



Chapter 3

ETHICS AND SOCIAL RESPONSIBILITY

OBJECTIVES OF THE CHAPTER

Recent concerns about ethics and social responsibility transcend national borders. In this era of globalization MNCs must be concerned with how they carry out their business and their social role in foreign countries. This chapter examines business ethics and social responsibility in the international arena, and it looks at some of the critical social issues that will be confronting MNCs in the years ahead. The discussion includes ethical decision making in various countries, regulation of foreign investment, the growing trends toward environmental sustainability, and current responses to social responsibility by today's multinationals. The specific objectives of this chapter are:

- 1. EXAMINE** ethics in international management and some of the major ethical issues and problems confronting MNCs.
- 2. DISCUSS** some of the pressures on and actions being taken by selected industrialized countries and companies to be more socially and environmentally responsive to world problems.
- 3. EXPLAIN** some of the initiatives to bring greater accountability to corporate conduct and limit the impact of corruption around the world.

The World of *International Management*

GE's Imagination: Strategic CSR

General Electric corporation (GE) has refocused its business model to capitalize on the growing demand for products and services that respond to social and environmental challenges while also contributing to GE's "bottom line." This "strategic" approach to corporate social responsibility (CSR) is becoming increasingly common among companies seeking to show that they are responsible to concerns about their social and environmental footprint, while also approaching social and environmental challenges from the perspective of commercial opportunity. At GE, this focus has taken the form of two corporatewide initiatives: "ecomagination" and "healthymagination."

Ecomagination is a GE strategic initiative to use innovation to improve energy efficiency across the globe. By meeting the demand for "green" products and services, GE is generating value for shareholders as well as promoting environmental sustainability. According to GE's 2009 Annual Report, healthymagination is "GE's six-year, \$6 billion commitment to healthcare innovation that will help deliver better care to more people at lower cost" around the world. Through both of these initiatives, GE has reached beyond what is required of an MNC in order to make a difference in the world. GE recognizes that the global society at large is an important stakeholder of its multinational business.

Projects in Process

The following are specific examples of GE's ecomagination and healthymagination at work.

At a GE Hitachi Nuclear Energy power plant in North Carolina, a new wastewater system "has reduced water usage by 25 million gallons annually, avoiding nearly 80 tons per year of CO₂ emissions and realizing annual savings of \$160,000 in water and energy costs." GE's

ecomagination ZeeWeed® membrane bioreactor (MBR) technology transforms up to 65,000 gallons per day of wastewater into treated water that can be used in the facility's cooling towers.

GE Jenbacher engines capture gas from various fuel sources, even garbage, to create power. Jenbacher engines are at the core of a Mexican landfill gas to energy project, which President Felipe Calderón called "a model renewable energy project" for Latin America. This project's power supports "Monterrey's light-rail system during the day and city street lights at night."

In addition, GE's Flight Management System (FMS) for Boeing 737 planes has enabled airlines to lower fuel costs and reduce emissions. According to the GE ecomagination 2008 Annual Report, "The FMS enables pilots to determine, while maintaining a highly efficient cruise altitude, the exact point where the throttle can be reduced to flight idle while allowing the aircraft to arrive precisely at the required runway approach point without the need for throttle increases." SAS Scandinavian Airlines estimates that FMS will save the airline \$10 million annually.

With GE's Qualibria™ computerized system, a doctor making patient rounds will receive an alert if a "patient's reading falls out of normal range—and each alert is fueled by the full patient record, including case history and best care recommendations." In addition, doctors at even remote clinics have real-time access to "evidence-based best practices in use at the largest medical centers" by using Qualibria™.

Further, GE researchers are developing new technology for magnetic resonance imaging systems (MRI) that will enable more than 10,000 hospitals around the world to have MRIs for the first time. MRIs currently use cryogenic liquids which require a particular type of venting and room specifications. These specifications are costly. If researchers are successful in developing a cryogen-free magnet for MRIs, millions more people could have access to MRIs.

GE's new product Vscan has the potential to revolutionize health care in the developing world. Vscan is a "pocket-sized visualization tool that . . . [provides] an immediate look inside the body to help speed detection and diagnosis." According to healthymagination advisor board member and former U.S. senator Bill Frist, "With [Vscan's] small size and powerful capabilities, it can provide a view into the body that used to take a room full

of equipment to produce. The access to vital information like this in the field will give healthcare providers a valuable tool in assessing diseases and injuries quicker, which will undoubtedly save lives."

Strategic Commitments

Because GE seeks to make ecomagination and healthymagination part of its long-term business strategy, it has identified specific commitments to make its overall goals a reality. In GE's 2008 Annual Report for Ecomagination, GE shared its strategic performance targets:

1. Increase revenues from ecomagination products
From its more than 80 ecomagination product offerings, GE earned revenues of \$17 billion in 2008. By 2010, GE aims to grow its ecomagination revenues to \$25 billion.
2. Double investment in R&D
GE invested \$1.4 billion in "green" technology research in 2008. By 2010, GE aims to invest \$1.5 billion in R&D (twice the \$750 million it invested in 2005).
3. Reduce greenhouse gas (GHG) emissions and improve the energy efficiency of GE's operations
GE reduced its intensity of GHG emissions by 30 percent in 2008. By 2012, GE aims to reduce its absolute GHG emissions worldwide by 1 percent and improve its energy efficiency by 30 percent (both versus 2004 levels).
4. Reduce water use and improve water reuse
GE aims to reduce its water consumption by 20 percent by 2010 versus its 2006 water usage.
5. Keep the public informed
GE increased awareness in several ways, including ecomagination.com and a Superbowl commercial.

GE described its Healthymagination key commitments in its 2009 Healthymagination Annual Report:

1. Work with partners to focus innovations on critical needs.
2. Expand employee health efforts.

3. Invest \$3 billion in R&D, \$2 billion in financing, and \$1 billion in technology and content by 2015.
4. Increase the “value gap.”
GE has focused on its key cost drivers to reduce its healthcare costs.
5. Engage and report on healthymagination progress.
GE has promoted healthymagination through healthymagination.com and the healthymagination Facebook group.

Doing Well by Doing Good

Not only has GE worked to solve two of the most pressing issues facing our world today (energy and health care), but it has also generated tremendous cost savings for GE and its customers in doing so. GE has reduced its costs by over \$100 million through ecomagination since 2005. By investing in “green” technology, GE is investing in the future. GE’s ecomagination 2008 Annual Report states, “By some estimates, the total green component of all global stimulus programs now exceeds \$400 billion.” A growing sector of the world economy will certainly be the “green sector” and GE is well-positioned to take advantage of this opportunity.

According to CEO Jeffrey R. Immelt and Vice President of ecomagination Steven M. Fludder, “ecomagination is playing a role in boosting economic recovery, supporting the jobs of the future, improving the environmental impact of our customers’ (and our own) operations,

furthering energy independence, and fostering innovation and growth in profitable environmental solutions.”

GE has made it possible for U.S. hospitals to cut their costs by a total of \$91 million by simplifying processes and “ensur[ing] the right tools are on hand to address patient needs.” Since 98 percent of this cost was recurring annually, GE has “worked with hospital partners to take out almost half a billion in unnecessary cost over the next five years.” Through healthymagination, GE has achieved two goals at once: (1) It has expanded access to better quality health care in underprivileged communities, and (2) it has improved its reputation as a company. GE has demonstrated its global mindset by helping health-care providers everywhere from the Appalachian region of Kentucky to Kijabe, Kenya.

GE’s ecomagination and healthymagination are significant examples of corporate social responsibility. Yet, some have criticized GE for not going far enough in its ecological commitment. Stuart Hart and Mark Milstein of Cornell University argue that GE’s ecomagination includes few “Beyond Greening” elements—initiatives that truly transform the enterprise and its business model. Hart and Milstein do acknowledge, however, that ecomagination includes some of these “Beyond Greening” elements, such as offshore wind turbines, residential solar electric power systems, and desalination technology. At any rate, GE can serve as one example to international managers seeking to incorporate strategic CSR into their businesses.

Our opening discussion of GE demonstrates how corporations are shifting their focus from traditional market-responsive strategies to broader approaches that incorporate both business and social or environmental goals. GE has radically transformed its business to focus on what it expects to be increasing demand for “green” products as well as those that contribute to improved health care, especially in poorer and rural areas. “Ecomagination” called attention to GE’s commitment to contributing to a more sustainable economy via its development of clean energy and other environmentally sensitive technologies. Its “healthymagination” initiative is focused, in part, on developing and deploying low-cost equipment, such as portable ultrasound and EKG/ECG equipment. By combining its commitment to social and environmental sustainability with its business and commercial objectives, GE appears to be setting an example for a new approach to integrating social and business goals among global corporations, tapping into consumers’ desire for products and services that are consistent with their values. This “triple bottom line” approach, which simultaneously considers social, environmental, and economic sustainability (“people, planet, profits”) could make a real and lasting impact on the world’s human and environmental conditions by harnessing business and managerial skills and techniques.

More broadly, recent scandals have called attention to the perceived lack of ethical values and corporate governance standards in business. In addition, assisting impoverished countries by helping them gain a new level of independence is both responsible and potentially profitable. Indeed, corporate social responsibility is becoming more than just good moral behavior. It can assist in avoiding future economic and environmental setbacks and may be the key to keeping companies afloat.

■ Ethics and Social Responsibility

The ethical behavior of business and the broader social responsibilities of corporations have become major issues in the United States and all countries around the world. Ethical scandals and questionable business practices have received considerable media attention, aroused the public's concern about ethics in international business and brought attention to the social impact of business operations.

Ethics and Social Responsibility in International Management

Unbiased ethical decision-making processes are imperative to modern international business practices. It is difficult to determine a universal ethical standard when the views and norms in one country can vary substantially from others. **Ethics**, the study of morality and standards of conduct, is often the victim of subjectivity as it yields to the will of cultural relativism, or the belief that the ethical standard of a country is based on the culture that created it and that moral concepts lack universal application.¹

The adage “When in Rome, do as the Romans do” is derived from the idea of cultural relativism and suggests that businesses and the managers should behave in accordance with the ethical standards of the country they are active in, regardless of MNC headquarter location. It is necessary, to some extent, to rely on local teams to execute under local rule; however, this can be taken to extremes. While a business whose only objective is to make a profit may opt to take advantage of these differences in norms and standards in order to legally gain leverage over the competition, it may find that negative consumer opinion about unethical business practices, not to mention potential legal action, could affect the bottom line. Dilemmas that arise from conflicts between ethical standards of a country and business ethics, or the moral code guiding business behavior, are most evident in employment and business practices, recognition of human rights, including women in the workplace, and corruption. The newer area of corporate social responsibility (CSR) is closely related to ethics. However, we discuss CSR issues separately. Ethics is the study of or the learning process involved in understanding morality, while CSR involves taking action. Furthermore, the area of ethics has a lawful component and implies right and wrong in a legal sense, while CSR is based more on voluntary actions. Business ethics and CSR may be therefore viewed as two complementary dimensions of a company's overall social profile and position.

ethics

The study of morality and standards of conduct.

Ethics Theories and Philosophy

There are a range of ethical theories and approaches around the world, many emanating from religious and cultural traditions. We focus on the cultural factors in Part Two of the book. Here we review three tenets from Western philosophy, and briefly describe Eastern philosophy, which can be used to evaluate and inform international management decisions. The nearby International Management in Action feature explores how these perspectives might be used to inform the ethics of a specific international business decision.

Kantian philosophical traditions argue that individuals (and organizations) have responsibilities based on a core set of moral principles that go beyond those of narrow self-interest. In fact, a Kantian moral analysis rejects consequences (either conceivable or likely) as morally irrelevant when evaluating the choice of an agent: “The moral worth of an action does not lie in the effect expected from it, nor in any principle of action which requires to borrow its motive from this expected effect.”² Rather, a Kantian approach asks us to consider our choices as implying a general rule, or maxim, that must be evaluated for its consistency as a universal law. For Kant, what is distinctive about rational behavior is not that it is self-interested or even purpose driven, though all actions do include some purpose as part of their explanation. Instead, rational beings, in addition

to having purposes and being able to reason practically in their pursuit, are also capable of evaluating their choices through the lens of a universal law, what Kant calls the moral law, or the “categorical imperative” (Kant 1949). From this perspective, we ought always to act under a maxim that we can will consistently as a universal law for all rational beings similarly situated.

Aristotelian virtue ethics focus on core, individual behaviors and actions and how they express and form individual character. They also consider social and institutional arrangements and practices in terms of their contribution to the formation of good character in individuals. A good, or virtuous, individual does what is right for the right reasons and derives satisfaction from such actions because his or her character is rightly formed. For Aristotle, moral success and failure largely come down to a matter of right desire, or appetite: “In matters of action, the principles of initiating motives are the ends at which our actions are aimed. But as soon as people become corrupted by pleasure or pain, the goal no longer appears as a motivating principle: he no longer sees that he should choose and act in every case for the sake of and because of this end. For vice tends to destroy the principle or initiating motive of action.”³ It is important to have an understanding of what is truly good and practical wisdom to enable one to form an effective plan of action toward realizing what is good; however, absent a fixed and habitual desire for the good, there is little incentive for good actions. There is also an important social component to virtue theory insofar as one’s formation is a social process. The exemplars and practices one finds in one’s cultural context guide one’s moral development. Virtue theory relies heavily on existing practices to provide an account of what is good and what character traits contribute to pursuing and realizing the good in concrete ways.

Utilitarianism—a form of consequentialism—favors the greatest good for the greatest number of people under a given set of constraints.⁴ A given act is morally correct if it maximizes utility, that is, if the ratio of benefit to harm (calculated by taking everyone affected by the act into consideration) is greater than the ratio resulting from an alternative act. This theory was given its most famous modern expression in the works of Jeremy Bentham (1788) and John Stuart Mill (1803), two English utilitarians writing in the 18th and 19th centuries, both of whom emphasized the greatest happiness principle as their moral standard.⁵ Utilitarianism is an attractive perspective for business decision making, especially in Western countries, because its logic is similar to an economic calculation of utility or cost-benefit, something many Western managers are accustomed to doing.

Eastern philosophy, which broadly can include various philosophies of Asia, including Indian philosophy, Chinese philosophy, Iranian philosophy, Japanese philosophy and Korean philosophy tend to view the individual as part of, rather than separate from, nature. Many Western philosophers generally assume as a given that the individual is something distinct from the entire universe, and many Western philosophers attempt to describe and categorize the universe from a detached, objective viewpoint. Eastern perspectives, on the other hand, typically hold that people are an intrinsic and inseparable part of the universe, and that attempts to discuss the universe from an objective viewpoint, as though the individual speaking were something separate and detached from the whole, are inherently absurd.

In international management, executives may rely upon one or more of these perspectives when confronted with decisions that involve ethics or morality. While they may not invoke the specific philosophical tradition by name, they likely are drawing from these fundamental moral and ethical beliefs when advancing a specific agenda or decision. The nearby International Management in Action box regarding an offshoring decision shows how a given action could be informed by each of these perspectives.

Human Rights

Human rights issues present challenges for MNCs as there is currently no universally adopted standard of what constitutes acceptable behavior. It is difficult to list all rights inherent to humanity since there is considerable subjectivity involved, and cultural

The Ethics of an Offshoring Decision

The financial services industry has been especially active in offshoring. Western investment banks including Citigroup, Deutsche Bank, Goldman Sachs, Credit Suisse and UBS have established back-office functions in India. JP Morgan was the first to offshore staff to the country in 2001 and has more than 8,000 staff in Mumbai, nearly 5 percent of its 170,000 employees worldwide. In October 2007, Credit Suisse announced the expansion of its center of excellence in Pune, India, with 300 new jobs, bringing staff numbers to 1,000 by December. Deutsche Bank has 3,500 staff in Bangalore and Mumbai. UBS began outsourcing work to third-party information technology vendors in 2003 and has 1,220 employees in Hyderabad and Mumbai. Goldman Sachs started offshoring to India three years ago and has about 2,500 employees there. On October 17, 2007, JP Morgan announced plans to build a back-office workforce of 5,000 in the Philippines over the next two years. Its traditional offshoring center of Mumbai in India has become overcrowded by investment banks that have set up similar operations. The bank will develop credit card and treasury services in the Philippines. A source close to the bank said the move was to diversify its back-office locations and because JP Morgan has strong links with a human resources network in the country. Mark Kobayashi-Hillary, an outsourcing specialist, said: "Because India's finance center is almost wholly based in Mumbai, the resources are finite and there is a supply and demand problem. It's no surprise people are looking elsewhere. But banks are not just after keeping costs down; these moves are also strategic." He said he was surprised that banks had not opened more offices in

the Philippines, considering its strong links with the U.S., cheap rent and wealth of resources. "In Manila there is a high density of people who have worked in the financial sector with the skills that investment banks look for. We should see more banks setting up shop there soon."

Ethical philosophy and reasoning could be used to inform offshoring decisions such as these. A *Kantian* approach to offshoring would require us to consider a set of principles in accord with which offshoring choices were made such that decisions were measured against these core tenets, such as a corporate code of conduct. A *virtue theory* perspective would suggest that the decision should consider the impact on communities and a goal of humans flourishing more generally; such an analysis could include economic as well as social impacts. A *utilitarian* perspective would urge that benefits and costs be measured; e.g., who is losing jobs, who is gaining, and do the gains (either measured in jobs, income, utility, quality of life) outweigh the losses. An *Eastern* philosophical approach would suggest a broader, more integrative and longer term view, considering impacts not just on humans but also on the broader natural environment in which they operate.

Taken together, an understanding of these ethical perspectives could help managers to decide how to make their own ethical decisions in the international business environment.

Source: Jonathan Doh and Bret Wilmot, "The Ethics of Offshoring," working paper, Villanova University, 2010.

differences exist among societies. Some basic rights include life, freedom from slavery or torture, freedom of opinion and expression, and a general ambiance of nondiscriminatory practices.⁶ One violation of human rights that resonated with MNCs and made them question whether to move operations into China was the violent June 1989 crackdown on student protesters in Beijing's Tiananmen Square. Despite this horrific event, most MNCs continued their involvement in China, although friction still exists between countries with high and low human rights standards. Even South Africa is beginning to experience the healing process of transitioning to higher human rights standards after the 1994 dismantling of apartheid, the former white government's policy of racial segregation. Unfortunately, human rights violations are still rampant worldwide. For several decades, for example, Russia has experienced widespread human trafficking, but this practice has accelerated in recent years.⁷ Here, we take a closer look at women in the workplace.

Women's rights and gender equity can be considered a subset of human rights. While the number of women in the workforce has increased substantially worldwide, most are still experiencing the effects of a "glass ceiling," meaning that it is difficult, if not impossible, to reach the upper management positions. Japan is a good example, since both harassment and a glass ceiling have existed in the workplace. Sexual harassment also remains a major social issue in Japan. Many women college graduates in Japan are

still offered only secretarial or low-level jobs. Japanese management still believes that women will quit and get married within a few years of employment, leading to a two-track recruiting process: one for men and one for women.⁸ Japan ranked 101st in the “gender gap index” study by the World Economic Forum, an international nonprofit organization, which measured the economic opportunities and political empowerment of women by nation in 2009. Iceland ranked no. 1, and the U.S. was no. 31. Japanese women make up 9 percent of senior executives and managers, a tiny share compared with 43 percent in the U.S., 17 percent in China, and 38 percent in France, according to data from the International Labor Office compiled by Catalyst Inc., a New York–based nonprofit that pushes for business opportunities for women. There is some evidence that women are beginning to assume managerial positions in some industries, but Japan has a long way to go in this regard.⁹

Equal employment opportunities may be more troubled in Japan than other countries, but the glass ceiling is pervasive throughout the world. Today, women earn less than men for the same job in the United States, although progress has been made in this regard. France, Germany, and Great Britain have seen an increase in the number of women not only in the workforce but also in management positions. Unfortunately, women in management tend to represent only the lower level and do not seem to have the resources to move up in the company. This is partially due to social factors and perceived levels of opportunity or lack thereof. The United States, France, Germany, and Great Britain all have equal opportunity initiatives, whether they are guaranteed by law or are represented by growing social groups. Despite the existence of equal opportunity in French and German law, the National Organization for Women in the United States, and British legislation, there is no guarantee that initiatives will be implemented. It is a difficult journey as women attempt to make their mark in the workplace, but soon it may be possible for them to break through the glass ceiling.

Labor, Employment, and Business Practices

Labor policies vary widely among countries around the world. Issues of freedom to work, freedom to organize and engage in collective action, and policies regarding notification and compensation for layoffs are treated differently in different countries. Political, economic, and cultural differences make it difficult to agree on a universal foundation of employment practices. It does not make much sense to standardize compensation packages within an MNC that spans both developed and underdeveloped nations. Elements such as working conditions, expected consecutive work hours, and labor regulations also create challenges in deciding which employment practice is the most appropriate. For example, the low cost of labor entices businesses to look to China; however, workers in China are not well paid, and to meet the demand for output, they often are forced to work 12-hour days, seven days a week. In some cases, children are used for this work. Child labor initially invokes negative associations and is considered an unethical employment practice. The reality is that of the 215 million children age 5–17 working globally in 2009, most are engaged in work to help support their families.¹⁰ In certain countries it is necessary for children to work due to low wages. UNICEF and the World Bank recognize that in some instances family survival depends on all members working; and that intervention is necessary only when the child’s developmental welfare is compromised. There has been some progress in the reduction of child labor. It continues to decline, especially among girls, but only modestly. Child labor was reduced by 10 percent from 2000 to 2004 and an additional 3 percent from 2004 to 2008. There has also been considerable progress in the ratification of ILO standards concerning child labor, namely of Conventions 182 (on the worst forms of child labor) and 138 (on minimum age). However, one-third of the children in the world live in countries that have not ratified these conventions.¹¹

In early 2010, the issue of relatively low wages paid by Chinese subcontractors made the headlines after a number of suicides by workers at factories run by Foxconn,

one of the largest contractors for electronics firms such as Apple, and a strike by workers at a Honda plant. As a result of these controversies, Foxconn, which employs more than 800,000 workers in China making products for companies such as Dell, Hewlett-Packard, and Apple, agreed to raise its base wage by more than 30 percent. Earlier, Honda had raised wages at some of its factories by 24 percent.¹² Some analysts believe these higher wages, combined with the longstanding shortage of and high turnover of factory workers in China, will eventually result in the lowest wage manufacturing moving to other countries, such as Vietnam, while higher value-added production will remain in China.

Environmental Protection and Development

Conservation of natural resources is another area of ethics and social responsibility in which countries around the world differ widely in their values and approach. Many poor, developing countries are more concerned with improving the basic quality of life for their citizens than worrying about endangered species or the quality of air or water. There are several hypotheses regarding the relationship between economic development, as measured by per capita income, and the quality of the natural environment. The most widely accepted thesis is represented in the Environmental Kuznets Curve (EKC), which hypothesizes that the relationship between per capita income and the use of natural resources and/or the emission of wastes has an inverted U-shape. (See Figure 3–1.) According to this specification, at relatively low levels of income the use of natural resources and/or the emission of wastes increase with income. Beyond some turning point, the use of the natural resources and/or the emission of wastes decline with income. Reasons for this inverted U-shaped relationship are hypothesized to include income-driven changes in (1) the composition of production and/or consumption; (2) the preference for environmental quality; (3) institutions that are needed to internalize externalities; and/or (4) increasing returns to scale associated with pollution abatement. The term EKC is based on its similarity to the time-series pattern of income inequality described by Simon Kuznets in 1955. A 1992 World Bank Development Report made the notion of an EKC popular by suggesting that environmental degradation can be slowed by policies that protect the environment and promote economic development. Subsequent statistical analysis, however, showed that while the relationship might hold in a few cases, it could not be generalized across a wide range of resources and pollutants.¹³

Despite improvements in environmental protection and ethical business practices, many companies continue to violate laws and/or jeopardize safety and environmental concerns in their operations. The tragic 2010 Gulf of Mexico oil rig explosion and leak has underscored the importance of continued vigilance when it comes to the environment, health, and safety as well as the disastrous consequences for companies such as BP, which appears to have cut corners when it came to these considerations. The nearby A Closer Look feature provides a timeline of the devastating BP Gulf of Mexico oil rig explosion and leak and its impact.

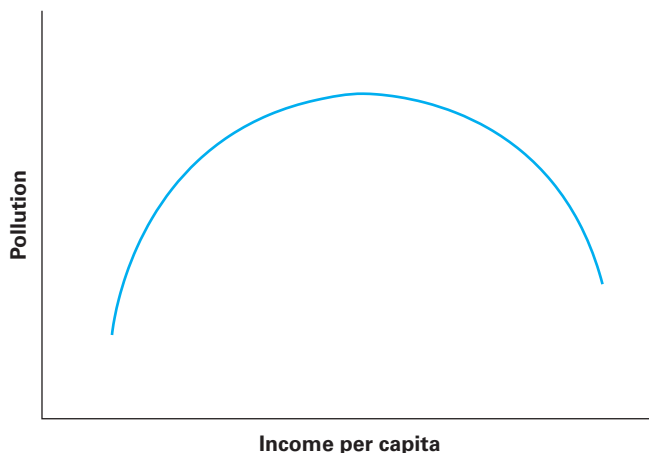


Figure 3–1
The Environmental Kuznets Curve

Anatomy of a Disaster: Key Events in 2010 BP Oil Spill, the Largest in History

Below is a timeline of the BP oil spill in the Gulf of Mexico and its impact.

April 20, 2010: Explosion and fire on Transocean Ltd's drilling rig Deepwater Horizon licensed to BP; 11 workers are killed. The rig was drilling in BP's Macondo project 42 miles southeast of Venice, Louisiana, beneath about 5,000 feet of water and 13,000 feet under the seabed.

April 22: The Deepwater Horizon rig, valued at more than \$560 million, sinks and a 5-mile-long oil slick forms.

April 25: Efforts to activate the well's blowout preventer fail.

April 29: U.S. President Barack Obama pledges "every single available resource," including the U.S. military, to contain the spreading spill and says BP is responsible for the cleanup.

April 30: An Obama aide says no drilling will be allowed in new areas, as the president had recently proposed, until the cause of the Deepwater Horizon accident is known. BP Chief Executive Tony Hayward says the company takes full responsibility and will pay all legitimate claims and the cost of the cleanup.

May 2: Obama visits the Gulf Coast. U.S. officials close areas affected by the spill to fishing for 10 days. BP starts drilling a relief well alongside the failed well, a process that may take two to three months to complete.

May 7: An attempt to place a containment dome over the spewing well fails when the device is rendered useless by frozen hydrocarbons that clogged it.

May 9: BP says it might try to plug the under-sea leak by pumping materials, such as shredded tires and golf balls, into the well at high pressure, a method called a "junk shot."

May 11/12: Executives from BP, Transocean, and Halliburton appear at congressional hearings in Washington. The executives blame each other's companies.

May 14: Obama slams companies involved in the spill, criticizing them for a "ridiculous spectacle" of publicly trading blame over the accident in his sternest comments yet.

May 16: BP inserts a tube into the leaking riser pile of the well and captures some oil and gas.

May 19: The first heavy oil from the spill hits fragile Louisiana marshlands. Part of the slick

enters a powerful current that could carry it to the Florida Keys and beyond.

May 26: A "top kill" maneuver starts, involving pumping drilling mud and other material into the well shaft to try to stifle the flow.

May 28: Obama tours the Louisiana coast, saying, "I am the president and the buck stops with me." BP CEO Tony Hayward flies over the Gulf.

May 29: BP says the complex "top kill" maneuver to plug the well has failed, crushing hopes for a quick end to the largest oil spill in U.S. history on its 40th day.

June 1: BP shares plunge 17 percent in London trading, wiping \$23 billion off its market value, on news the latest attempt to plug the well has failed. U.S. Attorney General Eric Holder says the Justice Department has launched a criminal and civil investigation into the rig explosion and the spill.

June 2: BP tries another capping strategy but has difficulty cutting off a leaking riser pipe. U.S. authorities expand fishing restrictions to cover 37 percent of U.S. federal waters in the Gulf.

June 4: Obama, on his third trip to the region, warns BP against skimping on compensation to residents and businesses.

June 7: BP, which says it has now spent \$1.25 billion on the spill, sees shares gain on news of the progress in containing the leak.

June 8: Obama says he wants to know "whose ass to kick" over the spill, adding to the pressure on BP. U.S. weather forecasters give their first confirmation that some of the oil leaking has lingered beneath the surface rather than rising to the top.

June 9: U.S. Interior Secretary Ken Salazar says BP must pay the salaries of thousands of workers laid off by a moratorium on drilling, at a congressional hearing.

June 10: The White House says that Obama has invited BP Chairman Carl-Henric Svanberg to the White House on June 16 to discuss the spill. In his first comments, Prime Minister David Cameron says Britain is ready to help BP deal with the spill. U.S. scientists double their estimates of the amount of oil gushing from the well, saying between 20,000 and 40,000 barrels (840,000 and 1.7 million gallons/3.2 million and 6.4 million liters) of oil flowed from the well before June 3.

August 4: After several unsuccessful efforts BP is able to stop the leak by injecting mud

and in so doing, pushing crude back to the source.

June 11: Supportive comments from Britain lift BP's shares in London gaining 6.4 percent. However, the rise does not mend damage done to BP shares—the company is worth 70 billion pounds (\$102 billion) against over 120 billion pounds in April.

June 14: Obama, on his fourth trip to the Gulf, says he will press BP executives at a White House meeting on June 16 to deal “justly, fairly and promptly” with damage claims. Under intense pressure, BP unveils a new plan to vastly boost the amount of oil it is siphoning off. Two U.S. lawmakers release a letter to BP CEO Hayward saying: “It appears that BP repeatedly chose risky procedures in order to reduce costs and save time and made minimal efforts to contain the added risk.”

June 15: Lawmakers summon top executives from Exxon Mobil, Chevron, ConocoPhillips, Royal Dutch Shell and BP in what is likely to be a heated showdown on the safety of drilling in the deep waters off America's coasts. Obama says in his first televised speech from the Oval Office in the White House: “But make no mistake: we will fight this spill with everything we've got for as long it takes. We will make BP pay for the damage their company has caused. And we will do whatever's necessary to help the Gulf Coast and its people recover from this tragedy.”

June 16: The White House and BP announce agreement on the establishment of a \$20 billion compensation fund for victims of the Gulf oil spill to be headed by Kenneth Feinberg.

Source: David Cutler, London Editorial Reference Unit, Reuters, <http://www.reuters.com/article/idUSTRE65F05V20100616>.

■ Globalization and Ethical Obligations of MNCs

All this conjures the question, How much responsibility do MNCs have in changing these practices? Should they adopt the regulations in the country of origin or yield to those in the country of operation? One remedy could be to instill a business code of ethics that extends to all countries, or to create contracts for situations that may arise. The nearby International Management in Action box regarding Johnson & Johnson underscores how, despite a strong commitment to ethics and social responsibility in its “credo,” J&J found itself the subject of numerous safety and quality problems which resulted in lawsuits and severely tarnished its reputation.

“Doing the right thing” is not always as simple as it appears. Levi Strauss experienced this issue in the early 1990s with its suppliers from Bangladesh. Children under the age of 14 were working at two locations, which did not violate the law in Bangladesh, but did go against the policy of Levi Strauss. Ultimately, Levi Strauss decided to continue paying the wages of the children and secured a position for them once they reached the age of 14, after their return from schooling.¹⁴ While the level of involvement is hard to standardize, having a basic set of business ethics and appropriately applying it to the culture in which one is managing is a step in the right direction. Managers need to be cautious not to blur the lines of culture in these situations. The Prince of Wales was once quoted as saying, “Business can only succeed in a sustainable environment. Illiterate, poorly trained, poorly housed, resentful communities, deprived of a sense of belonging or of roots, provide a poor workforce and an uncertain market.”¹⁵ Businesses face much difficulty in attempting to balance organizational and cultural roots with the advancement of globalization.

One recent phenomenon in response to globalization has been not just to offshore low-cost labor-intensive practices, as described in Chapter 1, but to transfer a large percentage of current employees of all types to foreign locations. The inexpensive labor available through offshore outsourcing in India has aided many institutions, but has also put a strain on some industries, particularly home-based technology services. Accenture, a company specializing in management consulting, technology services, and outsourcing, moved almost 22 percent of its employees to India by August 2007 in hopes of avoiding dwindling revenues and stock prices due to the continuous investment in India. With labor costs in

Johnson & Johnson's Challenges with Ethical Business Practices

The corporate credo of Johnson & Johnson follows:

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

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

We are responsible to the communities in which we will live and work and to the world community as well. We must be good citizens—support good works and charities and bear our fair share of taxes. We must encourage civic improvements and better health and education. We must maintain, in good order, the property we are privileged to use, protecting the environment and natural resources.

Johnson & Johnson (J&J) has experienced its fair share of ethical dilemmas over the past 25 years. The first occurred in 1982 in Chicago, Illinois, when bottles of extra-strength Tylenol capsules were found to be laced with cyanide. J&J looked to its credo of "the customer always comes first," and quickly responded to the tragedy only three days after the second tainted bottle was discovered. A recall of an estimated 31 million bottles swept the nation and lightened J&J's wallet

as it experienced losses of about \$100 million and an almost 30 percent drop, bringing it to single digits, in market share for pain relievers. By 1986 an almost full recovery showed J&J with a 33 percent market share for pain relievers when another unfortunate poisoning occurred. At this point, J&J recalled all Tylenol capsules and still maintained 96 percent of sales despite the setback. J&J is often cited for its impressive response to this crisis. More recently, J&J disclosed that "improper payments in connection with the sale of medical devices" were made in some units. Adding insult to injury, Janssen, a J&J subsidiary, inappropriately marketed a psychiatric product targeted for use in children, resulting in a combined \$117 million in costs to the Texas Medicaid program. More recently, J&J has faced several scandals. In January 2010, the U.S. Justice Department charged J&J with paying millions of dollars in kickbacks to Omnicare, the nation's largest pharmacy that specializes in dispensing drugs to nursing home patients so its Risperdal antipsychotic would be widely prescribed. In April 2010, J&J's Ortho-McNeil Pharmaceutical and Ortho-McNeil-Janssen Pharmaceuticals subsidiaries agreed to pay \$81 million in order to resolve criminal and civil lawsuits charging the units with illegally promoting the Topamax epilepsy drug for so-called off-label use. The government alleged that the company promoted Topamax for off-label psychiatric uses through a program called "Doctor-for-a-Day" in which the J&J unit hired outside physicians to join sales reps in visiting other doctors and to speak at meetings and dinners about prescribing Topamax for unapproved uses and doses. Also in April 2010, the FDA found quality problems at a J&J facility, prompting a broad-based recall affecting about 70 percent of the market for over-the-counter paediatric liquid medications, including Tylenol, Motrin, Benadryl and Zyrtec, among dozens of others. Why is Johnson & Johnson facing continued problems of this sort? Is the credo helping J&J to resolve these issues?

Source: Johnson & Johnson website, <http://www.pharmalot.com>.

India at less than half of those in the United States, Accenture is already gaining the competitive advantage by offering similar low-cost services, but with consulting expertise that is not yet matched by Indian cohorts. Accenture recognized the rising competition early, and careful strategies have enabled it to maintain, if not gain, a foothold in India.¹⁶

The transfer of the labor force overseas creates an interesting dynamic in the scope of ethics and corporate responsibility. While most international managers concern themselves with understanding the social culture in which the corporation is enveloped and how that can mesh with the corporate culture, this recent wave involves the extension of an established corporate culture into a new social environment. The difference here is that the individuals being moved offshore are part of a corporate citizenship, meaning that they will identify with the corporation and not necessarily the outside environment;

the opposite occurs when the firm moves to another country and seeks to employ local citizens. Accenture proves that it is possible to succeed with such an effort, but as more and more companies follow suit, other questions and concerns may arise. How will the two cultures work together? Will employees adhere to the work schedule of the home or the host country? Will the host country be open or reluctant to an influx of new citizens? The latter may not be a current concern due to the infrequency of offshoring, but MNCs may face a time when they have to consider more than just survival of the company. One must also bear in mind the effects these choices will have on both cultures.

Reconciling Ethical Differences across Cultures

As noted in the introduction to this section, ethical dilemmas arise from conflicts between ethical standards of a country and business ethics, or the moral code guiding business behavior. Most MNCs seek to adhere to a code of ethical conduct while doing business around the world, yet must make some adjustments to respond to local norms and values. Navigating this natural tension can be challenging. One approach advocated by two prominent business ethicists suggests that there exist implied social contracts that generally govern behavior around the world, some of which are universal or near universal. These “hyper” norms include fundamental principles like respect for human life, or abstention from cheating, lying, and violence. Local community norms are respected within the context of such hyper norms, when they deviate from one society to another.

This approach, called “Integrative Social Contracts Theory” (ISCT), attempts to navigate a moral position that does not force decision makers to engage exclusively in relativism versus absolutism. It allows substantial latitude for nations and economic communities to develop their unique concepts of fairness, but draws the line at flagrant neglect of core human values. It is designed to provide international managers with a framework when confronted with a substantial gap between the apparent moral and ethical values in the country in which the MNC is headquartered and the many countries in which it does business. Although ISCT has been criticized for its inability to provide precise guidance for managers under specific conditions, it nonetheless offers one approach to helping reconcile a fundamental contradiction in international business ethics.¹⁷

Corporate Social Responsibility and Sustainability

In addition to expectations that they adhere to specific ethical codes and principles, corporations are under increasing pressure to contribute to the societies and communities in which they operate and to adopt more socially responsible business practices throughout their entire range of operations. **Corporate social responsibility (CSR)** can be defined as the actions of a firm to benefit society beyond the requirements of the law and the direct interests of the firm.¹⁸ It is difficult to provide a list of obligations since the social, economic, and environmental expectations of each company will be based on the desires of the stakeholders. Pressure for greater attention to CSR has emanated from a range of stakeholders, including civil society (the broad societal interests in a given region or country) and from **nongovernmental organizations (NGOs)**. These groups have urged MNCs to be more responsive to the range of social needs in developing countries, including concerns about working conditions in factories or service centers and the environmental impacts of their activities.¹⁹ As a result of recent ethics scandals and concerns about the lack of corporate responsibility, trust in business is at one of the lowest levels on record in the U.S. and Europe (see Figure 3–2).²⁰

Many MNCs such as Intel, HSBC, Lenovo, and others take their CSR commitment seriously. These firms have integrated their response to CSR pressures into their core business strategies and operating principles around the world (see the section “Response to Social and Organizational Obligations” below and the Internet Exercise later in this chapter).

Civil Society, NGOs, MNCs, and Ethical Balance The emergence of organized civil society and NGOs has dramatically altered the business environment globally and

corporate social responsibility (CSR)

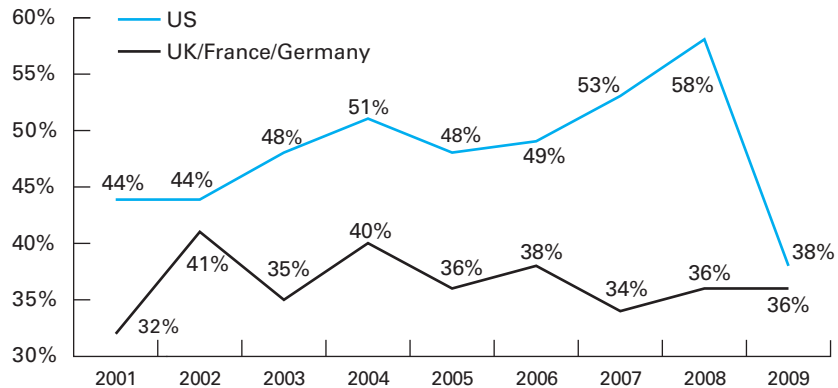
The actions of a firm to benefit society beyond the requirements of the law and the direct interests of the firm.

nongovernmental organizations (NGOs)

Private, not-for-profit organizations that seek to serve society’s interests by focusing on social, political, and economic issues such as poverty, social justice, education, health, and the environment.

Figure 3–2

Response to Question:
“How much do you trust
business to do what’s
right?”



Source: Edelman Trust Barometer 2009, <http://www.edelman.com/trust/2009/>.

the role of MNCs within it. Although social movements have been part of the political and economic landscape for centuries, the emergence of NGO activism in the United States during the modern era can be traced to mid-1984, when a range of NGOs, including church and community groups, human rights organizations, and other antiapartheid activists, built strong networks and pressed U.S. cities and states to divest their public pension funds of companies doing business in South Africa. This effort, combined with domestic unrest, international governmental pressures, and capital flight, posed a direct, sustained, and ultimately successful challenge to the white minority rule, resulting in the collapse of apartheid.

Since then, NGOs generally have grown in number, power, and influence. Large global NGOs such as Save the Children, Oxfam, CARE, World Wildlife Fund, and Conservation International are active in all parts of the world. Their force has been felt in a range of major public policy debates, and NGO activism has been responsible for major changes in corporate behavior and governance. Some observers now regard NGOs as a counterweight to business and global capitalism. NGO criticisms have been especially sharp in relation to the activities of MNCs, such as Nike, Levi's, Chiquita, and others whose sourcing practices in developing countries have been alleged to exploit low-wage workers, take advantage of lax environmental and workplace standards, and otherwise contribute to social and economic problems. Three recent examples illustrate the complex and increasingly important impact of NGOs on MNCs.

In January 2004, Citigroup announced it would no longer finance certain projects in emerging markets identified by the Rainforest Action Network (RAN) as damaging to the environment. This announcement came after several years of aggressive pressure and lobbying by RAN, including full-page advertising in daily newspapers showing barren landscapes and blackened trees, lobbying by film and television personalities urging consumers to cut up their credit cards, blockades of Citigroup branches, and campaigns involving schoolchildren who sent cards to Citigroup's chairman, Sanford Weil, asking him to stop contributing to the extinction of endangered species.²¹ After heavy lobbying from NGOs, in August 2003, the U.S. pharmaceutical industry dropped its opposition to relaxation of intellectual property provisions under the WTO to make generic, low-cost antiviral drugs available to developing countries facing epidemics or other health emergencies²² (see the In-Depth Integrated Case at the end of Part One). In November 2009, after nearly two years of student campaigning in coordination with the apparel workers, a Honduran workers' union concluded an agreement with Russell Athletics, the apparel manufacturer owned by Fruit of the Loom, that puts all of the workers back to work, provides compensation for lost wages, recognizes the union and agrees to collective bargaining, and provides access for the union to all other Russell apparel plants in Honduras for union organizing drives in which the company will remain neutral. According to a November 18, 2009, press release of USAS, this has been an "unprecedented victory for labor rights" (see the related In-Depth Integrated Case at the end of Part One).²³

Many NGOs recognize that MNCs can have positive impacts on the countries in which they do business, often adhering to higher standards of social and environmental responsibility than local firms. In fact, MNCs may be in a position to transfer “best practices” in social or environmental actions from their home to host countries’ markets. In some instances, MNCs and NGOs collaborate on social and environmental projects and in so doing contribute both to the well-being of communities and to the reputation of the MNC. The emergence of NGOs that seek to promote ethical and socially responsible business practices is beginning to generate substantial changes in corporate management, strategy, and governance.

Response to Social and Organizational Obligations MNCs are increasingly engaged in a range of responses to growing pressures to contribute positively to the social and environmental progress of the communities in which they do business. One response is the agreements and codes of conduct in which MNCs commit to maintain certain standards in their domestic and global operations. These agreements, which include the U.N. Global Compact (see Table 3–1), the Global Reporting Initiative, the social accountability “SA8000” standards, and the ISO 14000 environmental quality standards, provide some assurances that when MNCs do business around the world, they will maintain a minimum level of social and environmental standards in the workplaces and communities in which they operate.²⁴ These codes help offset the real or perceived concern that companies move jobs to avoid higher labor or environmental standards in their home markets. They may also contribute to the raising of standards in the developing world by “exporting” higher standards to local firms in those countries.

Another interesting trend among businesses and NGOs is the movement toward increasing the availability of “fairly traded” products. Beginning with coffee and moving

Table 3–1
Principles of the Global Compact

Human Rights

Principle 1: Support and respect the protection of international human rights within their sphere of influence.

Principle 2: Make sure their own corporations are not complicit in human rights abuses.

Labor

Principle 3: Freedom of association and the effective recognition of the right to collective bargaining.

Principle 4: The elimination of all forms of forced and compulsory labor.

Principle 5: The effective abolition of child labor.

Principle 6: The elimination of discrimination with respect to employment and occupation.

Environment

Principle 7: Support a precautionary approach to environmental challenges.

Principle 8: Undertake initiatives to promote greater environmental responsibility.

Principle 9: Encourage the development and diffusion of environmentally friendly technologies.

Anticorruption

Principle 10: Business should work against all forms of corruption, including extortion and bribery.

Source: Reprinted by permission of the United Nations Global Compact.

Fair Trade helps farming families across Latin America, Africa, and Asia to improve the quality of life in their communities. Fair Trade Certification empowers farmers and farm workers to lift themselves out of poverty by investing in their farms and communities, protecting the environment, and developing the business skills necessary to compete in the global marketplace. Fair Trade is much more than a fair price. Fair Trade principles include:

- **Fair price:** Democratically organized farmer groups receive a guaranteed minimum floor price and an additional premium for certified organic products. Farmer organizations are also eligible for pre-harvest credit.
- **Fair labor conditions:** Workers on Fair Trade farms enjoy freedom of association, safe working conditions, and living wages. Forced child labor is strictly prohibited.
- **Direct trade:** With Fair Trade, importers purchase from Fair Trade producer groups as directly as possible, eliminating unnecessary middlemen and empowering farmers to develop the business capacity necessary to compete in the global marketplace.
- **Democratic and transparent organizations:** Fair Trade farmers and farm workers decide

democratically how to invest Fair Trade revenues.

- **Community development:** Fair Trade farmers and farm workers invest Fair Trade premiums in social and business development projects like scholarship programs, quality improvement trainings, and organic certification.
- **Environmental sustainability:** Harmful agrochemicals and GMOs are strictly prohibited in favor of environmentally sustainable farming methods that protect farmers' health and preserve valuable ecosystems for future generations.

TransFair USA, a nonprofit organization, is the only independent, third-party certifier of Fair Trade products in the U.S. and one of 20 members of Fairtrade Labeling Organizations International (FLO). TransFair's rigorous audit system, which tracks products from farm to finished product, verifies industry compliance with Fair Trade criteria. TransFair allows U.S. companies to display the Fair Trade Certified label on products that meet strict Fair Trade standards. Fair Trade Certification is currently available in the U.S. for coffee, tea and herbs, cocoa and chocolate, fresh fruit, sugar, rice, and vanilla.

fair trade

An organized social movement and market-based approach that aims to help producers in developing countries obtain better trading conditions and promote sustainability.

sustainability

Development that meets current needs without harming the future.

to chocolate, fruits, and other agricultural products, **fair trade** is an organized social movement and market-based approach that aims to help producers in developing countries obtain better trading conditions and promote sustainability. See the nearby A Closer Look box for a discussion of fair trade systems and products.

Sustainability In the boardroom, the term **sustainability** may first be associated with financial investments or the hope of steadily increasing profits, but for a growing number of companies, this term means the same to them as it does to an environmental conservationist. Partially this is due to corporations recognizing that dwindling resources will eventually halt productivity, but the World Economic Forum in Davos, Switzerland, has also played a part in bringing awareness to this timely subject. While the January 24, 2007, gathering obviously put profit at the top of the agenda, it was closely followed by the concern for global warming and environmentally damaging practices, marking a new era with sustainability as a high priority concern.²⁵

While the United States has the Environmental Protection Agency to provide information about and enforce environmental laws,²⁶ the United Nations also has a division dedicated to the education, promotion, facilitation, and advocacy of sustainable practices and environmentally sound concerns called the United Nations Environment Programme (UNEP).²⁷ The degree to which global awareness and concern are rising extends beyond laws and regulations, as corporations are now taking strides to be leaders in this "green" movement.

Walmart, one of the most well-known and pervasive global retailers (see In-Depth Integrative Case in Part Two), has begun to recognize the numerous benefits of the adage, “Think globally, act locally.” Working with environmentalists, it discovered that many changes in production and supply chain practices could reduce waste and pollution and therefore reduce costs. By cutting back on packaging, Walmart saves an estimated \$2.4 million a year, 3,800 trees, and 1 million barrels of oil. Over 80,000 suppliers compete to put their products on Walmart shelves, which means that this company has a strong influence on how manufacturers do business. And Walmart’s efforts are truly global. The company is buying solar and wind power in Mexico, sourcing local food in China and India, and analyzing the life cycle impact of consumer products in Brazil. Alleviating hunger has become a goal of Walmart’s charitable efforts, and so with CARE it is backing education, job-training, and entrepreneurial programs for women in Peru, Bangladesh, and India. Walmart is attempting to change global standards as it offers higher prices to coffee growers in Brazil and increases pressures on the factory owners in China to reduce energy and fuel costs.²⁸ As noted in this chapter’s opening discussion, GE has pursued an aggressive initiative to integrate environmental sustainability with its business goals through the “ecomagination” program. Management styles again are changing as agendas are refocused on not only seeing the present but also looking to the future of human needs and the environment.

Corporate Governance

The recent global, ethical and governance scandals have placed corporations under intense scrutiny regarding their oversight and accountability. Adelphia, Arthur Andersen, Enron, Global Crossing, Parmalat, Tyco, and UnitedHealth are just a few of the dozens of companies that have been found to engage in inappropriate and often illegal activities related to governance. In addition, a number of financial services firms, including Credit Suisse, Deutsche Bank, Lehman Brothers, Citigroup, and many others have been found to have engaged in inappropriate trading or other activities. Corporate governance is increasingly high on the agenda for directors, investors, and governments alike in the wake of financial collapses and corporate scandals in recent years. The collapses and scandals have not been limited to a single country, or even a single continent, but have been a global phenomenon.

Corporate governance can be defined as the system by which business corporations are directed and controlled.²⁹ The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation—such as the board, managers, shareholders, and other stakeholders—and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance.

Governance rules and regulations differ among countries and regions around the world. For example, the UK and U.S. systems have been termed “outsider” systems because of dispersed ownership of corporate equity among a large number of outside investors. Historically, although institutional investor ownership was predominant, institutions generally did not hold large shares in any given company; hence they had limited direct control.³⁰ In contrast, in an insider system, such as that in many continental European countries, ownership tends to be much more concentrated, with shares often being owned by holding companies, families, or banks. In addition, differences in legal systems, as described in Chapter 2, also affect shareholders’ and other stakeholders’ rights and, in turn, the responsiveness and accountability of corporate managers to these constituencies. Notwithstanding recent scandals, in general, North American and European systems are considered comparatively responsive to shareholders and other stakeholders. In regions with less well-developed legal and institutional protections and poor property rights, such as some countries in Asia, Latin America, and Africa, forms of

corporate governance

The system by which business corporations are directed and controlled.

“crony capitalism” may emerge in which weak corporate governance and government interference can lead to poor performance, risky financing patterns, and macroeconomic crises.

Corporate governance will undoubtedly remain high on the agenda of governments, investors, NGOs, and corporations in the coming years, as pressure for accountability and responsiveness continues to increase.

Corruption

As noted in Chapter 2, government corruption is a pervasive element in the international business environment. Recently publicized scandals in Russia, China, Pakistan, Lesotho, South Africa, Costa Rica, Egypt, and elsewhere underscore the extent of corruption globally, especially in the developing world. However, a number of initiatives have been taken by governments and companies to begin to stem the tide of corruption.³¹

The Foreign Corrupt Practices Act (FCPA) makes it illegal for U.S. companies and their managers to attempt to influence foreign officials through personal payments or political contributions. Prior to passage of the FCPA, some American multinationals had engaged in this practice, but realizing that their stockholders were unlikely to approve of these tactics, the firms typically disguised the payments as entertainment expenses, consulting fees, and so on. Not only does the FCPA prohibit these activities, but the U.S. Internal Revenue Service also continually audits the books of MNCs. Those firms that take deductions for such illegal activities are subject to high financial penalties, and individuals who are involved can even end up going to prison. Strict enforcement of the FCPA has been applauded by many people, but some critics wonder if such a strong stance has hurt the competitive ability of American MNCs. On the positive side, many U.S. multinationals have now increased the amount of business in countries where they used to pay bribes. Additionally, many institutional investors in the United States have made it clear that they will not buy stock in companies that engage in unethical practices and will sell their holdings in such firms. Given that these institutions have hundreds of billions of dollars invested, senior-level management must be responsive to their needs.

Looking at the effect of the FCPA on U.S. multinationals, it appears that the law has had far more of a positive effect than a negative one. Given the growth of American MNCs in recent years, it seems fair to conclude that bribes are not a basic part of business in many countries, for when multinationals stopped this activity, they were still able to sell in that particular market. On the other hand, this does not mean that bribery and corruption are a thing of the past.

Indeed bribery continues to be a problem for MNCs around the world. In fact, recent scandals at ALSTOM, BAE, Daimler, Halliburton, Siemens, and many other multinationals underscore the reality that executives continue to participate in bribery and corruption. Although Siemens paid a record fine, U.S. authorities are still concerned about enforcement of corruption laws in other countries.³² Figure 3–3 gives the latest corruption index of countries around the world. Notice that the United States ranks 19th in this independent analysis. These rankings fluctuate somewhat from year to year. Factors that appear to contribute to these fluctuations include changes in government or political party in power, economic crises, and crackdowns in individual countries.

In complying with the provisions of the FCPA, U.S. firms must be aware of changes in the law that make FCPA violators subject to Federal Sentencing Guidelines. The origin of this law and the guidelines that followed can be traced to two Lockheed Corporation executives who were found guilty of paying a \$1 million bribe to a member of the Egyptian parliament in order to secure the sale of aircraft to the Egyptian military. One of the executives was sentenced to probation and fined \$20,000 and the other, who initially fled prosecution, was fined \$125,000 and sentenced to 18 months in prison.³³

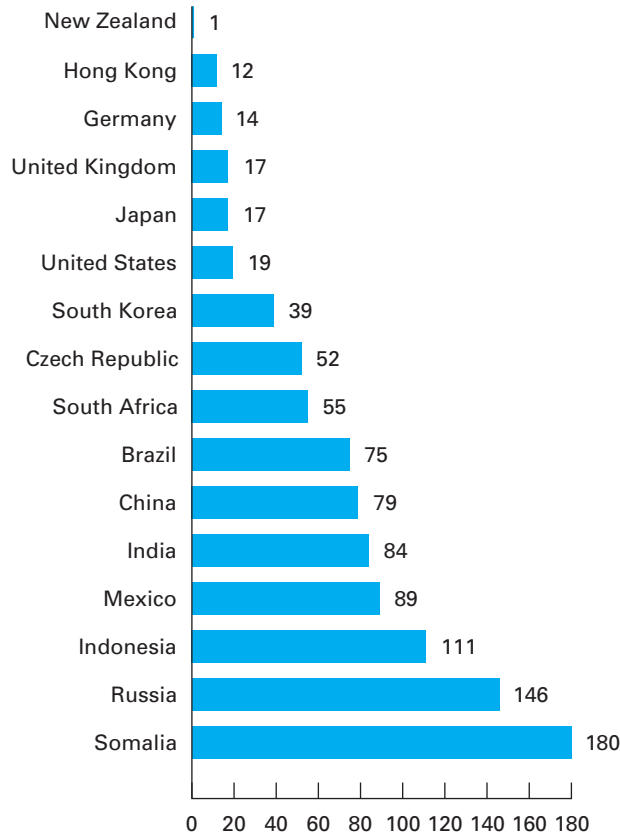


Figure 3–3
Selected Countries
Ranked in Transparency
International Corruption
Perceptions Index

Source: Adapted from Transparency International, CPI Table, http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table.

Another development that promises to give teeth to “antibribing” legislation is the recent formal agreement by a host of industrialized nations to outlaw the practice of bribing foreign government officials. The treaty, which initially included 29 nations that belong to the Organization for Economic Cooperation and Development (OECD), marked a victory for the United States, which outlawed foreign bribery two decades previously but had not been able to persuade other countries to follow its lead. As a result, American firms had long complained that they lost billions of dollars in contracts each year to rivals that bribed their way to success.³⁴

This treaty does not outlaw most payments to political party leaders. In fact, the treaty provisions are much narrower than U.S. negotiators wanted, and there undoubtedly will be ongoing pressure from the American government to expand the scope and coverage of the agreement. For the moment, however, it is a step in the direction of a more ethical and level playing field in global business. Additionally, in summing up the impact and value of the treaty, one observer noted: “For their part, business executives say the treaty . . . reflects growing support for antibribery initiatives among corporations in Europe and Japan that have openly opposed the idea. Some of Europe’s leading industrial corporations, including a few that have been embroiled in recent allegations of bribery, have spoken out in favor of tougher measures and on the increasingly corrosive effect of corruption.”³⁵

In addition to the 29 members of the OECD, a number of developing countries, including Argentina, Brazil, Bulgaria, Chile, and the Slovak Republic, have signed on to the OECD agreement. Latin American countries have established the Organization of American States (OAS) Inter-American Convention Against Corruption, which entered into force in March 1997, and more than 25 Western Hemisphere countries are

signatories to the convention, including Argentina, Brazil, Chile, Mexico, and the United States. As a way to prevent the shifting of corrupt practices to suppliers and intermediaries, the Transparent Agents Against Contracting Entities (TRACE) standard was developed after a review of the practices of 34 companies. It applies to business intermediaries, including sales agents, consultants, suppliers, distributors, resellers, subcontractors, franchisees, and joint-venture partners, so that final producers, distributors, and customers can be confident that no party within a supply chain has participated in corruption.

Both governments and companies have made important steps in their efforts to stem the spread of corruption, but much more needs to be done in order to reduce the impact of corruption on companies and the broader societies in which they operate.³⁶

International Assistance

In addition to government- and corporate-sponsored ethics and social responsibility practices, governments and corporations are increasingly collaborating to provide assistance to communities around the world through global partnerships. This assistance is particularly important for those parts of the world that have not fully benefited from globalization and economic integration. Using a cost-benefit analysis of where investments would have the greatest impact, a recent study identified the top priorities around the world for development assistance. The results of this analysis are presented in Table 3–2. Controlling and preventing AIDS, fighting malnutrition, reducing subsidies and trade restrictions, and controlling malaria are shown to be the best investments. Governments, international institutions, and corporations are involved in several ongoing efforts to address some of these problems.³⁷

At the United Nations Millennium Summit in September 2000, world leaders placed development at the heart of the global agenda by adopting the Millennium

Table 3–2
Copenhagen Consensus Development Priorities

Project Rating		Challenge	Opportunity
Very good	1	Diseases	Control of HIV/AIDS
	2	Malnutrition	Providing micro nutrients
	3	Subsidies and trade	Trade liberalization
	4	Diseases	Control of malaria
Good	5	Malnutrition	Development of new agricultural technologies
	6	Sanitation and water	Small-scale water technology for livelihoods
	7	Sanitation and water	Community-managed water supply and sanitation
	8	Sanitation and water	Research on water productivity in food production
	9	Government	Lowering the cost of starting a new business
Fair	10	Migration	Lowering barriers to migration for skilled workers
	11	Malnutrition	Improving infant and child nutrition
	12	Malnutrition	Reducing the prevalence of low birth weight
	13	Diseases	Scaled-up basic health services
Bad	14	Migration	Guest-worker programs for the unskilled
	15	Climate	“Optimal” carbon tax
	16	Climate	The Kyoto protocol
	17	Climate	Value-at-risk carbon tax

Source: Copenhagen Consensus.

Note: Some of the proposals were not ranked.

Table 3–3
The U.N. Millennium Development Goals

Goal 1: Eradicate extreme poverty and hunger.
 Goal 2: Achieve universal primary education.
 Goal 3: Promote gender equality and empower women.
 Goal 4: Reduce child mortality.
 Goal 5: Improve maternal health.
 Goal 6: Combat HIV/AIDS, malaria, and other diseases.
 Goal 7: Ensure environmental sustainability.
 Goal 8: Develop a Global Partnership for Development.

Source: www.unmillenniumproject.org.

Development Goals (see Table 3–3). The eight Millennium Development Goals constitute an ambitious agenda to significantly improve the human condition by 2015. The goals set clear targets for reducing poverty, hunger, disease, illiteracy, environmental degradation, and discrimination against women.³⁸ For each goal, a set of targets and indicators have been defined and are used to track the progress in meeting the goals.

A more specific initiative is the Global Fund to Fight AIDS, Tuberculosis and Malaria, which was established in 2001. By the end of November 2009, the Global Fund had contributed over US\$19 million in grants to over 140 countries.³⁹

Through these and other efforts, MNCs, governments, and international organizations are providing a range of resources to communities around the world to assist them as they respond to the challenges of globalization and development. International managers will increasingly be called upon to support and contribute to these initiatives.

■ The World of International Management—Revisited

The World of International Management feature that opened this chapter outlines how one company (GE) has sought to respond to pressures for greater ethical behavior and social and environmental responsibility by incorporating these imperatives in its business strategy. In this chapter we focused on ethics and social responsibility in global business activities, including the role of governments, MNCs, and NGOs in advancing greater ethical and socially responsible behavior. MNCs' new focus on environmental sustainability and "doing well by doing good" is an important dimension of this broad trend.

Global ethical and governance scandals have rocked the financial markets and implicated dozens of individual companies. New corporate ethics guidelines passed in the United States have forced many MNCs to take a look at their own internal ethical practices and make changes accordingly. Lawmakers in Europe and Asia have also made adjustments in rules over corporate financial disclosure. The continuing trend toward globalization and free trade appears to be encouraging development of a set of global ethical, social responsibility, and anticorruption standards. This may actually help firms cut compliance costs as they realize that economies have common global frameworks.

Having read the chapter, answer the following questions: (1) Do governments and companies in developed countries have an ethical responsibility to contribute to economic

growth and social development in developing countries? (2) Are governments, companies, or NGOs best equipped to provide this assistance? (3) Do corporations have a responsibility to use their “best” ethics and social responsibility practices when they do business in other countries, even if those countries’ practices are different? (4) How can companies leverage their ethical reputation and social and environmental responsibility to improve business performance?

SUMMARY OF KEY POINTS

1. Ethics is the study of morality and standards of conduct. It is important in the study of international management because ethical behavior often varies from one country to another. Ethics manifests itself in the ways societies and companies address issues such as employment conditions, human rights, and corruption. A danger in international management is the ethical relativism trap—“When in Rome, do as the Romans do.”
2. During the years ahead, multinationals likely will become more concerned about being socially responsible. NGOs are forcing the issue. Countries are passing laws to regulate ethical practices and
- governance rules for MNCs. MNCs are being more proactive (often because they realize it makes good business sense) in making social contributions in the regions in which they operate and in developing codes of conduct to govern ethics and social responsibility. One area in which companies have been especially active is in pursuing strategies that blend environmental sustainability and business objectives.
3. MNCs—in conjunction with governments and NGOs—are also contributing to international development assistance and working to ensure that corporate governance practices are sound and effective.

KEY TERMS

corporate governance, 75

corporate social responsibility (CSR), 71

ethics, 63

fair trade, 74

nongovernmental organizations (NGOs), 71

sustainability, 74

REVIEW AND DISCUSSION QUESTIONS

1. How might different ethical philosophies influence how managers make decisions when it comes to offshoring of jobs?
2. What lessons can U.S. multinationals learn from the political and bribery scandals in recent years, such as those affecting contractors doing business in Iraq (Halliburton), as well as large MNCs such as Siemens, HP, and others? Discuss two.
3. In recent years, rules have tightened such that those who work for the U.S. government in trade negotiations are now restricted from working for lobbyists for foreign firms. Is this a good idea? Why or why not?
4. What are some strategies for overcoming the impact of counterfeiting? Which strategies work best for discretionary (for instance, movies) versus nondiscretionary (pharmaceutical) goods?
5. Why are MNCs getting involved in corporate social responsibility and sustainable business practice? Are they displaying a sense of social responsibility, or is this merely a matter of good business, or both? Defend your answer.

INTERNET EXERCISE: SOCIAL RESPONSIBILITY AT JOHNSON & JOHNSON AND HP

In this chapter, the social responsibility actions of companies such as Johnson & Johnson and Hewlett-Packard (HP) were discussed.

At Johnson & Johnson, social responsibility flows from the company's credo. Consult the International Management in Action box about J&J in the chapter, and go to the J&J website, www.jnj.com, to the sections "Our Credo" and "Social Responsibility." Then answer these questions: (1) Which stakeholders are most important to J&J and why? (2) How does J&J ensure that all of its many operating companies adhere to the credo? (3) What are the main areas of social responsibility activities for J&J, and how do they relate to the credo?

At Hewlett-Packard, "global citizenship" means engaging in public-private partnerships and demonstrating model behavior and activities in governance, environmental policy and practices, community engagement models, and "e-inclusion initiatives." Go to the HP website, www.hp.com, to the sections on global citizenship and e-inclusion. Then answer these questions: (1) What does it mean to be a global citizen at HP? (2) How does HP measure and evaluate its success in global citizenship? (3) What is e-inclusion, and what are some specific examples of projects that advance HP's e-inclusion goals?



Saudi Arabia

Saudi Arabia is a large Middle Eastern country covering 865,000 square miles. Part of its east coast rests on the Persian Gulf, and much of the west coast rests along the Red Sea. One of the countries on its border is Iraq. After Iraq's military takeover of Kuwait in August 1990, Iraq threatened to invade Saudi Arabia. This, of course, did not happen, and Saudi Arabia was not an Iraqi target during the U.S.-led war in Iraq during 2003–2004. However, accusations stemming from rumors of terrorists financing activities have made Saudi Arabia a focus in the global war on terrorism, and Saudi Arabia itself was the target of terrorist attacks in 2003–2004.

There are approximately 22 million people in Saudi Arabia, and the annual per capita income is around \$11,500. This apparent prosperity is misleading because most Saudis are poor farmers and herders who tend their camels, goats, and sheep. In recent years, however, more and more have moved to the cities and have jobs connected to the oil industry. Nearly all are Arab Muslims. The country has the two holiest cities of Islam: Mecca and Medina. The country depends almost exclusively on the sale of oil (it is the largest exporter of oil in the world) and has no public debt. The government is a monarchy, and the king makes all important decisions but is advised by ministers and other government officials. Royal and ministerial decrees account for most of the promulgated legislation. There are no political parties.

Recently, Robert Auger, the executive vice president of Skyblue, a commercial aircraft manufacturing firm based in Kansas City, had a visit with a Saudi minister. The Saudi official explained to Auger that the government planned to purchase 10 aircraft over the next two years. A number of competitive firms were bidding for the job. The minister went on to explain that despite the competitiveness of the situation, several members of the royal family were impressed with Auger's company. The firm's reputation for high-quality performance aircraft and state-of-the-art technology gave it the inside track. A number of people are involved in the decision, however, and in the minister's words, "Anything can happen when a committee decision is being made."

The Saudi official went on to explain that some people who would be involved in the decision had recently suf-

fered large losses in some stock market speculations on the London Stock Exchange. "One relative of the King, who will be a key person in the decision regarding the purchase of the aircraft, I have heard, lost over \$200,000 last week alone. Some of the competitive firms have decided to put together a pool of money to help ease his burden. Three of them have given me \$100,000 each. If you were to do the same, I know that it would put you on a par with them, and I believe it would be in your best interests when the decision is made." Auger was stunned by the suggestion and told the minister that he would check with his people and get back to the minister as soon as possible.

As soon as he returned to his temporary office, Auger sent a coded message to headquarters asking management what he should do. He expects to have an answer within the next 48 hours. In the interim, he has had a call from the minister's office, but Auger's secretary told the caller that Auger had been called away from the office and would not be returning for at least two days. The individual said he would place the call again at the beginning of this coming week. Meanwhile, Auger has talked to a Saudi friend whom he had known back in the United States and who is currently an insider in the Saudi government. Over dinner, Auger hinted at what he had been told by the minister. The friend seemed somewhat puzzled about what Auger was saying and indicated that he had heard nothing about any stock market losses by the royal family or pool of money being put together for certain members of the decision-making committee. He asked Auger, "Are you sure you got the story straight, or as you Americans say, is someone pulling your leg?"

Questions

1. What are some current issues facing Saudi Arabia? What is the climate for doing business in Saudi Arabia today?
2. Is it legal for Auger's firm to make a payment of \$100,000 to help ensure this contract?
3. Do you think other firms are making these payments, or is Auger's firm being singled out? What conclusion can you draw from your answer?
4. What would you recommend that Skyblue do?

It Sounds a Little Fishy

For the past two years, the Chicago-based Brattle Company has been thinking about going international. Two months ago, Brattle entered into negotiations with a large company based in Paris to buy one of its branches in Lyon, France. This would give Brattle a foreign subsidiary. Final arrangements on the deal should be completed within a month, although a few developments have occurred that concern the CEO of Brattle, Angela Scherer.

The most serious concern resulted from a conversation that Scherer had with one of the Lyon firm's largest customers. This customer had been introduced to Scherer during a dinner that the Paris headquarters gave in her honor last month. After the dinner, Scherer struck up a conversation with the customer to assure him that when Brattle took over the Lyon operation, it would provide the same high-quality service as its predecessor. The customer seemed interested in Scherer's comments and then said, "Will I also continue to receive \$10,000 monthly for directing my business to you?" Scherer was floored; she did not know what to say. Finally she stammered, "That's something I think you and I will have to talk about further." With that, the two shook hands and the customer left. Scherer has not been back in touch with the customer since the dinner and is unsure of what to do next.

The other matter that has Scherer somewhat upset is a phone call from the head of the Lyon operation last week. This manager explained that his firm was very active in local affairs and donated approximately \$5,000 a month to charitable organizations and philanthropic activities. Scherer is impressed with the firm's social involvement but wonders whether Brattle will be expected to assume

these obligations. She then told her chief financial officer, "We're buying this subsidiary as an investment, and we are willing to continue employing all the local people and paying their benefits. However, I wonder if we're going to have any profits from this operation after we get done with all the side payments for nonoperating matters. We have to cut back a lot of extraneous expenses. For example, I think we have to cut back much of the contribution to the local community, at least for the first couple of years. Also, I can't find any evidence of payment of this said \$10,000 a month to that large customer. I wonder if we're being sold a bill of goods, or has it been paying him under the table? In any event, I think we need to look into this situation more closely before we make a final decision on whether to buy this operation."

Questions

1. If Scherer finds out that the French company has been paying its largest customer \$10,000 a month, should Brattle back out of the deal? If Brattle goes ahead with the deal, should it continue to make these payments?
2. If Scherer finds out that the customer has been making up the story and no such payments were actually made, what should she do? What if this best customer says he will take his business elsewhere?
3. If Brattle buys the French subsidiary, should Scherer continue to give \$5,000 monthly to the local community? Defend your answer.

Brief Integrative Case 1.1

Colgate's Distasteful Toothpaste

Colgate is a well-known consumer products company based in New York. Its present products are in the areas of household and personal care, which include laundry detergents such as Ajax and Fab, health care products manufactured for home health care, and specialty products such as Hill pet food. The household products segment represents approximately 75 percent of company revenues, while the specialty segment accounts for less than 7 percent. Colgate's value has been set in excess of \$5.6 billion. Through both recessionary and recovery periods in the United States, Colgate has always been advocated by investment analysts as a good long-term stock.

Colgate's domestic market share has been lagging for several years. In the 1970s, when diversification seemed to be the tool to hedge against risk and sustain profits, Colgate bought companies in various industries, including kosher hot dogs, tennis and golf equipment, and jewelry. However, such extreme diversification diverted the company's attention away from its key money-making products: soap, laundry detergents, toothpaste, and other household products. The product diversification strategy ended in 1984 when Reuben Mark became CEO. At the young age of 45, he ordered the sale of parts of the organization that deviated too far from Colgate's core competency of personal and household products. He followed consultant Tom Peters's prescription for excellence: "Stick to the knitting."

Colgate's International Presence

Colgate traditionally has had a strong presence overseas. The company has operations in Australia, Latin America, Canada, France, and Germany. International sales presently represent one-half of Colgate's total revenue. In the past, Colgate always made a detailed analysis of each international market for demand. For instance, its entry into South America required an analysis of the type of product that would be most successful based on the dental hygiene needs of South American consumers. Because of this commitment to local cultural differences, the company has the number-one brand of toothpaste worldwide, Total.

To gain a strong share of the Asian market without having to build its own production plant, Colgate bought a 50 percent partnership in the Hawley and Hazel group in August 1985 for \$50 million. One stipulation of this agreement was that Colgate had no management prerogatives:

Hawley and Hazel maintained the right to make the major decisions in the organization. This partnership turned out to be very lucrative for Colgate, with double-digit millions in annual sales.

Enter the Distasteful Toothpaste

Hawley and Hazel is a chemical products company based in Hong Kong. The company was formed in the early part of the twentieth century, and its only product of note, believe it or not, was called "Darkie" toothpaste. Over the years, this had been one of the popular brands in Asia and had a dominant presence in markets such as Taiwan, Hong Kong, Singapore, Malaysia, and Thailand.

"Darkie" toothpaste goes back to the 1920s. The founder of this product, on a visit to the United States, loved Al Jolson, then a very popular black-faced entertainer (i.e., a white person with black makeup on his face). The founder decided to re-create the spirit of this character in the form of a trademark logo for his toothpaste because of the character's big smile and white teeth. When the founder returned to Asia, he trademarked the name "Darkie" to go along with the logo. Since the 1920s, there has been strong brand loyalty among Asians for this product. One housewife in Taipei whose family used the product for years remarked, "The toothpaste featuring a Black man with a toothy smile is an excellent advertisement."

The Backlash against Colgate

"Darkie" toothpaste had been sold in Asia for about 65 years. After Colgate became partners with Hawley and Hazel and its distasteful product, however, there was a wave of dissatisfaction with the logo and name from U.S. minorities and civil rights groups. There really has been no definite source on how this issue was passed to U.S. action groups and the media; however, a book entitled *Soap Opera: The Inside Story of Procter and Gamble* places responsibility in the hands of Procter & Gamble in an effort to tarnish Colgate's image and lower its market share.

The Americans' irate response to "Darkie" was a surprise to the Hawley and Hazel group. The product had always been successful in their Asian markets, and there had been no complaints. In fact, the success of "Darkie" had led the firm to market a new product in Japan called "Mouth Jazz," which had a similar logo. A spokesperson

for Hawley and Hazel remarked, "There had been no problem before; you can tell by the market share that it is quite well received in Asia."

ICCR, the Interfaith Center on Corporate Responsibility, started the fight against Colgate about 10 years ago when it received a package of "Darkie" toothpaste from a consumer in Thailand. ICCR is composed of institutional investors that influence corporations through stock ownership. At the time the movement against Colgate's racially offensive product started, three members of ICCR already owned a small amount of stock in the company, and they filed a shareholder petition against Colgate requesting a change in the logo and name.

In a letter to Colgate, the ICCR executive director summarized the position against the distasteful toothpaste as follows:

"Darkie" toothpaste is a 60-year-old product sold widely in Hong Kong, Malaysia, Taiwan and other places in the Far East. Its packaging includes a top-hatted and gleaming-toothed smiling likeness of Al Jolson under the words "Darkie" toothpaste. As you know, the term "Darkie" is deeply offensive. We would hope that in this new association with the Hawley and Hazel Chemical Company, that immediate action will be taken to stop this product's name so that a U.S. company will not be associated with promoting racial stereotypes in the Third World.

In response to this letter, R. G. S. Anderson, Colgate's director of corporate development, replied, "No plans exist or are being contemplated that would extend marketing and sales efforts for the product in Colgate subsidiaries elsewhere or beyond this Far East area." Anderson then went on to explain that Darkie's founder was imitating Al Jolson and that in the Chinese view, imitation was the "highest form of flattery." The ICCR then informed Colgate that if the logo was not changed, the organization would create a media frenzy and help various civil rights action groups in a possible boycott.

Because Colgate still refused to remove the logo, ICCR did form a coalition with civil rights groups such as the NAACP and the National Urban League to start protest campaigns. The protest took many forms, including lobbying at the state and local levels. At one point, after heavy lobbying by the ICCR, the House of Representatives in Pennsylvania passed a resolution urging Colgate to change the name and logo. Similar resolutions had been proposed in the U.S. Congress.

The pressures at home placed Colgate in a difficult position, especially as it had no management rights in its agreement with Hawley and Hazel. In the Asian market, neither Colgate nor Hawley and Hazel had any knowledge of consumer dissatisfaction because of racial offensiveness, despite the fact that the local Chinese name for "Darkie" (pronounced *hak ye nga goh*) can be translated as "Black Man Toothpaste." The logo seemed to enhance

brand loyalty. One Asian customer stated, "I buy it because of the Black man's white teeth."

The demographics of the Asian market may help to explain the product's apparent acceptance. There are a relatively small number of Africans, Indians, Pakistanis, and Bangladeshis in the region; therefore, the number of people who might be offended by the logo is low. Also, some people of color did not seem disturbed by the name. For example, when asked about the implications of "Darkie" toothpaste, the secretary of the Indian Chamber of Commerce noted, "It doesn't offend me, and I'm sort of dark-skinned."

Initially, Colgate had no intentions of forcing Hawley and Hazel to change the product. R. G. S. Anderson issued another formal statement to the ICCR as follows: "Our position . . . would be different if the product were sold in the United States or in any Western English-speaking country, which, as I have stated several times, will not happen." Hawley and Hazel concurred with the stance. The alliance was very fearful of a loss of market share and did not believe that the complaints were issues relevant to Pacific Rim countries. A spokesperson for the alliance referred to the protest campaign as "a U.S. issue." The trade-off for revamping a successful product was deemed to be too risky and costly.

Colgate's Change of Heart

The issue did not go away. As U.S. leaders in Congress began to learn about this very offensive logo and name, the pressure on Colgate mounted. Interestingly, however, the value of Colgate's stock increased throughout this period of controversy. Wall Street seemed oblivious to the charges against Colgate, and this was another reason why Colgate took no action. Colgate management believed that an issue about overseas products should not have a negative effect on the company's domestic image. However, pressures continued from groups such as the Congressional Black Caucus, a strong political force. Colgate finally began to waver, but because of its agreement with Hawley and Hazel, it felt helpless. As one Colgate executive remarked, "One hates to let exogenous things drive your business, but you sometimes have to be aware of them."

Colgate CEO Reuben Mark eventually became very distressed over the situation. He was adamantly against racism of any kind and had taken actions to exhibit his beliefs. For instance, he and his wife had received recognition for their involvement in a special program for disadvantaged teenagers. He commented publicly about the situation as follows: "It's just offensive. The morally right thing dictates that we must change. What we have to do is find a way to change that is least damaging to the economic interests of our partners." He also publicly stated that Colgate had been trying to change the package since 1985, when it bought into the partnership.

Colgate's Plan of Action to Repair the Damage

The protest campaign initiated by ICCR and carried further by others definitely caused Colgate's image to be tarnished badly in the eyes not only of African Americans but of all Americans. To get action, some members of the Congressional Black Caucus (including Rep. John Conyers, D-Mich.) even bypassed Colgate and tried to negotiate directly with Hawley and Hazel. To try to repair the damage, two years after ICCR's initial inquiry, Colgate, in cooperation with Hawley and Hazel, finally developed a plan to change the product. In a letter to ICCR, CEO Mark stated, "I and Colgate share your concern that the caricature of a minstrel in black-face on the package and the name 'Darkie' itself could be considered racially offensive." Colgate and Hawley and Hazel then proposed some specific changes for the name and logo. Names considered included Darlie, Darbie, Hawley, and Dakkie. The logo options included a dark, non-descript silhouette and a well-dressed black man. The alliances decided to test-market the options among their Asian consumers; however, they refused to change the Chinese name ("Black Man Toothpaste"), which is more used by their customers.

They decided that changes would be implemented over the course of a year to maintain brand loyalty and avoid advertising confusion with their customers. There was the risk that loyal customers would not know if the modified name/logo was still the same toothpaste that had proven itself through the years. Altogether, the process would take approximately three years, test marketing included. Colgate also decided to pay for the entire change process, abandoning its initial suggestion that the change be paid for by Hawley and Hazel.

Colgate and Hawley and Hazel then made a worldwide apology to all insulted groups. Although Hawley and Hazel was slow to agree with the plan, a spokesperson emphasized that racial stereotyping was against its policy. It also helped that Hawley and Hazel would pay no money to make the needed changes. It felt that the product was too strong to change quickly; thus, three years was not too long to implement the new logo and name fully into all Asian markets. Further, it insisted that as part of the marketing campaign, the product advertising use the following statement in Chinese, "Only the English name is being changed. Black Man Toothpaste is still Black Man Toothpaste."

Response Worldwide

Colgate and Hawley and Hazel still suffer from the effects of their racially offensive product. In 1992, while dealing with its own civil rights issues, the Chinese government placed a ban on Darlie toothpaste because of the product's violation of China's trademark laws. Although the English name change was implemented across all markets, the retained Chinese name and logo still were deemed derogatory by the Chinese, and the government banned the product. Also, Eric Molobi, an African National Congress representative, was outraged at the toothpaste's logo on a recent visit to the Pacific Rim. When asked if Darlie toothpaste would be marketed in his country, the South African representative replied, "If this company found itself in South Africa it would not be used. There would be a permanent boycott."

Today, the name of Colgate cannot be found anywhere on the packaging of what is now called Darlie toothpaste. In a strategic move, Colgate has distanced itself completely away from the controversial product. In the Thailand and Indonesia health-products markets, Colgate even competes against Darlie toothpaste with its own brand.

Questions for Review

1. Identify the major strategic and ethical issues faced by Colgate in its partnership with Hawley and Hazel.
2. What do you think Colgate should have done to handle the situation?
3. Is it possible for Colgate and Hawley and Hazel to change the toothpaste's advertising without sacrificing consumer brand loyalty? Is that a possible reason for Colgate's not responding quickly to domestic complaints?
4. In the end, was a "no management rights" clause good for Colgate? What could have happened during the negotiations process to get around this problem?

Source: Reprinted with permission of Alisa L. Mosley.

Brief Integrative Case 1.2

Advertising or Free Speech? The Case of Nike and Human Rights

Nike Inc., the global leader in the production and marketing of sports and athletic merchandise including shoes, clothing, and equipment, has enjoyed unparalleled worldwide growth for many years. Consumers around the world recognize Nike's brand name and logo. As a supplier to and sponsor of professional sports figures and organizations, and as a large advertiser to the general public, Nike is widely known. Nike was a pioneer in offshore manufacturing, establishing company-owned assembly plants and engaging third-party contractors in developing countries.

In 1996, *Life* magazine published a landmark article about the labor conditions of Nike's overseas subcontractors, entitled, "On the Playgrounds of America, Every Kid's Goal Is to Score: In Pakistan, Where Children Stitch Soccer Balls for Six Cents an Hour, Their Goal Is to Survive." Accompanying the article was a photo of a 12-year-old Pakistani boy stitching a Nike embossed soccer ball. The photo caption noted that the job took a whole day, and the child was paid US\$.60 for his effort. Up until this time, the general public was neither aware of the wide use of foreign labor nor familiar with the working arrangements and treatment of laborers in developing countries. Since then, Nike has become a poster child for the questionable unethical use of offshore workers in poorer regions of the world. This label has continued to plague the corporation as many global human interest and labor rights organizations have monitored and often condemned Nike for its labor practices around the world.

Nike executives have been frequent targets at public events, especially at universities where students have pressed administrators and athletic directors to ban products that have been made under "sweatshop" conditions. Indeed, at the University of Oregon, a major gift from Phil Knight, Nike's CEO, was held up in part because of student criticism and activism against Nike on campus.¹

In 2003 the company employed 86 compliance officers (up from just three in 1996) to monitor its plant operations and working conditions and ensure compliance with its published corporate code of conduct. Even so, the stigma of past practices—whether perceived or real—remains emblazoned on its image and brand name. Nike found itself constantly defending its activities, striving to shake this reputation and perception.

In 2002 Marc Kasky sued Nike, alleging that the company knowingly made false and misleading statements in

its denial of direct participation in abusive labor conditions abroad. Through corporate news releases, full-page ads in major newspapers, and letters to editors, Nike defended its conduct and sought to show that allegations of misconduct were unwarranted. The action by the plaintiff, a local citizen, was predicated on a California state law prohibiting unlawful business practices. He alleged that Nike's public statements were motivated by marketing and public relations and were simply false. According to the allegation, Nike's statements misled the public and thus violated the California statute. Nike countered by claiming its statements fell under and within the protection of the First Amendment, which protects free speech. The state court concluded that a firm's public statements about its operations have the effect of persuading consumers to buy its products and therefore are, in effect, advertising. Therefore, the suit could be adjudicated on the basis of whether Nike's pronouncements were false and misleading. The court stated that promoting a company's reputation was equivalent to sales solicitation, a practice clearly within the purview of state law. The majority of justices summarized their decision by declaring, "because messages in question were directed by a commercial speaker to a commercial audience, and because they made representations of fact about the speaker's own business operations for the purpose of promoting sales of its products, we conclude that these messages are commercial speech for purposes of applying state laws barring false and misleading commercial messages" (*Kasky v. Nike Inc.*, 2002). The conclusion reached by the court was that statements by a business enterprise to promote its reputation must, like advertising, be factual representations and that companies have a clear duty to speak truthfully about such issues.²

In January 2003 the U.S. Supreme Court agreed to hear Nike's appeal of the decision in *Kasky v. Nike Inc.* from the California Supreme Court. In particular, the U.S. Supreme Court agreed to rule on whether Nike's previous statements about the working conditions at its subcontracted, overseas plants were in fact "commercial speech" and, separately, whether a private individual (such as Kasky) has the right to sue on those grounds. Numerous amici briefs were filed on both sides. Supporters of Kasky included California, as well as 17 other states, Ralph Nader's Public Citizen Organization, California's AFL/CIO, and California's attorney general. Nike's friends of the court included the American

Civil Liberties Union, the Business Roundtable, the U.S. Chamber of Commerce, other MNCs including Exxon/Mobil and Microsoft, and the Bush administration (particularly on the grounds that it does not support private individuals acting as public censors).³

Despite the novelty of this First Amendment debate and the potentially wide-reaching effects for big business (particularly MNCs), the U.S. Supreme Court dismissed the case (6 to 3) in June 2003 as “improvidently granted” due to procedural issues surrounding the case. In their dissenting opinion, Justices Stephen G. Breyer and Sandra Day O’Connor suggested that Nike would likely win the appeal at the U.S. Supreme Court level. In both the concurring and dissenting opinions, Nike’s statements were described as a mix of “commercial” and “noncommercial” speech.⁴ This suggested to Nike, as well as other MNCs, that if the Court were to have ruled on the substantive issue, Nike would have prevailed.

Although this case has set no nationwide precedent for corporate advertising about business practices or corporate social responsibility (CSR) in general, given the sensitivity of the issue, Nike has allowed its actions to speak louder than words in recent years. As part of its international CSR profile, Nike has assisted relief efforts (donating \$1 million to tsunami relief in 2004) and advocated fair wages and employment practices in its outsourced operations. Nike claims that it has not abandoned production in certain countries in favor of lower-wage labor in others and that its factory wages abroad are actually in accordance with local regulations, once one accounts for purchasing power and cost-of-living differences.⁵ The Nike Foundation, a nonprofit organization supported by Nike, is also an active supporter of the Millennium Development Goals, particularly those directed at improving the lives of adolescent girls in developing countries (specifically Bangladesh, Brazil, China, Ethiopia, and Zambia) through better health, education, and economic opportunities.⁶

As part of its domestic CSR profile, Nike is primarily concerned with keeping youth active, presumably for health, safety, educational, and psychological/esteem reasons. Nike has worked with Head Start (2005) and Special Olympics Oregon (2007), as well as created its own community program, NikeGO, to advocate physical activity among youth. Furthermore, Nike is committed to domestic efforts such as Hurricane Katrina relief and education, the latter through grants made by the Nike School Innovation Fund in support of the Primary Years Literacy Initiative.⁷

Despite Nike’s impressive CSR profile, if the California State Supreme Court decision is sustained and sets a global precedent, Nike’s promotion or “advertisement” of its global CSR initiatives could still be subjected to legal challenge. This could create a minefield for multinational firms. It would effectively elevate statements on human rights treatment by companies to the level of corporate marketing and advertising. Under these conditions, it might be difficult for

MNCs to defend themselves against allegations of human rights abuses. In fact, action such as the issuance and dissemination of a written company code of conduct could fall into the category of advertising declarations. Although *Kasky v. Nike* was never fully resolved in court, the issues that it raised remain to be addressed by global companies.

Also to be seen is what effect a court decision would have on Nike’s financial success. Despite the publicity of the case, at both the state and Supreme Court levels, and the lingering criticism about its labor practices overseas, Nike has maintained strong and growing sales and profits. The company has expanded its operations into different types of clothing and sports equipment and has continued to choose successful athletes to advertise its gear. Nike has shown no signs of slowing down, suggesting that its name and logo have not been substantially tarnished in the global market.

Questions for Review

1. What ethical issues faced by MNCs in their treatment of foreign workers could bring allegations of misconduct in their operations?
2. Would the use of third-party independent contractors insulate MNCs from being attacked? Would that practice offer MNCs a good defensive shield against charges of abuse of “their employees”?
3. Do you think that statements by companies that describe good social and moral conduct in the treatment of their workers are part of the image those companies create and therefore are part of their advertising message? Do consumers judge companies and base their buying decision on their perceptions of corporate behavior and values? Is the historic “made in” question (e.g., “Made in the USA”) now being replaced by a “made by” inquiry (e.g., “Made by Company X” or “Made for Company X by Company Y”)?
4. Given the principles noted in the case, how can companies comment on their positive actions to promote human rights so that consumers will think well of them? Would you propose that a company (a) do nothing, (b) construct a corporate code of ethics, or (c) align itself with some of the universal covenants or compacts prepared by international agencies?
5. What does Nike’s continued financial success, in spite of the lawsuit, suggest about consumers’ reactions to negative publicity? Have American media and NGOs exaggerated the impact of a firm’s labor practices and corporate social responsibility on its sales? How should managers of an MNC respond to such negative publicity?

Source: This case was prepared by Lawrence Beer, W. P. Carey School of Business, Arizona State University as the basis for class discussion.

In-Depth Integrative Case 1.1

Student Advocacy and “Sweatshop” Labor: The Case of Russell Athletic

Introduction

In November 2009, after nearly two years of student campaigning in coordination with the apparel workers, the Honduran workers’ union concluded an agreement with Russell Athletic, a major supplier of clothing and sportswear to college campuses around the country. The agreement included a commitment by Russell to put all of the workers back to work, to provide compensation for lost wages, to recognize the union and agree to collective bargaining, and to allow access for the union to all other Russell apparel plants in Honduras for union organizing drives in which the company will remain neutral. According to a November 18, 2009, press release of United Students Against Sweatshops (USAS), this has been an “unprecedented victory for labor rights.”¹

Outsourcing of production facilities and labor to developing countries has been one of the important business strategies of large U.S. corporations. While in the United States, a typical corporation is subject to various regulations and laws such as minimum wage law, labor laws, safety and sanitation requirements, and trade union organizing provisions, in some developing countries these laws are soft and rudimentary, allowing a large corporation to derive significant cost benefits from outsourcing. Moreover, many developing countries like India, China, Vietnam, Pakistan, Bangladesh, and Honduras encourage the outsourcing of work from the developed world to factories within their borders as a source of employment for their citizens, who otherwise would suffer from lack of jobs in their country.

However, in spite of the obvious positive fact of creating new jobs in the hosting country, the large multinational corporations very often have been criticized for violating the rights of the workers, creating unbearable working conditions, and increasing workloads while cutting compensation. They have been attacked for creating a so-called “sweatshop” environment for their employees. A few of the recent targets of the criticism have been Walmart,² Disney,³ JCPenney, Target, Sears,⁴ Toys R Us,⁵ Nike,⁶ Reebok,⁷ Adidas,⁸ Gap,⁹ IBM, Dell, HP,¹⁰ Apple and Microsoft,¹¹ etc.

This case addresses advocacy by students and other stakeholders toward one of these countries and documents the evolution and outcome of the dispute.

What Is a Sweatshop?

By common agreement, a *sweatshop* is a workplace that provides low or subsistence wages under harsh working conditions, such as long hours, unhealthy conditions, and/or an oppressive environment. Some observers see these work environments as essentially acceptable if the laborers freely contract to work in such conditions. For others, to call a workplace a sweatshop implies that the working conditions are illegitimate and immoral. The U.S. General Accounting Office would hone this definition for U.S. workplaces to include those environments where an employer violates more than one federal or state labor, industrial homework, occupational safety and health, workers’ compensation, or industry registration laws. The AFL-CIO Union of Needletrades, Industrial and Textile Employees would expand on that to include workplaces with systematic violations of global fundamental workers’ rights. The Interfaith Center on Corporate Responsibility (ICCR) defines sweatshops much more broadly than either of these; even where a factory is clean, well organized, and harassment free, the ICCR considers it a sweatshop if its workers are not paid a sustainable living wage. The purpose of reviewing these varied definitions is to acknowledge that, by definition, sweatshops are oppressive, unethical, and patently unfair to workers.¹²

History of Sweatshops

Sweatshop labor systems were most often associated with garment and cigar manufacturing of the period 1880–1920. Sweated labor can also be seen in laundry work, green grocers, and most recently in the “day laborers,” often legal or illegal immigrants, who landscape suburban lawns.¹³ Now, sweatshops are often found in the clothing industry because it is easy to separate higher and lower skilled jobs and contract out the lower skilled ones. Clothing companies can do their own designing, marketing, and cutting, and contract out sewing and finishing work. New contractors can start up easily; all they need is a few sewing machines in a rented apartment or factory loft located in a neighborhood where workers can be recruited.¹⁴ Sweatshops make the most fashion-oriented clothing—women’s and girls’—because production has to be flexible, change quickly, and done in small batches. In less style-sensitive sectors—men’s and boys’ wear, hosiery, and knit products—there is less change and longer production runs, and clothing can

be made competitively in large factories using advanced technology.¹⁵ Since their earliest days, sweatshops have relied on immigrant labor, usually women, who were desperate for work under any pay and conditions. Sweatshops in New York City, for example, opened in Chinatown, the mostly Jewish Lower East Side, and Hispanic neighborhoods in the boroughs. Sweatshops in Seattle are near neighborhoods of Asian immigrants. The evolution of sweatshops in London and Paris—two early and major centers of the garment industry—followed the pattern in New York City. First, garment manufacturing was localized in a few districts: the *Sentier* of Paris and the Hackney, Haringey, Islington, the Tower Hamlets, and Westminster boroughs of London. Second, the sweatshops employed mostly immigrants, at first men but then primarily women, who had few job alternatives.¹⁶

In developing countries, clothing sweatshops tend to be widely dispersed geographically rather than concentrated in a few districts of major cities, and they often operate alongside sweatshops, some of which are very large, that produce toys, shoes (primarily athletic shoes), carpets, and athletic equipment (particularly baseballs and soccer balls), among other goods. Sweatshops of all types tend to have child labor, forced unpaid overtime, and widespread violations of workers' freedom of association (i.e., the right to unionize). The underlying cause of sweatshops in developing nations—whether in China, Southeast Asia, the Caribbean or India and Bangladesh—is intense cost-cutting done by contractors who compete among themselves for orders from larger contractors, major manufacturers, and retailers.¹⁷ Sweatshops became visible through the public exposure given to them by reformers in the late 19th and early 20th centuries in both England and the United States. In 1889–1890, an investigation by the House of Lords Select Committee on the Sweating System brought attention in Britain. In the United States the first public investigations came as a result of efforts to curb tobacco homework, which led to the outlawing of the production of cigars in living quarters in New York State in 1884.¹⁸

The spread of sweatshops was reversed in the United States in the years following a horrific fire in 1911 that destroyed the Triangle Shirtwaist Company, a women's blouse manufacturer near Washington Square in New York City. The company employed 500 workers in notoriously poor conditions. One hundred and forty-six workers perished in the fire; many jumped out windows to their deaths because the building's emergency exits were locked. The Triangle fire made the public acutely aware of conditions in the clothing industry and led to pressure for closer regulation. The number of sweatshops gradually declined as unions organized and negotiated improved wages and conditions and as government regulations were stiffened (particularly under the 1938 Fair Labor Standards Act, which imposed a minimum wage and required overtime

pay for work of more than 40 hours per week).¹⁹ Unionization and government regulation never completely eliminated clothing sweatshops, and many continued on the edges of the industry; small sweatshops were difficult to locate and could easily close and move to avoid union organizers and government inspectors. In the 1960s, sweatshops began to reappear in large numbers among the growing labor force of immigrants, and by the 1980s sweatshops were again "business as usual." In the 1990s, atrocious conditions at a sweatshop once again shocked the public.²⁰ A 1994 U.S. Department of Labor spot check of garment operations in California found that 93 percent had health and safety violations, 73 percent of the garment makers had improper payroll records, 68 percent did not pay appropriate overtime wages, and 51 percent paid less than the minimum wage.²¹

Sweatshop Dilemma

The fight against sweatshops is never a simple matter; there are mixed motives and unexpected outcomes. For example, unions object to sweatshops because they are genuinely concerned about the welfare of sweated labor, but they also want to protect their own members' jobs from low-wage competition even if this means ending the jobs of the working poor in other countries.²² Also, sweatshops can be evaluated from moral and economic perspectives. Morally, it is easy to declare sweatshops unacceptable because they exploit and endanger workers. But from an economic perspective, many now argue that without sweatshops developing countries might not be able to compete with industrialized countries and achieve export growth. Working in a sweatshop may be the only alternative to subsistence farming, casual labor, prostitution, and unemployment. At least most sweatshops in other countries, it is argued, pay their workers above the poverty level and provide jobs for women who are otherwise shut out of manufacturing. And American consumers have greater purchasing power and a higher standard of living because of the availability of inexpensive imports.²³

NGOs Anti-Sweatshop Involvement

International nongovernmental organizations (NGOs) have attempted to step into sweatshop conflict to suggest voluntary standards to which possible signatory countries or organizations could commit. For instance, the International Labour Office has promulgated its Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, which offers guidelines for employment, training, conditions of work and life, and industrial relations. The "Tripartite" nature refers to the critical cooperation necessary from governments, employers' and workers' organizations, and the multinational enterprises involved.²⁴

On December 10, 1948, the General Assembly of the United Nations adopted its Universal Declaration of Human Rights, calling on all member countries to publicize the text of the Declaration and to cause it to be disseminated, displayed, and read. The Declaration recognizes that all humans have an inherent dignity and specific equal and inalienable rights. These rights are based on the foundation of freedom, justice, and peace. The UN stated that the rights should be guaranteed without distinction of any kind, such as race, color, sex, language, religion, political or other opinion, national or social origin, property, birth, or other status. Furthermore, no distinction shall be made on the basis of the political, jurisdictional, or international status of the country or territory to which a person belongs. The foundational rights also include the right to life, liberty, and security of person and protection from slavery or servitude, torture, or cruel, inhuman, or degrading treatment or punishment.²⁵ Articles 23, 24, and 25 discuss issues with immediate implications for sweatshops. By extrapolation, they provide recognition of the fundamental human right to nondiscrimination, personal autonomy or liberty, equal pay, reasonable working hours and the ability to attain an appropriate standard of living, and other humane working conditions. All these rights were reinforced by the United Nations in its 1966 International Covenant on Economic, Social, and Cultural Rights.²⁶

These are but two examples of standards promulgated by the international labor community, though the enforcement of these and other norms is spotty. In the apparel industry in particular, the process of internal and external monitoring has matured such that it has become the norm at least to self-monitor, if not to allow external third-party monitors to assess compliance of a supplier factory with the code of conduct of a multinational corporation or with that of NGOs. Though a number of factors affected this evolution, one such factor involved pressure by American universities on their apparel suppliers, which resulted in two multistakeholder efforts—the Fair Labor Association, primarily comprising and funded by the multinational retailers, and the Worker Rights Consortium, originally perceived as university driven. Through a cooperative effort of these two organizations, large retailers such as Nike and Adidas have not only allowed external monitoring but Nike has now published a complete list of each of its suppliers.²⁷

The Case of Russell Athletic

While some argue that sweatshop scandals cause little or no impact on the corporate giants because people care more for the ability to buy cheap and affordable products rather than for working conditions of those who make these products,²⁸ the recent scandal around Russell Athletic brand has proved that it may no longer be as easy for a corporation to avoid the social responsibility for its

outsourcing activities as it has been for a long time. November 2009 became a tipping point in the many years of struggle between the student antisweatshop movement and the corporate world. An unprecedented victory was won by United Students Against Sweatshops (USAS) coalition against Russell Athletic, a corporate giant owned by Fruit of the Loom, a Berkshire-Hathaway portfolio company. USAS pressure tactics persuaded one of the nation’s leading sportswear companies, Russell Athletic, to agree to rehire 1,200 workers in Honduras who lost their jobs when Russell closed their factory soon after the workers had unionized.²⁹

Russell Corporation, founded by Benjamin Russell in 1902, is a manufacturer of athletic shoes, apparel, and sports equipment. Russell products are marketed under many brands, including Russell Athletic, Spalding, Brooks, Jerzees, Dudley Sports, etc. This company with more than 100 years of history has been a leading supplier of the team uniforms at the high school, college, and professional level. Russell Athletic™ active wear and college licensed products are broadly distributed and marketed through department stores, sports specialty stores, retail chains, and college bookstores.³⁰ After an acquisition in August 2006, Russell’s brands joined Fruit of the Loom in the Berkshire-Hathaway family of products.

Russell/Fruit of the Loom is the largest private employer in Honduras. Unlike other major apparel brands, Russell/Fruit of the Loom owns all eight of its factories in Honduras rather than subcontracting to outside manufacturers.³¹ The incident related to Russell Athletic’s business in Honduras that led to a major scandal in 2009 was the company’s decision to fire 145 workers in 2007 for supporting a union. This ignited the antisweatshop campaign against the company. Russell later admitted its wrongdoing and was forced to reverse its decision. However, the company continued violating worker rights in 2008 by constantly harassing the union activists and making threats to close the Jerzees de Honduras factory. It finally closed the factory on January 30, 2009, after months of battling with a factory union.³²

NGOs Anti-Sweatshop Pressure

The Worker Rights Consortium (WRC) has conducted a thorough investigation of Russell’s activities, and ultimately released a 36-page report on November 7, 2008, documenting the facts of worker rights violations by Russell in its factory Jerzees de Honduras, including the instances of death threats received by the union leaders.³³ The union’s vice president, Norma Mejia, publicly confessed at a Berkshire-Hathaway shareholders’ meeting in May 2009 that she had received death threats for helping lead the union.³⁴ The Worker Rights Consortium continued monitoring the flow of the Russell Athletic scandal, and issued new reports and updates on this matter throughout 2009 including its recommendation for

Russell's management on how to mediate the situation and resolve the conflict.

As stated in its mission statement, the Worker Rights Consortium is an independent labor rights monitoring organization, whose purpose is to combat sweatshops and protect the rights of workers who sew apparel and make other products sold in the United States. The WRC conducts independent, in-depth investigations; issues public reports on factories producing for major U.S. brands; and aids workers at these factories in their efforts to end labor abuses and defend their workplace rights. The WRC is supported by over 175 college and university affiliates and is primarily focused on the labor practices of factories that make apparel and other goods bearing university logos.³⁵

Worker Rights Consortium assessed that Russell's decision to close the plant represented one of the most serious challenges yet faced to the enforcement of university codes of conduct. If allowed to stand, the closure would not only unlawfully deprive workers of their livelihoods, it would also send an unmistakable message to workers in Honduras and elsewhere in Central America that there is no practical point in standing up for their rights under domestic or international law and university codes of conduct and that any effort to do so will result in the loss of one's job. This would have a substantial chilling effect on the exercise of worker rights throughout the region.³⁶

The results of the WRC investigation of Russell Athletic unfair labor practices in Honduras spurred the nationwide student campaign led by United Students Against Sweatshops (USAS) who persuaded the administrations of Boston College, Columbia, Harvard, NYU, Stanford, Michigan, North Carolina, and 89 other colleges and universities to sever or suspend their licensing agreements with Russell. The agreements—some yielding more than \$1 million in sales—allowed Russell to put university logos on T-shirts, sweatshirts, and fleeces.³⁷

As written in its mission statement, United Students Against Sweatshops (USAS) is a grassroots organization run entirely by youth and students. USAS strives to develop youth leadership and run strategic student-labor solidarity campaigns with the goal of building sustainable power for working people. It defines "sweatshop" broadly and considers all struggles against the daily abuses of the global economic system to be a struggle against sweatshops. The core of its vision is a world in which society and human relationships are organized cooperatively, not competitively. USAS struggles toward a world in which all people live in freedom from oppression, in which people are valued as whole human beings rather than exploited in a quest for productivity and profits.³⁸

The role of the USAS in advocating for the rights of the Honduran workers in the Russell Athletic scandal is hard to overestimate. One can only envy the enthusiasm and effort contributed by students fighting the problem that did not seem to have any direct relationship to their

own lives. They did not just passively sit on campus, but went out to the public with creative tactical actions such as picketing the NBA finals in Orlando and Los Angeles to protest the league's licensing agreement with Russell, distributing fliers inside Sports Authority sporting goods stores and sending Twitter messages to customers of Dick's Sporting Goods urging them to boycott Russell products. The students even sent activists to knock on Warren Buffett's door in Omaha because his company, Berkshire-Hathaway, owns Fruit of the Loom, Russell's parent company.³⁹

United Students Against Sweatshops involved students from more than 100 campuses where it did not have chapters in the anti-Russell campaign. It also contacted students at Western Kentucky University in Bowling Green, where Fruit of the Loom has its headquarters.⁴⁰ The USAS activists even reached Congress trying to gain more support and inflict more political and public pressure on Russell Athletic. On May 13, 2009, 65 congressmen signed the letter addressed to Russell CEO John Holland expressing their grave concern over the labor violations.⁴¹

In addition, the Fair Labor Association (FLA), a nonprofit organization dedicated to ending sweatshop conditions in factories worldwide, issued a statement on June 25, 2009, putting Russell Athletic on probation for noncompliance with FLA standards.⁴² The Fair Labor Association, one of the powerful authorities that oversees the labor practices in the industry, represents a powerful coalition of industry and nonprofit sectors. The FLA brings together colleges and universities, civil society organizations, and socially responsible companies in a unique multistakeholder initiative to end sweatshop labor and improve working conditions in factories worldwide. The FLA holds its participants, those involved in the manufacturing and marketing processes, accountable to the FLA Workplace Code of Conduct.⁴³ The 19-member Board of Directors, the FLA's policy-making body, comprises equal representation from each of its three constituent groups: companies, colleges and universities, and civil society organizations.⁴⁴

Victory for USAS and WRC

As mentioned at the start of this case, on November 2009, after nearly two years of student campaigning in coordination with the apparel workers, the Honduran workers' union concluded an agreement with Russell that put all of the workers back to work, provided compensation for lost wages, recognized the union and agreed to collective bargaining, and provided access for the union to all other Russell apparel plants in Honduras for union organizing drives in which the company will remain neutral. According to the November 18, 2009, press release of USAS, this has been an "unprecedented victory for labor rights."⁴⁵

"This is the first time we know of where a factory that was shut down to eliminate a union was later reopened

after a worker-activist campaign. This is also the first companywide neutrality agreement in the history of the Central American apparel export industry, and it has been entered into by the largest private employer in Honduras, the largest exporter of T-shirts to the U.S. market in the world. This is a breakthrough of enormous significance for the right to organize—and worker rights in general—in one of the harshest labor rights environments in the world,” said Rod Palmquist, USAS International Campaign Coordinator and University of Washington alumnus.⁴⁶

This was not an overnight victory for the student movement and the coalition of NGOs such as USAS, WCR, and FLA. It took over 10 years of building a movement that persuaded scores of universities to adopt detailed codes of conduct for the factories used by licensees like Russell.⁴⁷ It is another important lesson for the corporate world in the era of globalization, which can no longer expect to conduct business activities in isolation from the rest of the world. The global corporations such as Russell Athletic, Nike, Gap, Walmart, and others will have to assess the impact of their business decisions on all the variety of stakeholders and take higher social responsibility for what they do in any part of the world.

Questions for Review

1. Assume that you are an executive of a large U.S. multinational corporation planning to open new manufacturing plants in China and India to save on labor costs. What factors should you consider when making your decision? Is labor outsourcing to developing countries a legitimate business strategy that can be handled without risk of running into a sweatshop scandal?
2. Do you think that sweatshops can be completely eliminated throughout the world in the near future? Provide an argument as to why you think this can or cannot be achieved.
3. Would you agree that in order to eliminate sweatshop conflicts large corporations such as Russell Athletic should retain the same high labor standards and regulations that they have in the home country (for example, in the U.S.) when they conduct business in developing countries? How hard or easy can this be to implement?
4. Do you think that the public and NGOs like USAS should care about labor practices in other countries? Isn't this a responsibility of the government of each particular country to regulate the labor practice within the borders of its country? Who do you think provides a better mechanism of regulating and improving the labor practices: NGOs or country governments?
5. Would you agree that Russell Athletic made the right decision by conceding to USAS and union demands? Isn't a less expensive way to handle this sort of situation simply to ignore the scandal? Please state your pros and cons regarding Russell's decision to compromise with the workers' union and NGOs as opposed to ignoring this scandal.

Source: This case was prepared by Jonathan Doh and Tetyana Azarova of Villanova University as the basis for class discussion.

In-Depth Integrative Case 1.2

Pharmaceutical Companies, Intellectual Property, and the Global AIDS Epidemic

In August 2003, after heavy lobbying from nongovernmental organizations (NGOs) such as Doctors Without Borders, the U.S. pharmaceutical industry finally dropped its opposition to relaxation of the intellectual property rights (IPR) provisions under World Trade Organization (WTO) regulations to make generic, low-cost antiviral drugs available to developing countries like South Africa facing epidemics or other health emergencies.¹ Although this announcement appeared to end a three-year dispute between multinational pharmaceutical companies, governments, and NGOs over the most appropriate and effective response to viral pandemics in the developing world, the specific procedures for determining what constitutes a health emergency had yet to be worked out. Nonetheless, the day after the agreement was announced, the government of Brazil said it would publish a decree authorizing imports of generic versions of patented AIDS drugs that the country said it could no longer afford to buy from multinational pharmaceutical companies. Although the tentative WTO agreement would appear to allow such production under limited circumstances, former U.S. trade official Jon Huenemann remarked, “They’re playing with fire. . . . The sensitivities of this are obvious and we’re right on the edge here.”²

Despite the role of developed and developing country governments, NGOs, large pharmaceutical companies, and their generic competitors in crafting this agreement, it was unclear how it would be implemented and whether action would be swift enough to stem the HIV/AIDS epidemic ravaging South Africa and many other countries.

The AIDS Epidemic and Potential Treatment

In 2008, after over two decades of fighting the AIDS epidemic and raising the public awareness, HIV/AIDS still remained one of the leading causes of death in the world, occupying the 6th position in WHO Top 10 Causes of Death list.³ According to the World Health Organization (WHO), in 2008 there were approximately 33.4 million people living with AIDS, with 2.7 million newly infected, and 2 millions deaths (see Table 1). Since 1980, AIDS has killed more than 25 million people. HIV is especially deadly because it often remains dormant in an infected person for years without showing symptoms and is transmitted to others often without the knowledge of either person. HIV leads to AIDS when the virus attacks the immune system and cripples it, making the person vulnerable to diseases.⁴

Table 1 Regional HIV/AIDS Statistics, 2008

	Adults and Children Living with HIV/AIDS	Adults and Children Newly Infected with HIV	Adult Prevalence Rate [%]*	Adult and Child Deaths Due to AIDS
Sub-Saharan Africa	20.8–24.1 million	1.6–2.2 million	4.9–5.4	1.1–1.7 million
North Africa and Middle East	250,000–380,000	24,000–46,000	0.2–0.3	15,000–25,000
South and Southeast Asia	3.4–4.3 million	240,000–320,000	0.2–0.3	220,000–310,000
East Asia	700,000–1.0 million	58,000–88,000	<0.1	46,000–71,000
Latin America	1.8–2.2 million	150,000–200,000	0.5–0.6	66,000–89,000
Caribbean	220,000–260,000	16,000–24,000	0.9–1.1	9,300–14,000
Eastern Europe and Central Asia	1.4–1.7 million	100,000–130,000	0.6–0.8	72,000–110,000
Western & Central Europe	710,000–970,000	23,000–35,000	0.2–0.3	10,000–15,000
North America	1.2–1.6 million	36,000–61,000	0.5–0.7	9,100–55,000
Oceania	51,000–68,000	2,900–5,100	<0.3–0.4	1,100–3,100
TOTAL	33.4 million [31.1–35.8 million]	2.7 million [2.4–3 million]	0.8% [<0.8–0.8]	2 million [1.7–2.4 million]

*The proportion of adults [15 to 49 years of age] living with HIV/AIDS in 2008, using 2008 population numbers. The ranges around the estimates in this table define the boundaries within which the actual numbers lie, based on the best available information. These ranges are more precise than those of previous years, and work is under way to increase even further the precision of the estimates.

Source: World Health Organization, UNAIDS, December 2009.

Table 2 Prices (in \$) of Daily Dosage of ARV, April 2000

Drug	U.S.A.	Côte d'Ivoire	Uganda	Brazil	Thailand
Zidovudine	10.12	2.43	4.34	1.08	1.74
Didanosine	7.25	3.48	5.26	2.04	2.73
Stavudine	9.07	4.10	6.19	0.56	0.84
Indinavir	14.93	9.07	12.79	10.32	NA
Saquinavir	6.5	4.82	7.37	6.24	NA
Efavirenz	13.13	6.41	NA	6.96	NA

Source: UNAIDS, 2000 Report on the Global HIV/AIDS Epidemic.

The health of a nation’s population is closely correlated with its economic wealth. Poor countries lack resources for health care generally, and for vaccination in particular. They are unable to provide sanitation and to buy drugs for those who cannot afford them. They also have lower levels of education, and therefore people are less aware of measures needed to prevent the spread of disease.⁵ There is no cure or vaccine for AIDS. Therefore, public health experts place a high priority on prevention. However, only a small percentage of the funds targeted to prevent AIDS was deployed in developing countries.

Drugs help combat AIDS by prolonging the lives of those infected and by slowing the spread of the disease. These drugs significantly reduce deaths in developed countries. Treatment, however, is very expensive. As with most medicines, manufacturers hold patents for drugs, thereby limiting competition from generic products and allowing firms to price well above manufacturing costs in order to recoup R&D investment and make a fair profit.

In 2000–2001, a year’s supply of a “cocktail” of anti-retroviral (ARV) drugs used to fight AIDS cost between \$10,000 and \$12,000 in developed countries, putting it beyond the reach of those in most developing countries, where per capita income is a fraction of this cost (see Tables 2 and 3).⁶ This discrepancy provokes strong reactions. Dr. James Orbinski, president of Doctors Without

Borders (Médecins Sans Frontières), an international humanitarian nongovernmental organization (NGO) that won the 1999 Nobel Peace Prize, lamented, “The poor have no consumer power, so the market has failed them. I’m tired of the logic that says: ‘He who can’t pay dies.’”⁷

AIDS in Southern Africa

In sub-Saharan Africa, approximately 22.4 million people are living with AIDS. Of the 2 million AIDS deaths globally in 2003, approximately three-quarters or 1.6 million were in sub-Saharan Africa (see Table 1).⁸ The disease took a heavy toll on women and children. In 2008, more than 1.8 million children were infected in the region and a disproportionate percentage of infected adults were women.

Most HIV transmission among southern Africans occurred through sexual activity rather than blood transfusion or use of infected needles. As a result of historic and economic factors, there are large numbers of single migrant male communities in southern Africa. These communities, many of whom served the mining industry, are at great risk of AIDS transmission, especially with easy access to alcohol and commercial sex workers (prostitutes).⁹

There is great stigma attached to AIDS in southern Africa. On International AIDS Day in 1998, Gugu Dlamini, a South African AIDS activist, declared on television that she was HIV-positive and was subsequently stoned to death for having shamed her community. Dr. Peter Piot, head of UNAIDS (the AIDS program of the United Nations), pointed out the tragic irony in the situation: Some of those who murdered Dlamini probably had AIDS but didn’t know it—25 percent of her community was infected.¹⁰

In the nation of South Africa, one out of every nine residents has HIV/AIDS. The disease had slashed South African life expectancy from 66 years to below 50, a level not seen since the late 1950s. Large pharmaceutical companies and the U.S. government resisted calls to relax intellectual property laws that were thought to limit the provision of low-cost AIDS treatments. South African president Thabo Mbeki himself had been accused of engaging in “denial” as he had disputed established wisdom regarding the source of and treatment for AIDS.

Table 3 Estimated Number of People in 2002 Who Needed “Triple Therapy” AIDS Treatment, Compared with the Number Who Received Treatment (in thousands)

	In Need of Treatment	Received Treatment
Latin America and the Caribbean	370	196
North Africa and Middle East	7	3
Eastern Europe and Central Asia	80	7
Asia Pacific	1,000	43
Sub-Saharan Africa	4,100	50

Source: UNAIDS, 2002 Report on the Global HIV/AIDS Epidemic.

Table 4 2003 Global Pharmaceutical Sales by Region

World Audited Market	2003 Sales (\$bn)	% Global Sales (\$)	% Growth (constant \$)
North America	229.5	49%	111%
European Union	115.4	25	8
Rest of Europe	14.3	3	14
Japan	52.4	11	3
Asia, Africa, and Australasia	37.3	8	12
Latin America	17.4	4	6
Total	\$466.3bn	100%	19%

Source: IMS World Review (2004).

Meanwhile, South Africans continued to die from the disease, and the South African economy also suffered direct and indirect costs from the disease's ravaging effects.¹¹

The Global Pharmaceutical Industry, R&D, and Drug Pricing

Most of the global \$466 billion of pharmaceutical sales in 2003 were in the developed countries of North America, Japan, and Western Europe (see Table 4). Leading pharmaceutical companies were large and profitable (see Table 5), although all of them have come under pressure from a range of factors—most notably, calls for lower health care costs in most major industrialized countries. Drug discovery is a long, expensive, and uncertain process. In recent years, the development of a new drug, starting with laboratory research and culminating in FDA approval, was estimated to take 10 to 15 years and cost around \$800 million on average. Only 30 percent of drugs marketed were reported to earn revenues that matched average R&D costs.¹²

Like most for-profit firms, pharmaceutical companies pursue opportunities with high profit potential. A spokesman for Aventis, a French-German pharmaceutical company, said, "We can't deny that we try to focus on top markets—cardiovascular, metabolism, anti-infection, etc. But we're an industry in a competitive environment—we have a commitment to deliver performance for shareholders."¹³ The industry tends to focus on diseases prevalent

in its major markets. Drug patents enable companies to charge prices several times the variable manufacturing costs and generate hefty margins to help recover R&D costs and deliver profits. Drugs tend to be relatively price insensitive during the period of patent protection.

Prices vary considerably across markets, as illustrated by the price of fluconazole, an antifungal agent as well as a cure for cryptococcal meningitis, which attacked 9 percent of people with AIDS and killed them within a month. According to a study by Doctors Without Borders, in 2000, wholesale prices for fluconazole averaged \$10 per pill and ranged from \$3.60 in Thailand to \$27 in Guatemala. Pfizer, which reportedly earned \$1 billion annually on fluconazole, claimed the range was narrower (\$6). Prices were considerably lower in countries that did not uphold foreign patents for pharmaceuticals. In India, Bangladesh, and Thailand it was sold by generic manufacturers for prices ranging from 30 to 70 cents.¹⁴ (Some of the countries that didn't recognize patents for pharmaceuticals did have laws for patent protection of other products.)

The pharmaceutical industry was criticized for spending large sums on sales, marketing, and lobbying. Pfizer's spokesman, Brian McGlynn, countered, "Yes, we spend a lot of money on advertising and marketing. But we don't sell soda pop. It's an enormous transfer of knowledge from our lab scientists to doctors, through those sales reps."¹⁵ Companies also spent heavily on lobbying governments on issues such as government-managed prescription drug plans for the elderly, which could create pressure to cap drug prices, and on strengthening and enforcing intellectual property protections.

Table 5 2001 Financials for Selected Pharmaceutical Companies (\$bn)

	Merck	Pfizer	GlaxoSmithKline
Country	U.S.	U.S.	U.K.
Revenue	47.7	32.3	29.7
COGS	29.0	5.0	6.9
SG&A	6.2	11.3	12.2
R&D	2.5	4.8	3.8
Net income	7.3	7.8	4.4

Source: Sushil Vachani, "South Africa and the AIDS Epidemic," *Vilkapala* 29, no. 1 (January–March 2004), p. 104; and company annual reports.

WTO and Intellectual Property Rights¹⁶

Intellectual property rights (IPR) grant investors rights for original creations. The goal of IPR protection is to stimulate creativity and innovation, and to provide incentives and funding for R&D. Intellectual property rights, such as patents, prevent people from using inventors' creations without permission.

The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which was agreed

Exhibit 1 Broad Areas Covered by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

1. Basic principles
 - a. National treatment. Equal treatment of foreign and domestic nationals.
 - b. Most-favored-nation treatment. Equal treatment of nationals of all WTO members.
 - c. Technological progress. Intellectual property rights had to strike a balance between technological innovation and technology transfer. The objective was to enhance economic and social welfare by making both producers and users benefit.
2. How to provide adequate protection.
3. Enforcement.
4. Dispute settlement.
5. Special transitional arrangements. WTO agreements took effect January 1, 1995. Developed countries were given one year to bring their laws and practices in line with TRIPS. Developing countries were given five years and least developed countries 11 years.

Source: WTO, www.wto.org/english/tratop_e/trips_e/trips_e.htm.

to under the Uruguay Round of the GATT (1986–1994), attempted to bring conformity among different nations’ protection of IPR. TRIPS covered five basic areas (see Exhibit 1). Patent protection extended a minimum of 20 years. Governments could deny patent protection on certain grounds (e.g., public order or morality) or for certain classes of inventions (e.g., surgical methods, plants, and so on). If the patent holder abused the rights granted by the patent (e.g., by refusing to supply the product to the market), the government could, under prescribed conditions, issue compulsory licenses that allowed competitors to produce the product.¹⁷

Also under TRIPS, a country that is in a state of medical emergency could resort to two actions: compulsory licensing, under which it could have generic products manufactured while paying a royalty to the patent holder, and parallel importing, which meant importing legally produced copies of a product that were cheaper in a foreign country than in the importing country. However, the WTO guidelines did not define a medical emergency. Developing countries’ view of what constituted a medical emergency was substantially different from that held by drug companies and the U.S. government.

Despite being a country with 85,000 AIDS patients,¹⁸ Brazil responded to international pressures and passed a law recognizing patents in 1996. This law specified that products commercialized anywhere before May 15, 1997,

would forever remain unpatented in Brazil. The Brazilian government encouraged local companies to produce unlicensed copies of several AIDS drugs, which it bought from them to distribute to its patients free of charge in a policy of universal access. AIDS deaths were halved between 1996 and 1999. Between 1996 and 2000, local production, together with bulk imports, reduced annual treatment costs by 80 percent for double therapy (a cocktail of two AIDS drugs, both nucleosides) and by about 35 percent for triple therapies (two nucleosides and a protease inhibitor or non-nucleoside).¹⁹

For drugs that had valid patents in Brazil, the government attempted to negotiate lower prices. When negotiations between Merck and the Brazilian government over prices of the drug Stocrin initially stalled, the government threatened to license the drug compulsorily under the provisions of Brazilian law. When Merck learned a copy was being developed in a government lab, it threatened to file a lawsuit. The U.S. government filed a complaint with the WTO, but Brazil refused to budge.²⁰ President Fernando Cardoso defended the patent-breaking practice, suggesting that this approach was not one of commercial interest, but rather a moral issue that could not be solved by the market alone. The pharmaceutical industry association’s position on intellectual property rights was summarized as follows:

Strong intellectual property protection is the key to scientific, technological and economic progress. Such protection is the *sine qua non* of a vibrant and innovative pharmaceutical industry—and thus to patients—in the United States and around the world. Without such protection, far fewer drugs would be developed, fewer generic copies would be manufactured, and the flow of medicines to the public would be greatly slowed—to the detriment of patients, public health, and economic development throughout the world.²¹

Pharmaceutical companies were worried about more than losing contributions from sales of a drug faced with a knockoff in a specific country. They feared a domino effect—compulsory licensing spreading across developing countries and sharply hurting profits in multiple markets. Even more alarming was the prospect that prices in developed countries might sink either because of a gray market in generics or because of pressure to cap prices as information on the significant price differential between countries became widely available and developed-country consumers clamored for lower prices.

Drug Pricing in Developing Countries: Government, Industry, and NGO Perspectives²²

Dr. Christopher Ouma, who cared for AIDS patients in a Kenyan public hospital, pointed out that half his patients couldn’t pay the \$2.60 daily bed charge. He usually didn’t tell patients’ families about the existence of drugs to treat AIDS. “This is where the doctor’s role goes from care-giver

to undertaker,” he added. “You talk to them about the cheapest method of burial. Telling them about the drugs is always kind of a cruel joke.”²³

Drug companies had been reluctant to provide AIDS drugs to developing countries at prices much lower than those charged in developed countries. They expressed concern that distributing drugs in unregulated and unreliable environments could risk creating new strains of drug-resistant HIV. In 1997, South Africa passed a law to permit compulsory licensing of essential drugs. Pharmaceutical companies, including Bristol-Myers Squibb and Merck, sued the South African government in an attempt to delay implementation of the law.

The Clinton administration lobbied the South African government to reverse its decision. U.S. Trade Representative Charlene Barshefsky placed South Africa on the “301 watch list,” which puts a nation on notice that U.S. trade sanctions will be imposed if it doesn’t change its policies.²⁴

The *Washington Post* reported, “Critics have accused U.S. trade policy of placing the profits of drug companies above public health, moving to block poor countries from manufacturing the drugs themselves, despite international laws that permit countries to do so when facing a public health emergency.”²⁵ The British newspaper *Guardian* referred to the U.S. government’s actions as “trade terrorism” and called for efforts to “defend developing countries against U.S. aggression.”²⁶ The World Bank official who oversaw the Bank’s African health investments and its annual \$800 million drug procurement said the drug-price structure “shows an increasing disconnect with the needs of the majority of the people in the world.”²⁷

As the U.S. government began to exert pressure on developing countries through the WTO and unilaterally, AIDS activists and NGOs, such as Doctors Without Borders, Act-Up, Health Action International, and the Consumer Project on Technology, swung into action. They targeted the public appearances of Vice President Al Gore during his presidential campaign. In September 1999, the administration backed off from the threats of placing trade sanctions against South Africa. The administration informed the South African government it would not object to issuance of compulsory licenses for essential drugs provided this was done within WTO guidelines.

In December 1999, President Bill Clinton told members of the WTO that the U.S. government would show “flexibility” and allow countries to obtain cheaper drugs during health emergencies on a case-by-case basis.²⁸ NGOs immediately called on the U.S. government to end trade pressure on poor countries in health care industry disputes.²⁹ Over the following year, the U.S. government declared it would not block compulsory licenses in the rest of sub-Saharan Africa and Thailand and elsewhere on a selected basis.

In the summer of 2000, at the 13th International AIDS Conference in Durban, South Africa, Boehringer Ingelheim, a German pharmaceutical company, offered to make its AIDS drug, Viramune, available for free. Bristol-Myers Squibb, Merck, and Glaxo Wellcome made similar offers. NGOs and developing governments, however, criticized the companies for making the announcements without consulting and working with the concerned governments, and for placing restrictions on distribution.³⁰ Jack Watters, Pfizer’s medical director for Africa, defended the conditions of the company’s pilot free-drug program in South Africa: “We want to evaluate how much impact the program has on survival.” The company was also concerned about corruption and diversion of supplies. He added, “There’s no guarantee that the drug will find its way to the people who need it most.”³¹ NGO activists continued to press the U.S. government, the WTO, and the pharmaceutical industry to make it easier for developing countries to produce or import generics. Some felt that if the pharmaceutical industry really wanted to make its products available it should drop its lawsuit against the South African government.³²

In spring 2001, three U.S. pharmaceutical companies—Merck, Bristol-Myers Squibb, and Abbott—announced they would sell HIV drugs to developing countries at cost. GlaxoSmithKline offered 90 percent discounts.³³ Merck planned to use the United Nations Human Development Index and offer the lowest prices to countries that received “low” rankings or had an AIDS infection rate of 1 percent or higher. It offered Brazil, which didn’t fall in that category, prices about 75 percent higher. Still, this was a steep discount compared to U.S. prices. Merck would sell efavirenz in Brazil for \$920 per year per patient (compared to \$4,700 in the United States) and Crixivan for \$1,029 (\$6,000 in the United States).³⁴ In October 2002, Merck announced further cuts in the price for Stocrin from the (already reduced) price of \$1.37 per patient per day to \$0.95 per patient per day in the poorest, hardest-hit countries. The price for middle-development countries with less than 1 percent HIV prevalence would be \$2.10 per patient per day, down from \$2.52.

On September 5, 2002, GlaxoSmithKline announced an additional price cut for antiretroviral drugs and malaria drugs for poor countries. The British company said it would cut the prices of its HIV/AIDS drugs by as much as 33 percent and the prices of its antimalarial drugs by as much as 38 percent in developing countries to help health workers fight two of the deadliest diseases that afflict the developing world. Under the new pricing plan, GlaxoSmithKline said it would supply its AIDS and antimalarial drugs at not-for-profit prices to the public sector, nongovernmental organizations, aid agencies, the United Nations, and the Global Fund to Fight AIDS, Tuberculosis and Malaria. To prevent cut-price drugs from being reimported into the West, Glaxo said it would seek regulatory

approval to provide special packaging for the cut-price drugs.

Indian generic manufacturers, such as Cipla, offered among the lowest prices in the world. Over the years Cipla had developed a range of pharmaceuticals. In 1985 the U.S. FDA approved Cipla's bulk drug manufacturing facilities. Cipla's net income in 2001–2002 was \$48 million on sales of \$292 million. Its major export markets were the Americas (41%), Europe (24%), and the Middle East and Africa (12% each). In late 2001 Cipla agreed to supply a three-drug antiretroviral combination to Nigeria for \$350 per person per year.³⁵ The Nigerian government initiated a \$4 million pilot program covering 10,000 adults and 5,000 children in which it planned to charge patients \$120 per year and cover the remaining cost from government funds.³⁶

In March 2002 the WHO released its first list of companies that are regarded as manufacturers of safe AIDS drugs. Of the 41 drugs listed, 26 were sold by multinationals and 10 by Cipla.

The Global Fund

In April 2001, while addressing an African summit in Nigeria, UN Secretary General, Kofi Annan, proposed creation of a global fund to combat AIDS. He stressed the need to ratchet up spending on fighting AIDS in developing countries from the current \$1 billion level to \$7–10 billion. He noted that pharmaceutical companies were beginning to accept that “generic medication can be produced where it can save lives.” The previous week pharmaceutical companies had dropped their lawsuit against the South African government over patent laws.³⁷

The proposal attracted significant support from world leaders. In May 2001, President George W. Bush announced \$200 million in seed money for the fund. The following month, addressing delegates from 180 nations at a UN conference, U.S. Secretary of State Colin Powell declared, “No war on the face of the world is more destructive than the AIDS pandemic. I was a soldier. I know of no enemy in war more insidious or vicious than AIDS, an enemy that poses a clear and present danger to the world.” He added, “We hope this seed money will generate billions more from donors all over the world, and more will come from the United States as we learn where our support can be most effective.”

The Global Fund, set up as an independent corporation, was broadened to address not just AIDS but tuberculosis and malaria as well. By July 2003, more than \$2 billion had been paid in by developed countries (see Table 6). In addition to leading country donors that included the United States, the EU, individual European countries, and Japan, the Gates Foundation contributed \$100 million. In April 2002, the Global Fund made its first awards, totaling \$616 million, to programs in 40 countries. Slightly more than half was designated for Africa. Experts

Table 6 Leading Donors (Paid to Date) to the Global Fund, July 2004

Country	\$m
U.S.A.	623
EU	401
France	304
Japan	230
Italy	215
U.K.	173
Gates Foundation	100

Source: theglobalfundatm.org.

predicted that the Fund's success hinged on how effective it proved to be as a “hard-nosed judge of its grantees' performance.”

In October 2003, the Fund announced it would slow the pace of its awards to one round per year because it had fallen short of its fund-raising goals and was concerned about running out of money. The Fund announced it had received pledges through 2008 of about \$5.2 billion, well short of its \$8–\$10 billion goal.³⁸ The decision came as the Fund announced \$623 million in grants to 71 disease prevention and treatment programs in about 50 countries. This round of grants, the third, was substantially smaller than the \$884 million awarded in January 2003.

By May of 2008 the Global Fund had distributed a total of US\$5.67 billion. Around 58 percent of funding in November 2007 was spent on HIV and AIDS.³⁹ Since the inception of the Global Fund, 50 donor governments have pledged US\$20.3 billion up to 2015 and paid in US\$14.5 billion. In 2007 and 2008 those 16 member countries of OECD/DAC that are the largest supporters of the Global Fund contributed 96 percent of the contributions of the public donors. Some additional 20 donor governments collectively provided the remaining 4 percent of such resources for the two-year period.⁴⁰

Other Funding Sources

A very large proportion of foreign funding for responses to the AIDS epidemic is provided by donor governments. The American government donates a substantial amount of money for the AIDS epidemic. In 2008 the United States was the largest donor in the world, accounting for more than half of disbursements by governments. It was followed by the United Kingdom, the Netherlands, France, Germany, Norway, and Sweden.⁴¹

In his State of the Union address in January 2003, President Bush announced the creation of PEPFAR, the President's Emergency Plan for AIDS Relief, a commitment to significantly increase U.S. spending on HIV/AIDS initiatives around the world. PEPFAR was a five-year program which was to direct US\$15 billion to countries most in need. PEPFAR was renewed in July 2008 with

the intention of spending \$48 billion from 2009 to 2013 on programs to tackle HIV and AIDS as well as tuberculosis and malaria. The U.K.'s Department for International Development (DFID), the world's second biggest bilateral donor for HIV/AIDS, spent about \$850 million in 2005/06, and is also a major donor to the Global Fund, committing up to £1 billion of funds for the years leading up to 2015.⁴²

The World Bank is the second largest multilateral donor to the HIV/AIDS response in developing countries besides the Global Fund and is one of eight co-sponsors of UNAIDS. By the end of 2006, it had dispersed US\$879.22 million to 75 projects to prevent, treat, and reduce the impact of HIV and AIDS. There are also a very large number of private sector organizations involved in the response to AIDS, including corporate donors, individual philanthropists, religious groups, charities, and non-governmental organizations (NGOs). These organizations vary in size, from small groups such as local churches, to large contributors such as the Bill and Melinda Gates Foundation and corporate donors. Overall, the private sector is by far the smallest of the four main sources of funding for the global AIDS response, accounting for around 4 percent of spending.⁴³

Pressure Mounts

In June 2002, two weeks before the 14th International AIDS Conference in Barcelona, the WTO council responsible for intellectual property extended until 2016 the transition period during which least-developed countries (LDCs) did not have to provide patent protection for pharmaceuticals.⁴⁴ Previously they'd been expected to comply by 2006. (See Exhibit 2 for a list of least-developed countries.)

The delegates from the 194 countries left the July 2002 International AIDS Conference in Barcelona with cautious optimism. Joep Lange, president of the International AIDS Society, said, "If we can get Coca-Cola and cold beer to every remote corner of Africa, it should not be impossible to do the same with drugs." However the conference wasn't without protests. Activists tore down the European Union exhibition stand, demanding larger contributions to the Global Fund. The World Health Organization estimated that given the public health infrastructure in developing countries, the maximum that could be spent productively each year by 2005 was about \$9 billion. This assumed \$4.8 billion for prevention and \$4.2 billion for

treatment. It also estimated that with a commitment of \$4.8 billion per year to prevention, 29 million infections could probably be avoided by 2010.

Several challenges remained. Drug prices had fallen significantly, but not low enough for everyone. While the large pharmaceutical companies were selling antiretroviral combinations for about \$1,200 per person per year in some developing countries, the lowest generic prices out of India were \$209. Health economists estimated that prices needed to fall as low as \$30–\$40 per person per year for drugs to reach the poorest recipients. Such low prices were unlikely to materialize anytime soon. NGOs, such as Doctors Without Borders, were expected to push for optimizing use of scarce funds by deploying Global Fund allocations for purchase of generics only. Tough decisions needed to be made about the allocation of resources between AIDS and other diseases, and between prevention and treatment of AIDS.

In early August 2003, the South African government reversed its policy on AIDS, signed the Global Fund, and announced production of its first generic AIDS drug. Aspen Pharmacare, a South African firm, announced it would be the initial provider of generic treatments. Backed by many activist groups, including the influential Treatment Action Campaign, revisions to the \$41 million deal detailed an operational plan to make the drugs available by the end of September 2003. South African president Thabo Mbeki finally agreed to the long-standing proposal after a recent World Bank report predicted "a complete economic collapse" within four generations if the government didn't act swiftly.

The 2003 WTO Agreement and Its Aftermath

In August 2003, the United States and other WTO members announced that they had finalized a solution to streamline the supply of disease-fighting medications to poor countries. As part of the compromise deal, the United States agreed to language that would allow compulsory licensing only for "genuine health reasons" and not for commercial advantage. This appeared to prompt action.

On December 10, 2003, Britain's GlaxoSmithKline and Germany's Boehringer Ingelheim agreed to expand the licensing of their patented AIDS drugs to three generic manufacturers in South Africa and other African countries as part of an out-of-court settlement with South Africa's

Exhibit 2 Countries Classified as Least-Developed by WTO

Angola	Djibouti	Maldives	Sierra Leone
Bangladesh	Gambia	Mali	Solomon Islands
Benin	Guinea	Mauritania	Tanzania
Burkina Faso	Guinea Bissau	Mozambique	Togo
Burundi	Haiti	Myanmar	Uganda
Central African Republic	Lesotho	Niger	Zambia
Chad	Madagascar	Rwanda	
Congo	Malawi	Senegal	

Treatment Action Campaign. In return, the South African Competition Commission, a government body that monitors free-market practices, agreed to drop a yearlong probe into whether the companies had overcharged for their AIDS drugs. Glaxo and Boehringer Ingelheim already had existing agreements with a fourth generic manufacturer, South Africa's Aspen Pharmacare. Under the settlement pact in South Africa, Glaxo also agreed to cap royalty fees at no more than 5 percent of net sales and to extend the generic licenses to the private and public sectors. It said it would allow the generic licensees to export AIDS drugs manufactured in South Africa to 47 sub-Saharan African countries. The Competition Commission said it had not asked for a fine or administrative penalty against Glaxo, which is the world's largest maker of AIDS medicines.⁴⁵

Shareholder activists have also begun to put pressure on companies to provide more comprehensive reporting about their potential to support efforts to fight AIDS. In March 2004, a consortium of religious investors forwarded shareholder resolutions at four top drug makers, asking the companies to assess how much charity work they are doing for HIV and AIDS in developing countries and to estimate how much the epidemic could affect their businesses. The Interfaith Center on Corporate Responsibility (ICCR) and roughly 30 religious groups requested that pharmaceutical companies offer shareholders a report of their conclusions six months after the annual meetings. Although the boards of directors at Pfizer, Merck, and Abbott said they opposed the measure, Coca-Cola's board said it supported a similar shareholder proposal to assess the business risks associated with the HIV/AIDS epidemic.⁴⁶

2005: Making the WTO Agreement Official and Its Aftermath

At the end of 2005, members of the WTO approved changes to the intellectual property agreement making permanent the August 2003 "waiver" which facilitated access for developing countries to cheaper, generic versions of patented medications.⁴⁷ Director-General Pascal Lamy said, "This is of particular personal satisfaction to me, since I have been involved for years in working to ensure that the TRIPS Agreement is part of the solution to the question of ensuring the poor have access to medicines."⁴⁸

According to Doctors Without Borders, prices of first-line treatments have dropped from more than \$10,000 to as little as \$150 a year since 2000 largely due to competition from generics.⁴⁹ Brazil and Thailand have been able to launch successful national AIDS programs because key pharmaceuticals were not patent protected and could be locally produced for very low costs. Still, the method of implementation at the national or regional trade level of TRIPS can cause problems.⁵⁰

In early 2006, Bristol-Myers Squibb (BMY) announced an agreement for technology transfer and voluntary license with generic manufacturers Aspen Pharmacare and Emcure Pharmaceuticals for atazanavir, first approved for combination therapy in the United States in June 2003. Peter R. Dolan, Bristol-Myers Squibb's CEO, highlighted his company's commitment to the global fight against AIDS: Under the deal, the generic company will set prices in Africa and India.

Generic drug manufacturers have lowered the costs of some much-needed drugs to developing countries, but often new drugs were still priced much higher than old treatments, and are hence unavailable in many of the countries with the most need. Doctors Without Borders spoke out in March 2006 against what it calls the standard practice of drug companies marketing less adapted drugs to African, Asian, and Latin American countries, while reserving new and improved drugs for more wealthy countries.⁵¹ The NGO specifically criticized Abbot Laboratories' lopinavir/ritonavir, which was only available in the United States at a cost of US\$9,687 per patient per year. Doctors Without Borders worker Dr. Helen Bygrave commented, "It's a cruel irony that although this drug—with no need for refrigeration—seems to have been designed for places like Nigeria, it is not available here."⁵²

In December 2005, the WHO released a statement urging countries to adopt a policy of free access at the point of service delivery to HIV care and treatment, including antiretroviral therapy.⁵³ This recommendation came in the wake of a 2005 endorsement by G8 leaders and UN member states to provide universal access to HIV treatment and care by 2010. After a similar effort, the "3 by 5" program, which aimed to provide treatment for 3 million patients in 50 developing countries by the conclusion of 2005, it had become apparent that charging users at the point of service undermines efforts to provide universal care.

The number of people receiving antiretroviral aid has increased under the 3 by 5 program, but not to desired levels. More than 1 million people in developing countries received antiretroviral treatment in 2005, and expanded treatment helped to prevent 250,000–350,000 deaths.⁵⁴

Pressure Mounts Again

The increasing severity of the AIDS epidemic, compounded by the constant lack of access to drugs, has recently prompted more drastic action among some developing countries. In January 2007 Thailand, a nation with nearly half a million residents infected with HIV, announced its intentions to break the patent on an important AIDS drug (Kaletra) produced by Abbott Laboratories,⁵⁵ setting a precedent for other nations such as Brazil, Indonesia, and the Philippines. Abbott retaliated by revoking the introduction of seven new drugs in Thailand.

Doctors Without Borders called Abbott's reaction "calculus," and Abbott has since backed down.

The UN and World Bank have openly supported Thailand's landmark patent-breaking decision as part of its serious treatment of AIDS within its new health program.⁵⁶ The global impact of Thailand's decision is likely to be magnified by subsequent policy changes by other countries; for instance, Brazil renounced the patent on a Merck AIDS drug in May 2007 (after years of threatening to do so).⁵⁷ Although the U.S.-Brazil Business Council warns that this IPR violation might deter future business investment from Brazil, the government still went through with the decision, likely prompted by Thailand's precedent as well as Merck's inability to offer what Brazil viewed as a satisfactory discount on patented drug purchases.⁵⁸

The increased global effort to fight HIV/AIDS has been supported by other organizations. Among others, the Clinton Foundation has recently stepped up its work with drug companies to lower prices of AIDS medications. In October 2003, former president Bill Clinton first announced a landmark program to attack two of the toughest obstacles to treating AIDS in the developing world: high drug prices and low-quality health infrastructures. The Clinton Foundation HIV/AIDS Initiative reached a deal with four generic-drug companies, including one in South Africa, to slash the price of antiretroviral AIDS medicine. In April 2004, Clinton's foundation announced that these special drug prices were being extended from the initial 16 countries in the Caribbean and Africa to any country supported by UNICEF, the World Bank, and the UN-administered Global Fund to Fight AIDS, Tuberculosis, and Malaria. "With these agreements, we are one step closer to making sure future generations can live without the scourge of AIDS," Clinton said in a statement released by his U.S.-based foundation.

In May 2007 the Foundation struck a deal with Cipla and Matrix Laboratories to lower prices on "second-line" AIDS drugs.⁵⁹ The Clinton Foundation, which is financed by Unitaid (an organization of 20 nations that donate a portion of airline tax revenues for HIV/AIDS programs in developing countries), provides access to lower-priced AIDS drugs for approximately 65,000 people in 65 countries worldwide.⁶⁰

Under the Clinton Foundation agreement, five generic-drug manufacturers—Pharmacare Holdings of South Africa and the Indian companies Cipla, Hetero Drugs, Ranbaxy Laboratories, and Matrix Laboratories—provide basic HIV treatment for as little as \$140 per person per year, one-third to one-half of the lowest price available elsewhere. Diagnostic tests are supplied by five different companies and include machines, training, chemicals, and maintenance at a price that is up to 80 percent cheaper than the normal market price. "This new partnership works to break down some of the

barriers—such as price, supply and demand—that are impeding access to lifesaving AIDS medicines and diagnostics in developing countries," said UNICEF Executive Director Carol Bellamy.⁶¹

AIDS Medicine Development

As reported by Pharmaceutical Research and Manufacturers of America (PhRMA) at the end of 2008, U.S. pharmaceutical research companies were testing 109 medicines and vaccines to treat or prevent HIV/AIDS and related conditions.⁶² This showed a substantial effort by the pharmaceutical community to combat the disease, although only 31 medicines to treat HIV/AIDS have been approved so far since the virus that causes AIDS was first identified more than 20 years ago.⁶³ As noted in PhRMA 2008 Report, an effective HIV vaccine could prevent almost 30 million of the 150 million new infections projected in the coming decades. A highly effective vaccine could prevent more than 70 million infections in 15 years. In 2008, 29 vaccines were in development. In addition to the vaccines, there were 57 antivirals, 4 cancer treatments, 6 immunomodulators, 2 gene therapies, and 12 other medicines in human clinical trials or before the Food and Drug Administration awaiting approval.⁶⁴

Opportunistic infections are a particular problem for patients infected with the HIV virus. Opportunistic infections include candidiasis of the mouth (thrush), the most common opportunistic infection in people with HIV; *Mycobacterium avium* complex (MAC), a bacterial infection that up to 50 percent of people with AIDS may develop; and *Pneumocystis carinii* pneumonia (PCP), the most common AIDS-defining infection in the United States. Examples of HIV medicines and vaccines in the pipeline for HIV-related opportunistic infections include antisense gene therapy that uses two novel technologies to boost immune responsiveness against HIV; and a vaccine that is designed to protect against the three most common types of HIV-1 virus found around the world.⁶⁵

From 2000 to 2007, pharmaceutical research companies contributed more than \$9.2 billion to improve health care in the developing world, according to the International Federation of Pharmaceutical Manufacturers & Associations.⁶⁶ Despite that progress, AIDS remains a devastating and growing worldwide health problem in developing countries, particularly in sub-Saharan Africa, China, India, and the Russian Federation.

Pharmaceutical Companies and UN Joint Efforts to Combat AIDS

United Nations Secretary-General Ban Ki-moon and other UN officials met in September 2008 with senior executives from 17 companies, including Abbott, Boehringer Ingelheim, Glaxo, Pfizer, Roche, Merck,

Becton-Dickinson, Johnson & Johnson, Gilead Sciences, and Ranbaxy, among others. Companies agreed to invest further in research and development of new HIV-related medicines adapted to resource-limited settings. All participants agreed that increasing access to vaccines, diagnostics, and medicines is essential in scaling up prevention and treatment efforts.⁶⁷

Some progress was noted by UN officials in 2008: As many as 3 million people were on treatment by the end of 2007, up from 1.3 million in 2006. There have been significant price reductions for first-line and pediatric antiretroviral drugs, and some second-line products. Two new classes of drugs have been introduced and new heat-stable formulations and fixed-dose combinations have been developed. There has also been further investment and development of technologies for prevention and diagnosis of HIV and for monitoring the efficacy of antiretroviral therapy in adults and children.⁶⁸

The parties agreed to continuing to hold periodic high-level meetings, under the leadership of UNAIDS, to take stock of progress and to identify new collaborative measures.⁶⁹

Recent Initiatives

In April of 2009 two pharmaceutical rivals, GlaxoSmith-Kline and Pfizer announced that they intend to create a new company, headquartered in London, to manage their HIV operations with initial working capital of £250m. The lion's share of the business will be owned by GSK, which will take 85 percent to reflect its portfolio of big-selling HIV drugs such as Combivir and Kivexa. The other 15 percent will go to Pfizer, which will contribute potentially promising new treatments. The new company will have 11 drugs on the market and a further six in clinical development. It will have a market share of 19 percent and annual sales of £1.6bn.⁷⁰

GSK's chief executive, Andrew Witty, said the "clear focus" of the joint venture would be in delivering new drugs to build on what he described as the drug industry's remarkable success in tackling HIV over the last two decades. Witty recalled that as recently as 1990, it was extremely difficult to conduct clinical trials in HIV because patients rarely lived long enough to complete studies. He said: "I think it's one of the finest performances of the pharmaceuticals industry to have transformed an incredibly frightening infectious disease into something more manageable."⁷¹

Speaking in Kenya in July of 2009, Andrew Witty, GSK's chief executive, said the treatment of the conditions in children remains a "significant unmet medical need." Therefore, GSK will create a new Positive Action for Children Fund that will have access to £50m over the next 10 years, and has also granted Aspen Pharmacare, in which it acquired a 16 percent stake in May, a royalty-free

license to develop a cheaper, generic version of its HIV treatment abacavir. The company could make more drugs "appropriate for use in an African setting" available for a license, added Mr. Witty. GSK's new fund is designed to work alongside health organizations and pregnant mothers to prevent mother-to-child transmission of HIV in the developing world, especially sub-Saharan Africa. The company will also make £10m available to support a new public-private partnership which will research and develop new drugs.⁷²

In September 2009 a group of AIDS treatment activists after a yearlong study of the actions of nine major pharmaceutical companies to address the contagion in the United States, issued a report with the grades for the pharma efforts to fight HIV/AIDS. The report card graded the drug makers overall with a below-average C-minus and recommended improvements. The report gave its highest grade, a B, to Merck, for producing Isentress, the first of a new class of AIDS drugs called integrase inhibitors. It also praised Merck for freezing prices for lower income users. Isentress, approved in 2007, is already used by 11 percent of the more than 550,000 people treated in the United States. The group gave an F to Abbott for raising the wholesale price of Norvir, the first drug proved to increase survival in AIDS patients, by 400 percent in 2003. Norvir is a key ingredient in most AIDS treatment cocktails. The price increase provoked an outcry by many patients and others.⁷³

Questions for Review

1. Do pharmaceutical companies have a responsibility to distribute drugs for free or at low cost in developing countries? What are the main arguments for and against such an approach? What are the advantages and disadvantages of giving drugs for free versus offering them at low no-profit prices?
2. What are the principal arguments of pharmaceutical companies that oppose making exceptions to IPR laws for developing countries? What are the arguments by NGOs and others for relaxing IPR laws?
3. What impact would you expect South Africa's decision to levy duties on drug imports from Western nations to have on the international distribution of drugs to South Africa?
4. In June 2002, the WTO extended the transition period during which least-developed countries (LDCs) had to provide patent protection for pharmaceuticals. In your opinion, was this an appropriate change in policy or a dangerous precedent? What could be some of the negative ramifications of this resolution? What about the effects for other industries?

5. Given the initiatives announced by global development and aid organizations and among pharmaceutical companies themselves, was it necessary to relax IPR rules in order to ensure that adequate supplies of AIDS medications would be available for distribution in the developing world?
6. What role do MNCs have in providing funding or other assistance to international organizations such as the Global Fund, UN, and WHO?

Exercise

Although the WTO has now agreed to relax intellectual property rules in order to facilitate the production and distribution of inexpensive generic antivirals, the conditions under which this provision allows for production or importation of generics (“genuine health reasons”) are not entirely clear. The WTO is to hold a hearing for interested parties to provide input about how these rules should be implemented. Your group represents the interests of one of the key stakeholders (see table) and will be responsible for arguing that stakeholder’s position.

Team	Stakeholder
1	The WTO
2	Doctors Without Borders (NGO)
3	CIPLA (Indian generic manufacturer)
4	GlaxoSmithKline (representing pharma companies)
5	Government of Brazil (representing developing countries)
6	The Clinton Foundation HIV/AIDS Initiatives

Discuss with your group the major points to make to advance your perspectives. Come prepared to make a five-minute presentation summarizing how you would like the WTO to implement the new rules. The WTO group should ask questions during the hearing. It should then take 10 minutes to deliberate and come up with a proposed plan incorporating the interests of all of the stakeholders.

Source: © McGraw-Hill Irwin. This case was prepared by Jonathan Doh and Erik Holt of Villanova University with research assistance by Courtney Asher and Tetyana Azarova as the basis for class discussion. It is not intended to illustrate either effective or ineffective managerial capability or administrative responsibility. The authors thank Sushil Vachani for comments, suggestions, and input.