responsible behavior differs according to world views and value systems. In a globalized, pluralistic world and a global economy, mixed motivations influence behavior. This might not necessarily lead to value clashes or to a clash of civilizations, but may result in highly responsible cooperations. Manyfold examples of companies with Corporate Social Responsibility (CSR) show evidence for this phenomenon, even if the concepts of CSR still remain very debated and different (Enderle, 2006).

From an enlightened perspective, responsible behavior results from enlightened self-interest. Rational behavior includes responsibility because irresponsible behavior is self-destructive and violates the duties toward the community (Ulrich, 1997). Self interest and interest of others can be combined and reconciled. Social peace and a healthy environment help oneself as well as others. From a religious perspective, one has to act responsibly as a response toward God or the Deity. All power lies with God and is granted to man by God. Therefore man is responsible toward God to use his power for the benefit

of the community. The efforts for personal salvation, personal perfection and wholeness or (in a Protestant perspective) the liberation from these efforts by God's grace lead to responsible behavior (Stückelberger, 2007).

From a Confucian perspective, responsible behavior is the core of the concept of Ren, the ideal of the morale of benevolence and of humane behavior for the sake of humanity. According to The Analects of Confucius (I-III), all human relations in its orders and its respects are basically rooted in hierarchical and concurrent mutual responsibility. In this context, sustaining long-term and stable human relationships and friendships motivates responsibility.

From a communitarian perspective, the motivation for responsible behavior results from community-orientation. The wellbeing of the community is the goal of human action. Individual wellbeing depends on the wellbeing of the community (Etzioni, 2004). From a human rights perspective, to care for others and to support their human rights is an important responsibility of policy makers. But it is also the responsibility of everybody. Obviously, rights link to duties and responsibilities (Runzo, 2003).

From a liberal perspective, personal freedom finds its limitation at the freedom of other fellow human beings. In order to guarantee freedom in the long run, freedom must be linked with responsibility, which respects the freedom of others (Stückelberger & Mathwig, 2007). From a socialist perspective, the struggle for justice and equity between all human beings leads to the call for responsibility. Irresponsible use or abuse of power oppresses the poor and weakens the weak. Solidarity commands that individuals care for others (Stückelberger, 2003).

From a capitalist perspective, the goal of increasing and sustainable profit can – in the long run – only be reached by responsible behavior. Irresponsible short term profit maximization increases conflicts with stakeholders, results in negative media reports, legal court cases, and environmental damage, thereby leading to various reputation risks and to corresponding financial damage (Leisinger & Schmitt, 2003). This view leads to the CSR perspective. From a CSR perspective: "Corporate Social (and Environmental) Responsibility" (CSR) leads to a long term, sustainable perspective and avoids or at least reduces reputation risks. Financially, ethics pays off in the long run.

INDIVIDUAL AND STRUCTURAL ETHICS

In human relations, responsibility in the care for oneself and for others is an ethical category. First of all, as part of individual ethics one is first responsible for his or her own life. Responsibility is not only a fundamental value and a basic ethical principle, but also a virtue and a characteristic feature of personal behavior. Second, responsibility has to be incorporated and incarnated into the structures in all sectors of society. "Codes of Conduct," management procedures, corporate structures from planning to production, trading, reporting and recycling, the legal system of nations, international conventions of the global or regional community or states should be structures, mechanisms and institutions allowing each individual to behave in a responsible way. Managers, board members, members of parliament or governments, participants in Non-Governmental Organizations or religious communities build these structures and value systems. Individual and structural responsibility and ethics influence each other as a result of their interdependence. By itself, individual behavior generally is too weak to change the world and ethical "heroes" are rare species. On the other hand, the level to which social structures incorporate responsible

behavior depend on the efforts and struggles of individuals and communities.

RESPONSIBILITY OF GOVERNMENTS, PRODUCERS, TRADERS AND CONSUMERS

This concept of responsibility is valid for all sectors of the society. Consequently, it also applies to the sector of economic ethics (which includes all economic activities from micro to macro) and more specifically to the field of business ethics (as the part of economic ethics which concentrates on companies.) Two questions must be raised. First, what is responsibility? Second, how much must governments, producers, traders and consumers extend or emphasize responsibility while looking at the whole supply chain or the process of the production and consumption of goods and services? This very complex question lies at the crux of local and international debates concerning economic ethics.

Four main categories of actors can be distinguished: 1) *Individuals*: employees, workers, consumers, electorate; 2) *Private sector*: Companies, shareholders, informal sector, employer's federations, trade unions, financing institutions, ethical labeling institutions, auditing institutions; 3) *Civil society*: media, academic research institutions, consumer organizations, environmental organizations, religious institutions, networks; 4) *State*: national governments (including local, regional, national levels), supranational alliances, international organizations. In this paper, I can only indicate a few theses. Each actor has to contribute in his/her specific area to a responsible, ethical production, distribution and recycling of goods and services. This seems to be obvious and trivial. Yet, the reality is that many actors blame others for what they should or should not do. Yet, they do not mention their own responsibility.

In a free market economy, companies have the task to use their freedom in a responsible way so that business serves not only the shareholders, but also all other stakeholders such as the employees, the consumers, the local community, the state, the broader society and the environment. In situations where companies do not respect stakeholders, scandals may occur, putting the company's reputation at risk (Rothlin, 2006). Companies are responsible not only for their own production units, but they have the obligation to look at the standards (in quality, working conditions, social and environmental behavior) of their suppliers at least for the first and second layer of the chain. If these two levels are monitored ethically, a substantial increase in responsibility of production can be seen.

A study about German Companies in China showed that they respected the same high standards (working hours, working conditions, labor rights etc.) in their own production in China as in Germany, much above the legal requirement, The standards for the first layers in the supply chain (international companies) were also high, but the standards for the second layers (Chinese private companies) were much lower, closer to the legal minimum. The study concludes, "The situation gets worse along the supply chain" (Lübcke). In a globalized economy it obviously is impossible to include all steps of the supply chain in the producer's scope of responsibility. Yet, the responsibility of the producer must include at least a part of the supply chain.

The state plays a crucial role in defining the macroeconomic framework and conditions for economic activities in all continents. Reasonable laws and their enforcement, together with a transparent and faithful court system, are the most important pillars to encourage fair and responsible business activities. International organizations and conventions such as the legal framework of the WTO, the ILO conventions, the Kyoto protocol and UN conventions- above all the UN Universal Declaration of

Human Right build an important framework for all economic activities in a globalized economy, because these frameworks give all member states equal opportunities and obligations.

Consumers have enormous purchasing power (Zhou, 2006). Their influence on companies preferentially buying bio-products and fair trade-labeled products is substantial not only in industrialized countries, but also in countries with transitional economic systems and in developing countries. This trend results from the growing numbers of middle class consumers (Stückelberger, 2003). Information systems of state public and private media play a crucial role. Companies often change their environmental or social strategy and behavior only after an international audience views public reports and scandals. Also government officials, consumers and other actors can not assume their respective responsibilities if they have no access to relevant information. Information and communication are a pivotal pre-condition and foundation for ethically responsible behavior.

Investors play probably the most important role of all actors in influencing the strategy and responsibility or irresponsibility of companies. As long as they do not include social and environmental criteria in their rating of companies, companies are not pressured forcefully enough to emphasize companies' social responsibilities. But when the stock market reacts to a scandal, such as river pollution of a river by a company, companies understand the message immediately. Socially responsible investments, (SRI) therefore are important and already well-established instruments that push for responsibility in business.

ETHICAL STANDARDS AND BEHAVIOR AS A PROCESS

As a rule, the rating of companies (producers, traders) or consumers by ethical standards assesses certain conduct, as well as important features of a company or person at a certain point in time. Ratings use defined benchmarks to measure whether a company satisfies or does not satisfy certain financial, ecological, and social criteria. Accordingly, a company may be granted a fair-trade or bio label, meet an ISO standard, be given a score from a rating agency for ethical investment, or sign a code of conduct and give evidence of compliance with the code of conduct.

This static view of performance ratings is helpful and often necessary for measurability of ethical conduct. However, the performance ratings must be complemented by a process-oriented approach (Stückelberger, 2003). Concerning the factual improvement of conduct, the direction in which a company, non-governmental organization or government institution is moving is of equal importance. If an agent is moving in the direction of a relatively more ethical type of conduct, this must be rated positively in ethical terms even if he is still lagging behind others. If, say, an industry that has traditionally damaged the environment has made efforts to contribute to the solution of the problem, such efforts may be even greater than those of a service industry which has few environmental problems and satisfies environmental criteria more easily.

This relational view regards the present practice of an organization not only in regard to an absolute point of reference but assesses it in relation to the agent's point of departure. Even if the point of departure is unsatisfactory, a framework of fundamental values in terms of required legal obligations and minimum standards must still be respected. Above this level, process-oriented labels such as "transitional labels" may be given. They characterize "companies in transition" with more ethical conduct and can later lead to a "full" label of ethical conduct.

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THE PROLIFERATION OF PRODUCT PLACEMENT AS A MEANS OF ADVERTISING COMMUNICATION

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Abstract: This paper will examine the growth and rebirth of product placement, a technique being practiced in the communication process of marketing. It will examine various models of product placement and present some reasons why it is ethically problematic in regard to protecting the consumer.

Keywords: marketing, consumer behavior, advertising, product placement

The purpose of advertising is to communicate a manufacturer's or brand's message to the consumer base. This message includes relaying the attributes and benefits of the product and its value to the consumer via words, symbols, pictures and sometimes price. Traditionally, we have seen the flow of this communication disseminated from the company through specific media bases (print, television, radio, billboards, and so on) directly to the targeted consumer.

NEW COMMUNICATION CHALLENGES

Today there is a multiplicity of channels from which consumers can and are receiving messages. Due to technological advances and a shifting emphasis from product centricity to consumer centricity, consumers get their information about products not only from traditional advertising methods, but through word of mouth, blogs, the competition, their own researches, and their individual past experience and brand communities, all of which are widely available to them. In many cases consumers sustain no direct contact with the firm as they make purchasing decisions.

This phenomenon shapes the way consumers look at products. It influences buying behavior and buying decisions, and subsequently changes the way advertisers, (whether independent or in-house) have to advertise. The strategy of selecting and purchasing prime time spots to advertise your brand and brand message to the consumer no longer proves effective. DVRs and TIVO allow people watching a program to fast forward and escape the intended message entirely.

The question for a company or brand becomes: what changes have to be made to better fit the communication model to our advantage? Without altering the model, the brand or company has no idea who initiates, receives, and interprets the message. More importantly, they don't know the full response to it. This confusion causes companies to play catch-up, to look for alternative methods to capture the consumer's attention, because they don't know what was said and how it was heard. The new model has resulted in a company's loss of communication control.

Reliance on a fully integrated marketing approach is always necessary to build customer awareness, loyalty, brand equity and market share. Because of this recent communication shift in advertising, now more than ever, a brand or manufacturer needs to perfect this fully integrated marketing approach. This means media, website, TV, direct marketing campaigns, product placement, celebrity endorsements,

sponsorships, etc. all have to work together and deliver the same coherent message to the targeted audience.

GROWTH OF PRODUCT PLACEMENT

One of the most recent changes in marketing is the emphasis placed on product placement. While this certainly is not a new phenomenon, its importance has grown tremendously. Product placement used to be seen as a supplemental way of getting a company's brand message or name across to the consumer. At one point, television shows and movies went out of their way to disguise the brand of soft drink an actor was drank, food that he/she prepared, cars driven, etc. However, placing a branded product in entertainment allows the consumer to identify more completely with the story line. As a result we have seen product placement appear in TV shows, movies and books. In an article from Brandchannel.com, PQMedia found that 24% of all product placement deals were free in 1975. By 2005, that amount was 3.4% (Manning-Schaffer, 2006).

A massive change has occurred. Product placement, originally considered simply an additional way to market now appears to be a key aspect of marketing strategy. Firms worldwide try to find new ways to not only engage consumers but to encourage consumers to form an emotional attachment to their product. Their goal is two fold, to get the message of the product to the consumer and to create a revenue stream. The revenue stream resulting from product integration is a two-sided phenomenon, as the brand benefits from additional exposure and sales of the highlighted product and the production company receives various types of compensation for placing the product. According to research compiled by PQ Media, the value of global paid product placement spending in television, film and other media is expected to climb from \$2.21B in 2005 to \$7.55 by 2010.

Two examples of product placement which prove the growth of this phenomenon- movies and television- are Procter & Gamble's Crest in the television show, "The Apprentice" and the appearance of GM's vehicles in the movie "Transformers." TVX tracked the placement of Procter and Gamble's (P&G's) Crest toothpaste during "The Apprentice," a popular TV series. The toothpaste's appearance scored the equivalent of 10.8 commercials, which would translate into \$4.2M cost for the company. The success of the show guaranteed viewers would take notice of the product (Manning-Schafel, 2006). In the recently released movie, "Transformers," the vehicles prominently placed in the film, not the actors, were the main feature. GM Corporation's Camaro, Solstice, Topkick and Hummer H2 had starring roles and took on various human characteristics, thereby allowing the viewer to connect with his or her favorite. This was a conscious team effort by GM and DreamWorks/Paramount. GM is currently seeking the younger demographic of 18 to 34 year old viewers for its vehicles and the film capitalizes on a toy grouping popular in the 1980's (Householder, 2007). The collaboration created a mutually beneficial match for the automotive maker and the story line. According to industry press reports, there was no direct payment for the vehicles being featured in the movie. Instead, the movie was promoted in GM's ads. The film's director directed five ads for the automotive giant (Householder, 2007).

LEGAL CONSTRAINTS

The amount of product placement allowed depends on the legal constraints of the country where the ad will run. Most often a nation will place bans on products directed toward children or the elderly, groups

traditionally seen to be most vulnerable. According to the Brandweek article, the United States, by far, exhibits the most product placement, followed by Brazil, Australia, France and Japan. In the EU, there are differences in the prevalence of product placement. Spain commonly uses this practice while Germany is a critic of its application (Laitner, 2007). Paid product placement is expected to grow substantially in Europe due to relaxing regulations and the passage of the “Television Without Frontiers” directive, despite the fact that numerous European consumer groups have called for its ban. (Carvagil, 2005, 2006). The marketplaces of China and India are considered to be two of the key growth markets for this venue, due to increased brand awareness by the consumer base and marketing firms looking to diversify their mode of promotional activities in those countries. This method of reaching the consumer leads to the establishment of an emotional attachment between the customer and the product or brand resulting in the ability to create buzz and ultimately, increased market share.

CELEBRITY PRODUCT PLACEMENT

The intended impact of product placement has increased with the combination of celebrity placement. Brands and marketers have long used celebrities as spokespersons for their wares, some more successfully than others. Celebrity product placement differs from celebrity endorsement as with the latter, consumers realize they are seeing an advertisement in which the celebrity is compensated. With celebrity product placement, free products are distributed with the expectation that the celebrity will be seen using the product, thus leading to increased sales of the brand. This process of combining a celebrity with a brand becomes an additional impetus for the targeted customer to identify with and purchase the highlighted item. How does this occur and how does this serve as an added endorsement? Since the celebrity is seen wearing or using the product, it appears to the consumer that this product was the choice of the celebrity. Companies have gone to quite exorbitant lengths to capitalize on this. At the Academy Awards, last year, two gift bags contained products worth over \$110,000 each. Products such as Gucci sunglasses, Sprint phones, and Lacroix watches were enclosed (Holiff, 2005).

VIRTUAL

Product placement can appear and influence customers in an even more understated fashion. Walt Disney advertised “little Einsteins” DVDs for preschoolers on the paper liners of examination tables in pediatricians’ offices, according to Louise Story’s article (2007). Supply Marketing gave doctors free supplies in exchange for the use of branded products. While a pediatrician is not a celebrity in the traditional sense, he is seen as someone of authority by those utilizing his services, and thus perceived to have sound judgment. The doctor’s use of liner promoting Disney reminds the patient and caregiver of the company’s offering. Brands such as M&M’s, Skittles, Hershey Kisses, and Oreo, among others, have created learning books for children (Neer, 2007). While none of these brands are experts in education, using their products as learning tools for young children reinforces the brand in the child’s mind.

Product placement has now extended from the traditional entertainment venues of TV and film into the virtual world via Ad-placement in video games. These ads serve as a means to have the game player constantly see the brand’s name or logo while engaged in play. As most video games are played and replayed and consequently become favorites of their owner, this method of product placement serves to constantly reinforce the brand’s name in the consumers’ mind and thus build brand equity for the firm.

This, in turn, causes an individual player to achieve what every marketer covets, a customer's emotional connection to the brand.

REVERSE PRODUCT PLACEMENT

In addition, what seems to be emerging is a type of reverse product placement. Fictional products placed in games have emerged into the real world. "Square Enix, publisher of the Final Fantasy video game franchise partnered with Suntory to market an energy drink, Potion, in Japan, with the intention of carrying through an idea directly taken from the game, where characters drink a 'health potion' which restores their strength" (Edery, 2006, p.1). Should marketers take heed of this trend and act on it, endless marketing opportunities could present themselves and firms could save a tremendous amount of resources in market research and product development, among other brand equity activities.

It is undeniable that marketing has become driven by consumer interaction, and the customer, as a result, demands and expects this. Many video games today, WWE SmackDown vs. Raw and Tony Hawk Skateboarding, for example, allow the player to construct a wardrobe for his or her character. Noticing this trend, brands have positioned themselves in video games. "In Def Jam: Icon, a player who's earned enough cash can outfit his character in a pair of distressed Phat Farm jeans, a baby blue Ecko T-shirt, Air Jordan high tops, and a yellow Puma running jacket" (Healy, 2007).

In addition to building brand recognition and loyalty, the consumer's selection of specific styles and colors allows the manufacturer to assess the popularity of a particular item before or while launching it. It also augments the power of the consumer. Once the player has selected or created apparel for the game's character, he or she feels that coveted sense of ownership, which can translate into a sales transaction in the store. In addition, the player/consumer can subsequently place this character on a blog, thus gaining additional free product placement for the manufacturer when other bloggers view it. In all these scenarios, the consumer is never evaluating the benefit of using the product. The consumer is reacting to the setting in which the product is displayed and used by an authoritative presence. The consumer is reacting in an emotional manner.

ETHICAL CONSIDERATIONS IN MARKETING

The question which arises is how ethical is this? How much attention does the consumer pay to the identification of paid product placement if companies were forced to comply as a form of legal regulation? How can country norms be taken into consideration? How aware are consumers that the product they see in their favorite film or TV show or video game, with their favorite actor using it, is not necessarily something that celebrity would select or use if left to their own devices? Consumers are, to a degree, a predictable group in terms of shopping behavior despite all the talk about shifts in consumer power. To some degree they still take their cues from ad messages and campaigns they constantly encounter and absorb. A recently conducted study by Yankelovich, a market research firm, states that a city dweller sees over 5000 marketing messages per day (Story, 2007). Certainly in industrialized societies, where consumers are plagued daily or even hourly with a myriad of marketing messages, a new technique to try to reach them has to be quite startling and more importantly, engaging, in order to grab their attention, spur them into action and result in increased sales for the company. Product placement helps to achieve this.

Consumers have transitioned from traditional print ads to celebrity endorsements with ease. These methods are no longer new or noteworthy. They no longer work to engage the consumer. Both methods have served to spur on a purchase. In print ads, copy was written to relate exactly what the manufacturer or brand wanted to relay to the consumer. Celebrity endorsement allowed the consumer to think that a person of authority, a popular, well known person, gave approval to this product. This approval served as validation for the consumer in making the purchase. Does paid product placement continue this process? And if it does, is it really adhering to marketing ethics?

The American Marketing Association states that it “commits itself to promoting the highest standard of professional ethical norms and values for its members. In this role, marketers should embrace the highest ethical norms of practicing professionals and the ethical values implied by their responsibility toward stakeholders” (AMA, 2004). It continues “We will represent our products in a clear way in selling, advertising and other forms of communication; this includes the avoidance of false, misleading and deceptive promotion” (AMA, 2004). The Direct Marketing of Asia Association echoes this credo by stating, “Representations which, by their size, placement, duration, or other characteristics are unlikely to be noticed or are difficult to understand, should not be used. And all offers should be clear, honest and complete so that the consumer may know the exact nature of the what is being offered” (Direct Marketing of Asia Association, 2007).

These views are repeated by the European Association of Advertising Communications which claims to “promote honest, effective advertising, high professional standards, and awareness of the contribution of advertising in a free market economy and to encourage close co-operation between agencies, advertisers and media in European advertising bodies” (European Association of Advertising Communications, 2007). What these three organizations have in common is the concrete adherence to protecting the consumer. Does paid product placement protect the consumer? Does it adhere to these ethical standards? Should it be seen simply as a natural progression in advertising?

It would seem to be ethically problematic as the consumer is not even aware that what he is seeing is actually a well thought out and calculated advertising method. He or she is basically unconscious to what is happening and is being conditioned to respond to a very subtle pitch. The message is not in any of the traditional forms the consumer is used to seeing. There is no print media in which the ad is positioned, no catch phrase in the copy to read, no jingle heard in the background.

The impact of product placement on audiences will vary, of course, depending upon their level of sophistication, familiarity with ad campaigns, and longevity in making purchase decisions. Consumers in developing nations (especially those who engage in aspirational buying) as well as children are two groups with limited purchasing patterns, therefore, calling the technique of product placement into question. In the example of the Suntory /Square Enix partnership to launch the drink Potion, the consumer makes a decision to purchase the beverage based on having seen fictional characters in a game restored to health after the consumption of the Potion drink. Yet, these characters have no credibility. They are not real and the positive results of the characters’ ingestion of the health potion are virtual. Still, the consumer, who in many cases can be a child, without a long history of purchase decision-making, is not assessing this. The child is reacting only to what he or she has seen happen within a game setting and this is what urges him or her on, creates the desire, and drives him or her to make the purchase. Suntory launched two versions of the drink. One was contained in a regular bottle; the other packaged with a

Final Fantasy XII “art card.” The latter reinforces the connection for the consumer (Edery, 2006). The firm continued this practice, with the release of a limited edition drink, Final Fantasy VII 10th edition, to celebrate the 10th anniversary of the game’s release.

It would seem that this practice of advertising and promotion does not fall within the guidelines each of the previously mentioned marketing associations claim when they state their goals are to present products clearly when selling and advertising, to have advertisements be easily understood by the consumer base, and to have the consumer base know exactly what is being offered. Whether and how this can be better regulated becomes a question for individual countries and governments to make as each country’s culture, norms and consumers’ purchasing patterns differ.

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THE ETHICAL CHALLENGES FOR ENTERPRISE AND RISKS TO CONSUMERS OF LARGE MARKET SHARE THROUGH LOW-COST SUPPLIER STRATEGY

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Abstract: A corporate strategy of high market share, through being a low-cost supplier and rushing to market, carries ethical risks to the corporation and consumers. There are several examples of US corporations that engaged in low-cost strategy and rushed to market, compromising product quality as well as consumer interests in the process. These companies suffered long-term, negative consequences. Recently, China has experienced lapses in product quality that have injured consumers and are likely associated with attempts to achieve market penetration, if not market dominance, through strategically serving as a low-cost supplier. Lessons can be learned from the example of earlier debacles in policies and programs implemented to minimize the risks of a high-market share/ low cost supplier strategy. Specific recommendations are suggested to ensure product safety.

Keywords: product safety, product quality, consumer, low cost supplier, strategy

A corporate strategy of achieving high market share can pose ethical risks to a corporation, particularly when companies serve as a low-cost supplier to achieve large market share. Interests of consumers can be injured under such circumstances. Moreover, rush to market is sometimes a means of achieving high market share. There is a sound rationale for a rush to market. Often a company which is the first, or an early entrant to a market, achieves high market share. A low cost supplier strategy combined with a strategy of early market entrant can be a formula for market dominance. With the “flattening” of the world,¹ global sourcing has increased, and China is a major beneficiary. For example, Wal-Mart, the world’s largest manufacturer and retailer, produces 70% of its products in China; Wal-Mart is China’s single largest customer.² In addition, China produces 70% of the world’s toys.³

SINO-US INTERNATIONAL TRADE IN 2007

Recent events have raised concerns that some Chinese companies produce products harmful to consumers. The use of raw materials prohibited in the United States for consumer products (perhaps in violation of manufacturer standards) poses the risk that the ultimate consumers or purchasers of Chinese made goods will lose trust in the products. For example, during the summer 2007, there were successive waves of recalls of children’s toys resulting from the use of leaded-paint as part of the manufacturing process. The lead paint recalls follow on the heels of pet food contamination with a toxic ingredient melamine, and the fraudulent use of an industrial chemical replacing glycerin in tooth paste. The substitution of this industrial chemical, diethylene glycol, for glycerin in tooth paste causes kidney damage.⁴ Thousands of pets sickened or died from tainted pet food when an industrial chemical

melamine was added as filler.⁵ An upsurge in the sale of toys manufactured in the United States has been reported, indicating that global consumers, particularly US consumers, can readily switch their buying habits to support different product manufacturers.

An American manufacturer reported an upsurge of orders for his children's toys, similar to the Thomas & Friends wooden train sets recalled by RC2 Corporation of Oak Brook, Illinois. This upsurge has extended to other American based toy manufacturers. The loss of sales by Mattel, RC2 Corporation and other manufacturers is likely to lead to closer monitoring of their China-based plants and of sub-contractors/ suppliers, as well as possible severance of relationships. Although Mattel has not severed its sub-contract relationship with one sub-contractor involved in the incident of lead-painted toys, Early Light Industrial Co., Mattel has terminated its relationship with Hong Li Da (HLD), which had been sub-contracted the painting of the toys by Early Light Industrial.⁶

RISKS OF RUSH TO MARKET: CASE STUDIES

Lessons can be learned from corporate debacles resulting from utilizing low cost suppliers and rushing to market. For example, Beechnut apple juice used a low cost supplier whose prices were 25% under the going rate for apple juice concentrate. Beechnut (an American company) marketed its baby apple juice as 100% juice, even though there were strong indications, including an internal whistleblower, that the concentrate was not a natural product. Beechnut was prosecuted for fraud in the late 1980's. This case provided the first instance where American executives were jailed as a result of fraud. However, in the end, the executives' sentences were overturned due to an appeal concerning the jurisdiction of the trial court.

Rush to market, in an effort to achieve market dominance for small, American-made fuel efficient cars led Ford (the American automotive company) under the leadership of Lee Iacocca, to market a defectively designed car, the Ford Pinto. The Ford Pinto was developed and brought to market in 24 months, weighed under 2000 lbs and sold at a cost of \$2000 U.S. Ford engineers conducted tests that showed that a low impact rear collision would cause the precariously placed gas tank to catch on fire and explode. Ford executives decided not to recall, redesign, or repair the gas tank. It would have cost about \$11 per vehicle to install a rubber bladder inside the gas tank to prevent leaks. Instead the Ford executives decided that they would pay damages to the burn victims.⁷ Ford was wrong about its "cost-benefit" analysis, because U.S. juries awarded huge punitive damages. Moreover, Ford was prosecuted in the state of Indiana for reckless homicide. Ford was ultimately acquitted of the criminal reckless homicide charges after its trial in Indiana.⁸

POSITIVE EXAMPLES OF CRISIS MANAGEMENT

An alternative model for the management of contaminated or defective products is the case of Johnson and Johnson's handling of the Tylenol poisonings. In 1982 a number of deaths resulted from product tampering. Cyanide was inserted into the Tylenol capsules; this product tampering was enabled because the product was not sealed, allowing the poisoner access to the Tylenol capsules. In response to this crisis, the CEO of Johnson and Johnson company (J&J), (the corporate parent of the subsidiary company manufacturing Tylenol) broadly recalled the product, and re-designed the packaging to hinder product tampering.⁹ In undertaking the broad recall, J&J risked its market share in the analgesic market, and its

stock price. Although J&J's stock declined drastically after the recall, J&J's stock price and Tylenol's market share increased. J&J's corporate culture and corporate mission, embodied in its Credo which puts the interests of consumers first, has been credited as the basis for J&J's management of the Tylenol crisis.¹⁰

Moreover, a good model could be provided by Nike, a company that uses sub-contractors as an essential component of its corporate production strategy. Nike was criticized for the conditions of its sub-contractor factories, which were characterized as sweat-shops.¹¹ To resolve the criticisms, Nike developed and implemented sub-contractor codes of conduct and inspection systems.¹² Nike is now widely respected for the rehabilitation of its sub-contractor factory conditions.

RECOMMENDATIONS TO STAKEHOLDERS USING LOW COST SUPPLIER STRATEGY

1. Punish the wrongdoers. For example, the head of China's Food and Drug Administration was executed for taking bribes and for approving sub-standard products.¹³ The head of a company responsible for Mattel's recall of Dora the Explorer and other toys manufactured for the Fischer Price division of Mattel, committed suicide in August 2007,¹⁴ which can be speculated to result from the desire to avoid punishment. But this is not enough in itself. Holding the executives of companies responsible for the injuries caused by their products is a good start, and certainly sends a message to other executives to prevent the same kinds of injuries from occurring. However, the root causes of the problems must be corrected.

2. Develop Enterprise Mission Statements and Codes of Conduct. Enterprise mission statements and codes of conduct embody the commitment of a company to its stakeholders, particularly its customers. The Johnson and Johnson Credo served to guide the company and its managers during the Tylenol poisoning crisis. Similarly, Nike developed a Code of Conduct and a Supplier Code of Conduct to remediate the criticisms that the factories where its products were manufactured were operated as sweatshops.

3. Develop warranties and insurance. Suppliers should warrant against fraud, so that materials not to specifications would be at the cost of the supplier, not borne by the purchaser. For instance, the law governing warranty of merchantability is well developed in the United States. Prevailing law in the United States carries an implied warranty of merchantability. Implied warranty means that the expectations of consumers of a product that it is "reasonably suited for ordinary use" must be met, and that the manufacturer is liable to the buyer for damages if their product as manufactured is not "reasonably suited for ordinary use."¹⁵ Contracts between merchandisers such as Mattel or Wal-Mart and their subcontractors could include an explicit designation of US or EU law to govern warranties of merchantability in their choice of law clause. Damages could thus be collected in such cases as the substitution of lead paint on children's toys, melamine filler in pet food and diethylene glycol for glycerin in tooth paste. Since the substitution of low cost materials appears to be so rampant, the Chinese government could guarantee the insurance systems created for such crisis situations. Making the Chinese government ultimately liable for the breaches of its burgeoning private enterprise sector would likely increase the vigilance of Chinese state regulators.

4. Monitor supplier sub-contractors closely. It is recommended that Chinese suppliers monitor their sub-contractors, such as Early Light Industrial Company's sub-contracted relationship with Hong

Li Da. The Chinese suppliers should develop contracts and inspection systems which reflect the contract specifications between the supplier and its customer.

5. Punitive damages should result when products harm consumers. The development of a legal system that includes punitive damages and criminal prosecution for knowingly or recklessly using materials or designing products that will harm the consumer.¹⁶

6. Develop and enforce manufacturing standards. Multinational companies such as American companies doing business in China should include contractual clauses to require that manufacturing must be done in conformity to the production standards of the recipient customer, rather than the standards of the sourced factories. Contracts should also include choice of law clauses specifying that contract enforcement and litigation be done under the law system of the recipient customer.

7. Insist on right of inspection of sub-contracting activities. It is recommended that contracts of specifications for suppliers and supplier sub-contract include specification requirements subject to rejection by the corporate recipient of manufactured goods. A requirement should also exist that supplier sub-contracting must be approved by the customer. The contract should state that the cost of goods produced that are not in conformity with specifications will be borne by the supplier, including the out of specification production by sub-contractors arranged by the supplier.

8. Institute testing and documentation procedures. It is recommended that control procedures be instituted that include testing and documentation at all levels of the supply chain and documentation of all raw materials in the supply chain. Documentation and testing results should accompany the products at all stages in the supply chain. The inspection documentation should be bi-lingual or multi-lingual, in the language of the inspector and of the purchaser as to simplify the inspection process for quality control inspectors. In cases where a sub-contractor is producing products for a contractor, the documentation should be in the language of the merchandiser for which the products are being made.

9. Develop industry codes. It is recommended that industry codes such as the codes developed by the Pharmaceutical Industry and Toy Manufacturers' Association be developed for the Chinese industry, especially when the industry or product is at high risk for design defects or where products are inherently dangerous. For example, the Chain Saw Manufacturers' Association is an industry association that voluntarily develops standards for chain saws, an inherently dangerous product. Such a model can come from within China or be adapted to the Chinese situation.

10. Develop Government Regulatory Codes. It is recommended that government units develop regulatory codes. Such regulatory codes should include the right of testing and inspection by a governmental unit, as well as the right to close manufacturing operations, the right to recall unsafe or contaminated products and the right to fine or jail managers in extreme cases.

11. Development and implementation of international protocols. It is recommended that international protocols on the production of children's toys and food products be marketed and implemented internationally. These rules might prohibit the use of lead paint and known toxic materials and require documentation at all levels of the supply chain. Such conventions were developed, for example, for the marketing of infant formula and cigarettes, under the auspices of the World Health Organization (WHO).¹⁷ A United States-Sino Product Safety Summit was held in September 2007; it was agreed at the Summit that lead paint in children's toys is prohibited.¹⁸

Loss of trust by consumers, decline of sales, more pervasive and more detailed control procedures,

and loss of business will likely be the result of fraudulent supplier and manufacturing practices such as the ones detailed herein. Corrective and control measures to prevent future wrongdoing will raise the costs of doing business in China, and may erode some of China's competitive edge in the world market. However such measures are necessary if China is to remain integrated in the global economy and its enterprises are to do business in a socially responsible and ethical manner. The ethical challenges experienced by China present the opportunity for Chinese-based enterprises to return to traditional Chinese ethical culture, Confucian history, and honor-based transactions. As China joins the global economy, the traditional norms of friendship (pengyou-pengyou relationships) must prevail with its global trading partners.

Jun Zi Ai Cai Qu Zi You Dao!¹⁹

NOTES

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15. The Uniform Commercial Code provides, with respect to implied warranties: “§ 2-314. Implied Warranty: Merchantability; Usage of Trade. (1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale. (2) Goods to be merchantable must be at least such as (a) pass without objection in the trade under the contract description; and (b) in the case of fungible goods, are of fair average quality within the description; and (c) are fit for the ordinary purposes for which such goods are used; and (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and (e) are adequately contained, packaged, and labeled as the agreement may require; and (f) conform to the promise or affirmations of fact made on the container or label if any. (3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.” Available at <http://www.law.cornell.edu/ucc/2/2-314.html>.
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