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## ACHIEVING SOCIAL LICENSE TO OPERATE USING STAKEHOLDER THEORY

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**Abstract:** The concept of Corporate Social Responsibility (CSR) is gaining support in the global business environment. Some companies are adopting a model, the Social License to Operate (SLO), as part of their CSR strategy. This paper provides background on the concepts of Corporate Social Responsibility and Social License to Operate with examples supporting the business case for them. It proposes a process based on stakeholder theory for identifying and classifying stakeholders that divides stakeholders into two groups: vested and non-vested. Vested stakeholder groups have a vote in the awarding of a social license to operate, while non-vested stakeholder groups have only a voice. By using a process based on alignment of the norms and values of the company, and the stakeholder groups, social licenses to operate can be negotiated that can allow a company to succeed in different countries and cultures.

**Keywords:** social license to operate; corporate social responsibility; ethical global business; stakeholder theory

The concept of Corporate Social Responsibility (CSR) is gaining support with companies, especially those that operate in the global arena. At present, corporate social responsibility is “a voluntary approach that a business enterprise takes to meet or exceed stakeholder expectations by integrating social, ethical, and environmental concerns together with the usual measures of revenue, profit, and legal obligation” (BNET Business Dictionary, 2009).

However, global companies may find that Corporate Social Responsibility becomes less and less voluntary. CSR is currently finding support at the political level. At the recent World Economic Forums, politicians have told corporate leaders that they must have collective as well as company goals that must focus on sustainability. A subset of CSR, sustainability, when “based on the idea of sustainable development, refers to how well a company ensures its long-term viability based on its environmental, social, and economic performance” (The Ethical Funds Company, 2009). Organizations like the Global Reporting Initiative, and Mary Robinson’s (former President of Ireland) Realizing Rights, The Ethical Globalization Initiative, focus their efforts on helping companies recognize that ethical globalization “acknowledges shared responsibilities for addressing global challenges and affirms that our common humanity doesn’t stop at national borders” (What is Ethical Globalization?, 2009).

The recent McKinsey reports of business executives show this is having an effect on the responses of business to the need for corporate social responsibility as necessary to their business strategy, not just for public relations. They are translating the loss of customers due to poor CSR as a loss of profit when they see examples of companies using what could be profit to fight an Internet media attack accusing

them of mistreatment of workers, communities, or customers. They recognize the lost opportunity for profit when the local community forces a company to leave an area (“The McKinsey Global Survey,” 2008).

Some companies are adopting the Social License to Operate (SLO) model first used by global extraction companies to protect their profits, as part of their CSR strategy. The concept of a Social License to Operate is defined as:

*outside of the government or legally-granted right to operate a business. A company can only gain a Social License to Operate through the broad acceptance of its activities by society or the local community. Without this approval, a business may not be able to carry on its activities without incurring serious delays and costs. (The Ethical Funds Company, 2009)*

The social license to operate was developed as a response to a United Nations initiative that requires industries that operate in the territories of indigenous people to secure free, prior, and informed consent (FPIC) from those indigenous people. “Free, prior, and informed consent recognizes indigenous peoples’ inherent and prior rights to their lands and resources and respects their legitimate authority to require that third parties enter into an equal and respectful relationship with them, based on the principle of informed consent” (United Nations, 2004). Thus, both SLO and FPIC assume that those whose lives or livelihoods could be harmed by a company’s use of property must be fully informed of a company’s plans and must consent to them. This would include loss of fish to a community depending on fishing by polluting the water or diverting the water so that fish no longer thrive. It would also include polluting water or soil or emitting dangerous chemicals that would be dangerous to those who live in the area. Both SLO and FPIC require that companies meet sustainable development expectations by focusing on the needs and concerns of the communities in which they operate.

*In a nutshell, FPIC recognizes that communities have the right to self-determination. They have a right to give or withhold their consent for new production facilities that may impact local water supplies or prices.*

*From a legal point-of-view, FPIC is an evolving concept that is gaining wider acceptance by nongovernmental organizations, as well as a few private corporations. FPIC is now incorporated in some forms of international treaty law, especially when it comes to indigenous peoples and extractive industries such as oil and mining. What’s new is that FPIC is now being applied to water. (Asmus, 2009)*

Unfortunately, a process for achieving FPIC and/or SLO beyond indigenous groups has not been developed. Negotiating FPIC or an SLO with an indigenous people usually involves a defined community such as a tribe that has a leader who speaks for the community. Thus, a company can identify a known person with whom to start the process. However, when a company tries to secure a social license to operate in the greater community, it usually finds that this community is comprised of

many different stakeholder groups with many different leaders and interests. There is no recognized leader or spokesperson with whom to start a dialogue. Additionally, the concept of Social License to Operate does not mandate the consent of the community as a whole like FPIC does. A company may have a social license to operate from a small segment of the community or from the leader of one segment even though others are against it. A company may also engage a community in negotiating how it will operate, not if it will operate there.

The social license to operate, since it is both voluntary and involves gaining the consent of the community, is difficult to implement. At present, there are no definitions or processes to guide a company if it tries to use SLO in making strategic decisions. Asmus (2009) identifies three key issues that must be resolved:

1. How is “the community” defined? Is there a strict geographical limitation to “community,” and are elected officials given greater or equal status to local citizens?
2. If there is a lack of consensus within the “community,” what process validates any decision-making (i.e., majority vote of local governing body; a referendum)?
3. Absent a political process, what exactly represents an adequate level of consent?

This paper will provide background on the concepts of Free, Prior, and Informed Consent and Social License to Operate with examples supporting the business case for them. It will then propose a process to resolve Asmus’ (2009) three questions. The process is based on normative stakeholder theory for identifying and classifying stakeholders according to criteria that allow them a vote and/or a voice at the negotiation table, and for developing a social license to operate.

## Background

In 2007, The Economist argued that

*Every corporate strategy had to pass two tests—does it enhance the company’s long-term profitability, and does it serve the public good? But once you introduce two criteria, you undermine Friedman’s doctrine that if it’s profitable, it automatically serves the public good. (“The next question: Does CSR work?” 2008)*

However, it could be argued that Friedman’s (1970) rule that “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud” (para. 32), requires free, prior, and informed consent to insure there is no deception or fraud. As corporations extend their presence across the globe into countries with cultures, governments, norms, and values different not only from the one in which they were incorporated, but also different from one another, a focus on corporate social responsibility can help organizations operate ethically in this changing global environment. A social license to operate can be a pillar for corporate social responsibility.

### ***Free, Prior, and Informed Consent***

The first companies to feel pressure to obtain community consent in the new global order were those in

the extraction industry. The Declaration on the Rights of Indigenous Peoples was adopted in 2006 by the United Nations General Assembly by a majority of 144 states; although Australia, Canada, New Zealand, and the United States voted against it and 11 countries, Azerbaijan, Bangladesh, Bhutan, Burundi, Colombia, Georgia, Kenya, Nigeria, Russian Federation, Samoa and Ukraine abstained (UN Permanent Forum on Indigenous Issues, 2007).

A United Nations (2007) article that provides significant guidelines involving indigenous people states

1. Indigenous peoples have the right to determine and develop priorities and strategies for the development or use of their lands or territories and other resources.
2. States shall consult and cooperate in good faith with the indigenous peoples concerned through their own representative institutions in order to obtain their free and informed consent prior to the approval of any project affecting their lands or territories and other resources, particularly in connection with the development, utilization or exploitation of their mineral, water or other resources.
3. States shall provide effective mechanisms for just and fair redress for any such activities, and appropriate measures shall be taken to mitigate adverse environmental, economic, social, cultural, or spiritual impact. (Article 32)

Asmus (2009) claims that

*momentum is building globally toward establishing FPIC as a principle of customary international law. The two key challenges for FPIC is an apparent conflict with the sovereign rights of nations to exploit their own natural resources (as they deem fit), and a lack of clarity about how to implement FPIC. (para. 12)*

For example, in Canada, one of the countries that voted against the Declaration, mining companies can apply for a “treaty rights free zone” from the government that requires consultation but not consent. Thus, De Beers recently consulted with Muskrat Dam First Nation, but then drilled in an area that the tribe used for an annual spring goose hunt. As a result, the tribe declared a moratorium on mining exploration and development on its traditional lands. The conflict between an indigenous people’s cultural heritage and the state’s desire for control and for funds is not settled (“De Beers Risks Losing Social License,” 2006).

On the other end of the spectrum, Nevada-based Meridian Gold owns a gold mine in Argentina, a signatory to FPIC, which it was forced to abandon because the townspeople who lived below the mountain held a public referendum and rejected Meridian’s plan for an open-pit mine. The company found that a public relations campaign could not make up for lack of prior and informed consent, and was “forced to write down the value of the property by \$379 million” (World Resources Institute, 2009).

### ***Social License to Operate***

*The distinction between social license and consent is critical because accepting community consent as a basic operating standard sets a higher bar. If a community’s actual consent is required before operations begin, companies must treat the community as more of a partner in project development, rather than as an obstacle to*

*overcome. It also implies that a company must engage more holistically with a community, providing them access to critical information and allowing them adequate time to assess their needs and interests before making a decision about whether to accept a company's presence. The more vaguely defined social license does not necessarily imply these things. (Slack, 2009)*

For example, Williams, Gill, and Ponsford (2007) found that the role of stakeholder collaboration with Intrawest, a North American resort company and two Canadian mountain tourist communities qualified as a social license to operate.

The rights to use water are being challenged in the business of bottling and selling public water. For example, Nestle Waters has experienced community challenges over alleged excess withdrawals affecting private wells in Michigan, especially during the spring and summer, and over a 50-year contract with the County Community Service District in Northern California that gave Nestle priority rights to water that feeds streams with rainbow and steelhead trout (Asmus, 2009). Nestle has responded ethically by “developing and implementing a ‘Siting and Community Commitment Framework.’ A key element to be examined is the notion of FPIC” (Asmus, 2009).

Lack of a social license to operate shut down the Coca-Cola plant in Kerala, India, because community activists placed part of the blame for lack of drinking water during a drought on the company (Asmus, 2009).

*If an industry loses its social license, then it is forced to operate in a world full of regulations and restrictions. A good example of this is what happened to the meat packing industry back in 1906. Just imagine what meat and poultry processing might be like if loss of public trust hadn't led to government inspection of slaughter plants. . . . We have to build and communicate an ethical foundation for our activity and engage in value based communication if we want to build the trust that protects our freedom to operate. (O'Keefe, 2009)*

When social license to operate is used as a part of CSR, profit can increase. Royal/Dutch Shell, Chevron Texaco, and the Philippine National Oil Company were transparent about plans to develop an operation to extract natural gas off the Coast of Palawan Island in the Philippines. “. . . by working to obtain community consent at a project in the Philippines, Shell may have saved as much as \$72 million in project delays, which amounted to a 1,200 percent return on its community consent efforts” (Slack, 2008).

### ***The Issues***

The social license to operate is assumed to include free, prior, and informed consent. However, the level of consent has not been clarified, nor is the stakeholders from whom the consent is given. This is apparent in Post, Preston, and Sauter-Sachs' (2002) examination of the social licenses to operate of Cummins Engine Company, Motorola, and the Royal Dutch/Shell Group.

*Although the ultimate justification for the existence of the corporation is its ability to create wealth, the legitimacy of the contemporary corporation as an institution within society—its social charter, or “license to operate”—depends on its ability to meet the expectations of an increasingly numerous and diverse array of constituents. (p. 9)*

That “array of constituents” may be so diverse and numerous that consent from all of them becomes impossible. Each stakeholder group may have expectations and requirements that conflict with those of other stakeholders as well as with the corporation and the government. There may be many companies who have a legal right to operate from the government and are willing to negotiate for a social license to operate that does not include consent.

### **The Case for Identifying and Categorizing Stakeholders**

In order to answer Asmus’ (2009) three questions, the proposed process provides a means of defining community and who in that community has the power to give consent to a social license to operate. If social license to operate is to become a pillar of corporate social responsibility in the 21<sup>st</sup> century, defining ‘community’ is essential. In most communities in which corporations now operate, there are multiple groups who stake a claim in defining what is acceptable to the community. Thus achieving any level of consent, or even simply consultation that informs, must start with being able to identify those groups and their expectations.

*. . . the concept of the Social License to Operate presupposes that all of the families, clans, interest groups and institutions in a geographic area have arrived at a shared vision and attitude towards a resource development project. This kind of cohesion is often absent, and therefore may have to be built. That is why earning a Social License to Operate often involves building social capital in a process that is also known as ‘community building’, ‘capacity building’ and ‘institutional strengthening’, among others. (Thomson & Boutilier, n.d.)*

In order to build cohesion within a community, stakeholder theory can be used to identify the groups within a community.

*Stakeholders are any individual, group, organization, institution that can affect as well as be affected by an individual’s, group’s, organization’s, or institution’s policy or policies. . . .An organization is the entire set of relationships it has with itself and its stakeholders. An organization is not a physical “thing” per se but a series of social and institutional relationships between a wide series of parties. As these relationships change over time, the organization itself changes. It becomes a different organization. (Mitroff & Linstone, 1993)*

Stakeholders can be customers, suppliers, and partners, as well as social, political, and government entities. In communities, stakeholders can be family units, interest groups, property owners, property



users, businesses, farmers, etc. In some situations stakeholder groups that operate in a national or international arena, such as NGOs, religious groups, social justice groups, can claim an interest in a corporation's actions.

### ***Categorizing Stakeholders***

Because power to impose one's will upon others (Mitchell, Agle, & Wood, 1997) can prevent all stakeholders from having fair input into granting social license to operate, such as when a company ignores other stakeholders because a large landowner or a government entity agrees to a proposed contract, the authors propose that stakeholders be divided into two groups: vested and non-vested. Vested stakeholder groups would have a voice and a vote in the awarding of a social license to operate, while non-vested stakeholder groups would have only a voice.

In this model, vested stakeholder groups would be defined as those who have a right to the possession of something tangible in the community in which the social license to operate is being requested. This tangibility could be owning physical property or inhabiting property with a need for resources such as water, arable land, and clean air. The vested stakeholder groups could also claim the rights of their future generations' needs in the discussions of granting the social license. Thus, the need for water or breathable air would be a current and a future need. A company that purchased or leased property from a vested stakeholder, whether individual or government, would be a vested stakeholder. Each stakeholder group would have one vote in the decisions to grant a social license to operate, thus answering Asmus' (2009) first two questions about the definition of community and the power of each stakeholder group. Consent could then be defined as some level of majority of votes, thereby avoiding the power of one stakeholder group to override the majority.

Non-vested stakeholder groups would be those who have an interest in the activity that is being pursued in the license to operate. These groups would have a voice at the table; they could offer examples of the consequences of implementation of similar activities in other areas. In some cases, these stakeholder groups would be stakeholders who have an interest in global issues like protection of arable land, forests, water, global warming, or rights of workers. Many of these non-vested stakeholders can demonstrate great power, especially through the media, the Internet, and now, through social media. Greenpeace, Union of Concerned Scientists, and People for the Ethical Treatment of Animals are but a few of these non-vested stakeholders. As non-vested stakeholders, they could have a voice in the discussions; they could attempt to sway the decision of the vested stakeholders. However, they could not stop a social license to operate granted by the vested stakeholders. This would mean that stakeholder groups who have an interest in global environmental or resource issues should not physically disrupt the activity allowed by the SLO nor should they use their power to encourage a boycott of the products or services produced by the company allowed to operate by the SLO. On the other hand, in the cases of the mining companies in Canada or Argentina previously mentioned, such stakeholder groups could join a vested stakeholder group to bring pressure on another vested stakeholder group to change its position.

### ***Criteria for Social License to Operate***

If a corporation is to communicate and consult with stakeholder groups, it must understand their values. Freeman's (1994) stakeholder theory assumes that values are necessarily and explicitly a part of doing

business. Stakeholder discussions to develop the social license to operate can start with identifying what Donaldson and Dunfee (1999) call micro-social contracts that bind each stakeholder group. Micro-social contracts can be used to identify where there are shared norms, or accepted behaviors and shared values among the stakeholder groups. These norms and values can be used as the foundation on which to negotiate differences.

DeGeorge's (1986) ethical norms for multinational corporations (MNCs) operating in developing countries could be used as a set of values and norms of the corporation. MNCs should

*do no intentional direct harm, produce more good than bad for the host country, contribute by their activities to the host country's development, respect the human rights of their employees, pay their fair share of taxes, respect the local culture and work with it, not against it, to the extent that the local culture does not violate moral norms, and cooperate with the local governments in the development and enforcement of just background institutions. (p. 264)*

By committing itself to using these norms and values in its contract, a corporation thus has a basis for comparing individual stakeholder micro-social contracts with its own social contract. This helps all stakeholders identify where their norms and values converge and where they diverge. Settling disagreements about values or norms around harm or contribution to the development of the community could then start with an understanding of the other's definitions. Those definitions should be based on globally accepted norms such as those in the United Nations' Universal Declaration of Human Rights of 1948. The United Nations document Protect, Respect and Remedy: a Framework for Business and Human Rights, Promotion and Protection of All Human Rights, Civil, Political, Economic, Social and Cultural Rights, including The Right to Development, could also be used. John Ruggie (2008), Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, wrote of the UN document:

*This report presents a conceptual and policy framework to anchor the business and human rights debate, and to help guide all relevant actors. The framework comprises three core principles: the State duty to protect against human rights abuses by third parties, including business; the corporate responsibility to respect human rights; and the need for more effective access to remedies. The three principles form a complementary whole in that each supports the others in achieving sustainable progress. (p. 1)*

As Donaldson and Dunfee (1999) state: "the global contractors would not allow micro-social contracts (even with unanimous local consent) that condoned practices unethical wherever they occur, such as exploitative child labor, corporal punishment for employees, or barbarously unsafe working conditions" ( p. 44).

### **A Five Step Process for Social License to Operate**

The process the authors propose to achieve a social license to operate would use five steps. In Step 1, a company contemplating a project in an area would describe how the company, in its view, would meet DeGeorge's (1989) norms through its project. In Step 2, it would collect information on the micro-social contracts of the stakeholder groups in the community in which it would be operating. This information could include data from government and nongovernmental organization sources, but it should come primarily through direct communication with each stakeholder group. In Step 3, the company would analyze the alignment between its norms and the micro-social contracts of the stakeholders. In Step 4, the company must engage all stakeholder groups in a discussion of the project to produce a proposal that will result in consent by the majority of the vested stakeholder groups for a social license to operate. In Step 5, the company would monitor the progress of the project to ensure that the project is proceeding as agreed on.

At the end of Steps 3, 4, and 5, a Go/No Go decision to proceed would be made. For example, at the end of Step 3, if the analysis found limited alignment existed between the company's norms and the norms of the stakeholder groups or between the norms of different stakeholder groups, including non-vested ones, the company could consider not pursuing the project further. This would halt the project before many resources had been expended.

In the Step 4, the company must start by addressing how the project meets the micro-social contracts of the individual vested stakeholder groups as well as the norms of the non-vested stakeholder groups. The company may find that a number of vested stakeholder groups combine to operate as a community, and thus make collaboration easier. The dialogue must involve a genuine attempt on the part of the company to make changes to meet serious concerns of vested stakeholder groups. The stakeholder groups, in turn, must be willing to understand the economic constraints of the company. Only when collaboration has produced a social license to operate that includes metrics, should the project move forward. "The social license requires jointly agreed upon indicators of success. The company and the community jointly define a good outcome, whether it is improved health and education, jobs, infrastructure or protection of the environment" (Kurlander, 2001).

After Step 4 was completed, the company it might find that even though there was agreement with majority of vested stakeholder groups, there were enough powerful non-vested stakeholder groups who were opposed to it that going forward with the project might cost too much in time or money. This is especially true when environmental issues and the power of social media align.

#### ***Examples***

This process might have helped Tata Motors in 2008 when it was building its Nano factory in West Bengal, India. The analysis might have revealed that the land that West Bengal state officials were going to lease them was arable land purchased from farmers, even though most such projects in India are built on non-arable land. Tata might have also uncovered an ideological political rift between the local politicians and the state politicians. This was the foundation for a conflict among the vested stakeholders. There was a micro-social contract between the state and Tata, who both also shared a norm of providing a better life for a desperately poor population. There was a micro-social contract between local politicians and farmers of protecting ownership of farmland that had been in families for many

generations. As the construction continued, these four vested stakeholder groups clashed; the latter two enlisted non-vested stakeholder groups to join them. Information and misinformation was instantly on blogs and Websites; violence ensued. Tata Motors never had a meeting of the vested stakeholder groups, but assumed the micro-social contract of one vested stakeholder group, the state government that was trying to bring jobs to Singur, trumped all. Eventually Tata left West Bengal and built a plant in another state. The multimillion-dollar plant sits empty in Singur; the farmers do not have their land back because Indian law does not allow land taken by eminent domain to be returned (“India: Rising protests,” 2008; “India – Singur, West Bengal,” 2008).

Royal Dutch Shell might have also realized the micro-social contract with the government of Nigeria did not trump the norm of protection of human life when it sat on the sidelines as the Nigerian government killed tribesmen who were protesting Shell’s proposed gas-development and eventually hanged nine environmental activists. Nonvested stakeholder groups who used social media to send their message picked up the protesters’ complaints of environmental damage. The resulting global boycott of Shell products was devastating, and the current investigation by Dutch lawmakers is a continuation of the problem of not considering all stakeholders (Chazan, 2011). As cited previously, the company has been successful in the Palawan Island, Philippines, using social license to operate.

Another example involves the ongoing fight over palm oil, an ingredient in foods, shampoo, detergents, and cosmetics. The demand for palm oil accounted for 65 percent of all international vegetable oil trades in 2006 (“Cargill to Review,” 2010). As palm tree plantations have increased to meet the increased demand, deforestation, loss of habitat for endangered species, and reduced biodiversity have followed. In the spring of 2010 Greenpeace activists targeted companies who had contracts to buy palm oil from suppliers who were contributing to the deforestation of rainforests, and damaging orangutan habitats. The activists targeted Nestlé and Unilever in their protesters. Although news groups did not cover the actual protesters dressed in orangutan costumes, thousands of people shared photos of the protests and a video from Greenpeace’s Web site of an orangutan finger in a KitKat wrapper through Facebook and Twitter. Many advocated a boycott of all Nestlé products (Steel, 2010). Nestlé immediately posted a letter from its CEO saying that it had severed its contract with the supplier in question, and pledging to use only sustainable sources of palm oil by 2015. Unilever is trying to exit the palm oil market completely. It has decided to invest heavily in Solazyme Inc., a San Francisco firm that harvests algae oil, which could replace palm oil in soaps and lotions as well as food, and even fuel (Sonne, 2010).

### ***Monitoring the Project***

Step 5 in the process of implementing the social license to operate is the ongoing monitoring of the project. “For social license to work, there needs to be independent structure, monitoring and evaluation” (Kurlander, 2001, para. 11). For example, Nike and others who were boycotted for outsourcing to factories that used child labor now use Not for Profits and NGOs to monitor the factories for compliance with contract requirements. The Roundtable on Sustainable Palm Oil (RSPO), a not-for-profit association whose members include oil palm producers, palm oil processors or traders, consumer goods manufacturers, retailers, banks, and investors, environmental and nature conservation NGOs and social and developmental NGOs have developed global standards for sustainable palm oil, and RSPO certifies

palm growers (Why RSPO Certification, 2010). The World Wildlife Fund (WWF) partners with companies to review how palm oil suppliers are progressing toward more sustainable practices and in 2009 began producing a Palm Oil Buyers' Scorecard to document which companies were buying from certified palm growers (WWF to Grade Palm Oil Buyers, 2009).

In the case of problems during implementation, outside negotiators can be used. Newmont Mining used the Compliance Advisor/Ombudsman for the International Finance Corporation (IFC) last year in Peru to restore trust after a contractor's mercury spill made people in several villages sick. The IFC is the arm of the World Bank that holds a 5 percent interest in the mine, so they

*came into the community with established credibility, having already led an independent investigation of the mercury spill. Under the process developed, the CAO leads an ongoing roundtable to engage elected officials, community leaders, nongovernmental organizations (NGOs), and representatives of the company in dialogue. (Kurlander, 2001)*

There are methods for companies to use to account for the costs of using Social License to Operate. Elkington (1998) developed the cost accounting Triple-Bottom Line to include economic, ecological, and social activities. In 2007, the United Nations ratified this standard for the public sector. Additionally, Thomson and Boutilier (n.d.) have developed Social Licence™ that uses a number of indicators to measure the level of Social License that exists at any one time.

Companies can also report on their corporate social responsibilities, which can include Social License to Operate. The Global Reporting Initiative (2009b) has developed extensive guidelines for such reporting. Companies such as ArcelorMittal Limited, Bayer, BP, Coca Cola, De Beers, Dow Chemical, 3M, Fort Collins Utilities, General Electric, GlaxoSmithKline, Kia Motors, Microsoft, Mitsubishi, Office Depot, Owings Corning, Rio Tinto, Royal Dutch Shell, SAP, SAS Scandinavian Airlines, Suncor, Sun Microsystems, Tata Motors, The Walt Disney Corporation, Toshiba, Unilever, Walmart Brazil, and Wyeth have all submitted 2009 CSR reports (or Annual Reports with CSR components) to the Global Reporting Initiative (GRI). The number of companies for 2008 was over 1,000 compared to 10 in 1999 (Bristol-Myers Squibb Company, British Airways, Electrolux, ESAB, General Motors Corporation, Matsushita Electric Industrial, Procter & Gamble, Sasol, Suncor Energy, Sunoco). In 2009, 1,426 companies submitted CSR reports; 1,370 companies posted reports in 2010 (Global Reporting Initiative, 2010a).

### **Conclusion**

Many companies are adopting the social license to operate, because it protects their interests, but many others are using it as a way to ensure that there is commitment to norms and values as they move into developing countries. Donaldson and Dunfee (1999) cite DuPoint Chemical as employing whichever safety policies are higher, its own, or those of the country in which it operates. The University of British Columbia and Placer Dome, Inc. have developed an exploration template for mining companies that requires geologists to begin with clearly stated objectives and constraints, and listen to all stakeholder concerns. Lawrence T. Kurlander (2001), the senior vice president of one of the world's largest gold

mining corporations, Newmont Mining, headquartered in Denver, Colorado, explained that Newmont has moved its managers from a concern with only operational issues to the social license to operate. “Today the manager must be able to interact with the community and generate the consent of the people in order to move the operation forward in a stable environment” (para. 5).

Thomson and Boutilier (n.d.) found that some companies underestimated the time needed to build relationships, and the amount of information community members required. Since most stakeholder groups in communities grant SLOs based on relationships they found social legitimacy, credibility, and trust as key to implementing the social license to operate. “In practice the initial basis for social legitimacy comes from engagement with all members of the community and providing information on the project, the company and what may happen in the future and then answering any and all questions” (Thomson & Boutilier, n.d., para. 12). Credibility requires “consistently providing true and clear information and complying with any and all commitments made to the community” (Thomson & Boutilier, n.d., para. 12), although the authors warn that all commitments must be written to avoid future misinterpretation. Trust requires a willingness to be honest. “The challenge for the company is to go beyond transactions with the community and create opportunities to collaborate, work together and generate the shared experiences within which trust can grow” (Thomson & Boutilier, n.d.).

Charlie Arnot, a consultant to animal agriculture corporations, said “fact based arguments have little chance of convincing consumers unless consumers are convinced that you share their values” (as cited in O’Keefe, 2009, para. 6). Arnot said that if an industry has “social license” it is afforded the privilege of operating with minimal formalized restrictions because the industry has maintained public trust by doing what is right. He went on to say that having public trust means that society believes that the activities of the industry are consistent with social expectations and the values of the community and the other stakeholders.

By using the five step process based on alignment of the norms of the company and the norms and microsocial contracts of the vested stakeholder groups, social licenses to operate can be negotiated. By communicating this alignment, a company can assure nonvested stakeholder groups that it is concerned about their norms also. The transparency of the metrics for the implementation of social licenses to operate can assist company executives’ decision-making process in their responses to the need for corporate social responsibility as necessary to their business strategies.

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## ETHICAL CODE IN THE PUBLIC ACCOUNTING PROFESSION

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**Abstract:** The American Heritage Dictionary defines profession as "the body of qualified persons in an occupation or field." A major characteristic of a "qualified person" is the specialized knowledge of the profession: medical knowledge for medical doctors, accounting knowledge for certified public accountants (CPAs). Professionals have an ethical responsibility to have acquired the specialized knowledge before offering their professional services. Professionals are also expected to keep abreast of the knowledge enhancements through continuing professional education. Another characteristic of professionals is that they possess the mental attitude of serving the public with the best of their ability so as to earn the public trust. How does a profession enforce these ethical responsibilities? It should be achieved by self-monitoring, supported by a viable code of conduct. In fact, the existence of a code of professional conduct is considered a hallmark of any profession.

**Keywords:** ethical code; accounting profession; ethical responsibility

### Introduction

The Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA) is the primary source of guidance for accountants in public practice. Similar codes, issued by the Institute of Management Accountants (IMA) and the Institute of Internal Auditors (IIA), govern accountants and auditors in private practice. In recent times, the accounting profession has developed several recognized subspecialties, such as Certified Personal Financial Planner, or Certified Fraud Examiner. Each of the subspecialties has also adopted professional codes of conduct that are consistent with AICPA's Code of Professional Conduct. The focus of this chapter is on professional accountants in public practice. Consequently, we limit our discussion to the CPAs who are obliged to adhere to the Code of Professional Conduct of the AICPA. The AICPA Code (hereafter, the Code) is designed to serve a multitude of purposes:

1. A message that the professional CPA has a duty to serve the public (Collins & Schulz, 1995)
2. A means of conferring legitimacy upon the professional body, i.e., the AICPA (Preston et al., 1995)
3. Protecting public interest or a client where the professional delivers a specialized service which cannot be easily measured or judged as to its quality (Preston et al., 1995, p. 508; Neale, 1996)
4. Providing a filtering mechanism to limit the number of professionals to those who are willing and capable of adhering to the Code and unattractive to those who do not abide by it (Neale, 1996).

In the remainder of this chapter, first, we briefly discuss the types of services that are provided by CPAs. Of particular importance to the discussion of ethics is ethics audit services as an emerging area of

assurance services that major public accounting firms have begun to offer in recent years. Second, we provide a brief discussion of the AICPA's Code of Professional Conduct with a focus on its principles, but also examples of its rules. Third, the elaborate professional ethics enforcement program is discussed, where illustrative cases and descriptive statistics about the AICPA's disciplinary actions over a 20-year period are provided. The chapter ends with a concluding section where some observations about controversial ethical issues facing the profession are discussed.

### ***Public Accounting Services***

The AICPA has approximately 350,000 members, all of whom are CPAs. To be a CPA, most states require that an individual have had some experience in public accounting. The most distinguishing characteristic of a public accounting practice is to provide audit services for financial statements of various businesses. These financial statements are normally used by the CPA's clients to provide information to stockholders, potential investors, creditors, and regulatory agencies. However, not all CPAs remain in public practice. A large number of members of the AICPA are in industry, such as those working in accounting departments of private or public companies. Others are in private practice (provide clients with unaudited financial statements, tax and business consulting), government or education. While there are some minor differences in the ways in which these members keep their AICPA membership in "good standing," they all are required to adhere to the provisions of the Code. (For example, members in public practice are generally subject to more stringent continuing professional education requirements than those in industry or education.) However, due to the importance of the public trust to the profession, those in public practice are scrutinized more closely than others. For this reason, it is important to identify various areas of services provided by the CPAs in public practice with some emphasis on those in ethics audit services. CPAs in public practice provide these services:

1. Audit services
2. Compilation and review services
3. Attestation services
4. Management advisory services, including internal audit services
5. Tax services
6. Assurance services, including ethics audit services

The purpose of an *audit service* is to add credibility to financial statements of clients by issuing a report on the fair presentation of the financial statements taken as a whole. A vast majority of clients receive a standard three paragraph audit opinion (called an "unqualified" opinion) which is essentially a bill of health. Variations of this opinion indicate that the auditor is either taking some exceptions (called "modified wording" or a "qualified opinion" depending on the extent of the exception), or states that the financial statements are not presented fairly (called an "adverse opinion"). If the auditor finds that he/she is not independent of the client, then a "disclaimer of opinion" is issued. The Auditing Standards Board of the AICPA is responsible for developing the *Statements on Auditing Standards* that must be followed by auditors in the conduct of their audits. It is important to note that the issuance of an independent audit opinion can *only* be made by a CPA. The other services listed below can be provided by individuals that are not CPAs.

A *compilation* is the presentation of financial information, in the form of financial statements,

without the CPA expressing any opinion on them. A *review* is where a CPA has conducted only limited procedures and can give only limited assurance that the financial statements require no material modification. Compilation and review services are normally for non-public companies that may not require full audited statements, but do want some limited assurance about the reliability of their financial statements.

The Statement of Standards for Attestation Engagements, *Attestation Standards* (AT Section 100) defines an attest engagement as "one in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party." If the written communication is about historical financial statements, then the attestation is the same as an audit. However, a client may want an opinion on its representations related to its own internal controls, or investment performance history, or remaining reserves in an oil field. In these types of engagements, the CPA will still be held to the same level of professional standards as if they were auditing financial statements.

*Management advisory services*, including internal audit services, are often referred to as *consulting services*. Most of the consulting is related to the internal operations or planning for a client. A practitioner has developed an expertise in a client's affairs and is probably also an expert in the client's industry. This background makes the practitioner a logical choice to consult on matters related to accounting information systems (including hardware and software choices), inventory planning and flows, executive compensation arrangements, or designing pension and profit-sharing plans.

*Tax services* relate to corporations, other businesses, and individuals. The services can be limited to only the preparation of federal, state, and local tax returns, but frequently include advice on merger and acquisition, tax planning for current tax minimization or estate planning, and representation in tax audits from the Internal Revenue Service. The tax services area is an example where a practitioner is not required to be strictly independent from the client. The practitioner is expected to be an advocate for the client and to minimize the client's total tax liability.

*Assurance services, including ethics audit services* are defined by an AICPA special committee as "independent professional services that improve the quality of information, or its context, for decision makers" (Palfais, 1996). Assurance services can include audit and attestation, but also includes other non-traditional services. Assurance services are centered on improving the quality of information, and frequently involve situations when one party wants to monitor another, even when both parties work for the same company (Palfais, 1996). Ethics audit services would be an example of the latter service and will be discussed further in a later section.

A recent meeting of the National Association of State Boards of Accountancy concluded that regardless of the type of service provided, CPAs are required to have seven "competencies" (Haberman, 1998, p. 17): four of these competencies are technical in nature (e.g., the ability to assess the achievement of an entity's objectives); one relates to decision making, problem solving, and critical thinking; and another one concerns the ability to communicate the scope of work, findings and conclusions; but the one that is most relevant to ethics is "an understanding of the Code of Professional Conduct." Also, in a National Future Forum held in January 1998, five core values were identified for CPAs: continuing education and life-long learning, competence, integrity, attunement with broad business issues, and objectivity (CPA Vision Project, 1998). Of particular importance to this chapter are

integrity and objectivity that are part of the Code as well. This Code is discussed in the next section.

Among the services identified above, assurance services have gained much attention in recent years as an area of significant growth for the accounting profession. These services are provided to improve the quality of information or its context, for decision makers. An example of these assurance services is the CPA *WebTrust<sup>sm</sup>* service by which CPAs assess the reliability of information in company web sites, and if the information is found to be reliable, the *WebTrust<sup>sm</sup>* seal is stamped on the client's web site.

The AICPA's Special Committee on Assurance Services (also known as the Elliott Committee after its chairman, Robert Elliott) has proposed many areas of assurance services. Of special interest to ethicists is "assessment of ethics-related risk and vulnerabilities" (Elliott & Pallais, 1997). Some accounting firms (e.g., Arthur Andersen, KPMG Peat Marwick) have already begun offering ethics audit services. According to KPMG Peat Marwick, the ethics audit has four components (KPMG, 1997).

1. An assessment of the ethical climate of the client encompassing culture, environment, motives, and pressures

2. An assessment of performance incentives - the issue is whether the performance incentives provide a motivation to behave outside the moral norm

3. The communication of the message about what is acceptable or unacceptable ethical behavior - this communication covers issues of ethical policies, procedures, and training downstream from management to employees; it also covers the nature of upstream communication from employees to management

4. Compliance where the policies, procedures, and offices involved in the enforcement of the client's ethics program are assessed

Although an ethics audit is designed for a company's internal purposes, it is clear that there could be external ramifications. The fact that a company has conducted an ethics audit may have positive implications with outside regulatory agencies, suppliers, customers, or prospective employees. Ethics audit services are partly governed by *Statements on Auditing Standards* promulgated by the Auditing Standards Board (1997). However, there are significant differences between ethics audits and financial audits. For example, an ethics audit is used to identify a client's areas of vulnerability in comparison with its industry benchmarks. This is different from comparison of a company's ethical performance with absolute ethical philosophies. It is also different from a financial audit where the fairness of financial statements is assessed against generally accepted accounting principles. KPMG Peat Marwick LLP states that an ethics audit is a "positive confirmation of the existence and effective implementation of best ethical practices" (KPMG, 1996).

A concern about the multitude of services provided by CPAs is that conflict of interest may arise from an auditor performing the financial audit as well as other services. This is said to threaten auditor independence. As discussed in the next section, independence is one of the major rules in the Code. In the past, it was not uncommon for auditors to decline engagements or not provide additional services if there was any threat, real or perceived, to their independence. We will return to a discussion of the magnitude of this issue in the final section. Suffice it to say here that, today, it is common for CPAs to avoid this problem by offering various services from separate divisions of the audit firm so as to minimize issues of conflict of interest. In one case, the accounting firm split into two separate entities: Andersen World-wide split into Arthur Andersen to provide audit and tax services and Andersen

Consulting to provide management advisory services. Recently, however, Andersen Consulting has alleged that Arthur Andersen is also providing management advisory services to its big clients against the contract that resulted in the split of Andersen in the first place.

### ***AICPA's Code of Professional Conduct***

The AICPA's mission statement charges its CPA members with the responsibility to "serve the public interest in performing the highest quality of professional services" (AICPA, 1988). The Code calls for honorable behavior, even at the sacrifice of personal interest. Various steps are necessary to prepare the CPA for these services. These steps include education, certification, licensing, and practice, but also a mental ability and commitment to discharging one's responsibility with care and diligence. (Note that all states require that CPAs in public practice to be licensed. A CPA may choose *not* to be a member of the AICPA, and thus not subject to the AICPA Code. However, most state licensing authorities have adopted the AICPA Code as their ethical and professional standards.)

The AICPA's Code of Professional Conduct states, in its preamble, that being a member is voluntary, but by accepting membership one assumes an obligation to the public, clients, and colleagues. To guide behavior, the AICPA has instituted a Code that has four components:

1. Principles of professional conduct
2. Rules of conduct
3. Interpretations of rules of conduct
4. Rulings by the Professional Ethics Division of the AICPA and its Trial Board.

**Table 1. AICPA's Principles of Professional Conduct**

Principle and AICPA Directive
1. RESPONSIBILITIES - In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.
2. THE PUBLIC INTEREST - Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.
3. INTEGRITY - To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.
4. OBJECTIVITY AND INDEPENDENCE - A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.
5. DUE CARE - A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.
6. SCOPE AND NATURE OF SERVICES - A member in public should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided

*Source: AICPA (1988)*

There are six principles in the Code. These principles and the AICPA directives related to them are listed in table 14.1. They provide the basic foundation of ethical and professional conduct that is expected of

the CPA. However, due to their conceptual nature, these principles are not enforceable. Nevertheless, they point to the importance of public interest (Principles 1 and 2) and the requisite moral characteristics of CPAs in public practice (Principles 3-6).

The Rules of Conduct and the Interpretations of the Rules of Conduct are more specific in nature than the Principles, and as such, they are enforceable. A detailed discussion of these rules and their interpretation is beyond the scope of this chapter but may be found in the AICPA publications and standard auditing texts. To show the general tenet of the rules, we provide a summary here:

- Section 100: Independence, Integrity, and Objectivity (e.g., Rule 102-2 prohibiting conflict of interest)
- Section 200: General Standards and Accounting Principles (e.g., Rule 201-1 requiring competence)
- Section 300: Responsibilities to Clients (e.g., Rule 301-1 prohibition of dissemination of any confidential client information obtained during the course of an audit)
- Section 500: Other Responsibilities and Practices (e.g., Rule 501-1 forbidding retention of client records)

Section 400 that related to responsibilities to colleagues no longer has any rules at this time. However, concurrent with the issuance of the new Code in 1988, the AICPA also approved a mandatory quality peer review program where CPA firms provide reviews of the quality of practice in other CPA firms and present recommendations for improvement. The AICPA also established a number of practice-monitoring committees to facilitate these peer reviews for CPA firms.

The final component of the Code, Rulings by the Professional Ethics Division and the Trial Board of the AICPA, relates to the AICPA's activities to enforce the rules and their interpretations. These issues are discussed in the next section.

### ***Enforcement of the Code of Conduct***

Violations of the Code can be diverse and numerous. A detailed listing and discussion of these violations is beyond the scope of this chapter. Here are several examples:

- A CPA was engaged to prepare the financial statements of a company and then audited those same financial statements - a violation of the rule of independence.
- A practitioner prepared a fraudulent tax return on a client's behalf.
- A practitioner did not have the necessary technical skills to perform required work for an engagement - a violation of competence.
- A CPA did not release documents to a client - a violation of Rule 501-1 requirements.

These violations result in disciplinary actions by the AICPA such as admonishment, termination or suspension of membership in the Institute. Since 1975, the Joint Trial Board of the AICPA has been the source of disciplinary action with the participation of some state societies. This cooperation has recently been expanded to include virtually all 50 states and has resulted in the establishment of the Joint Ethics Enforcement Program (JEEP) since 1995. JEEP maximizes the resources for investigation and eliminates duplication (News Report, 1995).

Penalties for violation of the Code range from a recommendation that a member take remedial or corrective action, to a permanent expulsion from the AICPA. For example, a member who has violated

the Code may be recommended by the Professional Ethics Division to take a continuing professional education course. If the member does not comply with the recommendation, the Ethics Division may refer him/her to the Trial Board for a hearing. The Trial Board may suspend a member for up to two years or expel him or her for violating the Code. In cases, where a crime punishable by imprisonment for more than one year has occurred the member is automatically suspended or terminated from AICPA membership. A similar penalty can be imposed for filing a false income tax return on a client's behalf.

The disciplinary actions of the Joint Trial Board are publicized in the AICPA's newsletter, *The CPA Letter*. Generally, this means that a similar action has been taken by the professional state society of CPAs in the state where the violator has membership. (Note that a CPA can have membership in more than one state society. Furthermore, a CPA can get licensing from various state boards of CPA for practice in multiple states.) These state societies have codes of professional conduct for their membership that are identical with, or similar to, the AICPA Code (AICPA, 1997).

On the surface, the actions taken by the AICPA and/or state societies of CPAs may appear to be insignificant in nature since membership in these associations is voluntary and one can resign at any time. In reality, an action such as termination of membership, may indeed tarnish one's reputation as a CPA to the extent that one would voluntarily leave the profession altogether. Also, consider the fact that the practice of public accounting requires licensing by governmental regulatory agencies such as state boards of public accountancy. The AICPA and/or state society actions to terminate or suspend membership may precede or succeed revocation or suspension of practice licenses by state boards of accountancy. Thus, the CPA may be barred from practice, involuntarily, for a period of time or forever, depending on the nature of the violation.

State boards of public accountancy have been set up to enforce state accounting laws. These boards are generally charged with the responsibility of overseeing the accounting profession in their states. Consequently, they have mechanisms by which complaints against CPAs are documented, investigated, and adjudicated. These complaints "can come from a variety of sources, including clients, third parties such as federal, state and local governments; and other CPAs, especially successor accountants and auditors. The state board must investigate each complaint to assess its merit and, if necessary, determine the appropriate corrective action" (Ruble, 1997).

The disciplinary actions taken by state boards of accountancy and state societies of CPAs may also be the result of court action against a member. For example, a criminal conviction in a court of law may automatically result in suspension or termination of membership in state societies and the AICPA, as well as loss of practice license by the state board of public accountancy.

As stated earlier, violations of the AICPA Code may require a hearing by the Ethics Division of the AICPA or its Trial Board. State societies of CPAs have similar mechanisms, and they cooperate closely with the AICPA. Virtually all states boards have joined with the AICPA to create the Joint Ethics Enforcement Program (JEEP). This program has developed a detailed manual for effective and efficient treatment of code violations. According to the AICPA professional standards and the provisions of the JEEP manual (AICPA, 1997), there are two distinct methods of dealing with member violations. The first is suspension or termination of membership without a hearing, i.e., automatic disciplinary actions. The second is the AICPA disciplinary action process where provisions are made for a hearing.

The automatic sanctions are generally the result of court actions or other governmental (e.g., Securities and Exchange Commission) actions against CPAs. As soon as notification is received by the secretary of the AICPA, a suspension or termination notice is automatically mailed to the member via registered or certified mail. If the member does not appeal, then the action is viewed as final and publicized in *The CPA Letter*. However, if the member appeals in writing, then the Trial Board forwards the appeal to an *ad hoc* committee for a decision. If the appeal is granted, then the case is forwarded to the Ethics Division for appropriate action. Otherwise, the automatic decision is affirmed and publicized in *The CPA Letter*. The disciplinary action is termination in cases of:

- crime punishable by imprisonment for more than a year;
- willful failure to file an income tax return when required by law;
- filing false or fraudulent income tax return on own or client behalf; and
- willful aid in preparation and presentation of a false and fraudulent income tax return of a client.

Membership will be revoked or suspended without a hearing if the member's practice license is suspended or revoked as a disciplinary action by a governmental agency.

The cases that do not result in automatic suspension or termination of membership are Code violations that have been brought to the attention of state societies or the AICPA through complaints made by individuals, clients, or other CPAs. JEEP processes these cases. The member can plea guilty and/or resign from the AICPA and state society membership. In this case, the Trial Board may recommend acceptance of the member's resignation, but require that the member appear for a hearing by the Trial Board at a later date. If the member does not plead guilty or the Trial Board does not accept the member's resignation, a panel is set up by the Trial Board for investigation of the case. The Trial Board may choose not to accept a member's resignation due to the seriousness of a violation. They may feel that, to serve the public interest, the member needs to be publicly expelled. The panel may decide that no action is necessary or may schedule a hearing. The result of the hearing may be that no action is necessary or that the member must be admonished, suspended, terminated, or must perform some activity such as taking  $x$  hours of continuing professional education. The member can appeal this decision within thirty days, and if granted, the Trial Board will review the decision and will uphold it, change it, or find the member innocent and inform the member of its decision. If the decision is that a violation had occurred for which disciplinary action is taken, then the decision is publicized in *The CPA letter*.

### ***Illustrative Disciplinary Actions***

To illustrate the disciplinary actions against CPAs, we first present the facts about an individual who was found to have violated the AICPA Code. We will then present descriptive data to show the extent of the disciplinary actions taken over a 20-year period. This information is extracted from a disciplinary action database we have compiled from an examination of *The CPA Letter* published from 1977 till 1996.

Case 353 occurred in 1990. The individual was found to have violated the AICPA Code by having assisted in the preparation of a false tax return and having obstructed justice by lying about it (i.e., perjury). The information came from conviction in the court of law and automatically resulted in termination of AICPA membership. A summary of the 20-year data is presented in table 14.2. The data



are classified by the type of disciplinary action (termination, suspension, and other) and by the source of action (automatic or hearing). Also provided are the averages per year. These averages are calculated by dividing the raw numbers by 20 years (1977-1996). Finally, we have divided the average yearly disciplinary actions by the average number of members in the AICPA over the 20-year period to find the average number of disciplinary actions per 10,000 AICPA members.

Several observations from table 14.2 are interesting to note. First, a majority of cases were automatic disciplinary actions. Of the 488 terminations, 330 were automatic as compared with 158 that resulted from the Joint Trial Board hearings. Similarly, of the 250 cases of suspension, 138 were automatic as compared with 112 that resulted from hearings. The exception was "other" cases that resulted in admonishment, censure or other types of disciplinary actions. None of these cases was the result of an automatic disciplinary action. Thus, overall, of the 803 cases, 468 were subjects of automatic action as compared with 335 hearings by the Joint Trial Board.

**Table 2** *AICPA's disciplinary action statistics 1977-1996*

<i>Disciplinary action</i>	<i>Source</i>			<i>Average per 10,000</i>
	<i>Automatic</i>	<i>Hearing</i>	<i>Total</i>	
Termination	330 (16.5/year)	158 (7.9/year)	488 (24.4/year)	1.1
Suspension	138 (6.9 /year)	112 (5.6/year)	250 (12.5/year)	0.5
Other (e.g., admonish or censure)	0 (0/year)	65 (3.25/year)	65 (3.25/year)	0.1
<i>Total</i>	468 (23.4/year)	335 (16.75/year)	803 (40.15/year)	1.7
<i>Average per 10,000</i>	1.0	0.7	1.7	
<i>Membership size:</i>	1977	130, 331		
	1996	324, 938		
<i>Average</i>	227.	634		

*Source: Disciplinary Action Database compiled by the authors from the CPA Letter.*

Second, a related observation is that a majority of the cases, automatic or hearing, resulted in the termination of the violator from the AICPA membership. Of the 468 automatic cases, 330 resulted in termination of membership. Similarly, 158 of the 335 hearing cases resulted in termination of the violator. Suspension was next followed by "other" disciplinary actions.

Third, the average per 10,000 membership indicates that overall, only 1.7 persons (1 automatic and 0.7 from hearing) were disciplined per year. Of these 1.1 were terminated, 0.5 were suspended, and 0.1 were subjected to other disciplinary actions.

A conclusion from this data is that violations of the Code by the AICPA members are rare. The assumption is that all major cases are detected and adjudicated by the AICPA, state boards of accountancy, and state societies of CPAs. There are, of course, unreported or undetected violations of the Code as well. Thus, the true level of ethical behavior is not possible to observe. However, it is in the best interest of a self-regulating profession to expose unethical behavior. With this in mind, there are several significant overall ethical controversies facing the profession and these are discussed in the next section.

### ***Controversial Ethical Issues in the Accounting Profession***

As discussed in the previous sections, the accounting profession has developed a code of conduct and has an elaborate disciplinary program in place to enforce the Code.

Surveys of CPAs (e.g., Cohen & Pant, 1991) indicate that the Code and its enforcement are viewed as effective for the professional body. This does not, however, mean that the profession has been free from criticism. While CPAs, in general, do not believe that unethical behavior leads to success, they do perceive that opportunities exist in the accounting profession to engage in unethical behavior. This is because surveys of CPAs indicate that some clients request fraudulent alteration of tax returns or financial statements (Finn et al., 1988).

Critics allege that these client pressures, causing ethical problems for the profession, are partly due to the professionals having abandoned the legitimacy of ethical character that was the norm in the early 1900s. Critics support this allegation by noting that, in the early 1900s, there were virtually no general auditing or accounting standards, while today there is a large complicated set of standards and rules. Critics claim that today's CPAs rely on "following the rules" rather than focusing on what is the best, fairest, or clearest presentation of accounting information. As technical expertise has become the cornerstone of the CPA practice, the legitimacy of technique has replaced the legitimacy of character (Abbott, 1988, p. 190). Even within this technical expertise, critics argue that some CPAs have ignored their clients' creative accounting in which earnings have been manipulated in some cases. For example, Lomas Financial Corporation has filed a \$300 million lawsuit against its auditors, alleging that two audit partners collaborated with the management of Lomas Financial Corporation to conceal risky financial practices that contributed to the company's failure (MacDonald, 1997).

Similarly, a large potential area of concern for CPA firms is the exposure to lawsuits from consulting engagements. The largest lawsuit yet filed against a CPA firm (\$4 billion) was related to a consulting engagement by an accounting firm to develop and implement a "turnaround plan" for Merry-Go Round Enterprises (MacDonald, 1997). The suit alleges fraud, fraudulent concealment, negligence, and lack of independence. These are issues that are normally raised in an audit engagement lawsuit. William Brewer, an attorney, states "It's an unusual suit. Big Six accounting firms have generally not been sued for their consulting work. However, it's a sign of the times. You'll see many more of these cases in the future as accountants hold themselves out as business consultants" (MacDonald, 1997).

In other cases, rapid changes in the information technology have brought the CPA's knowledge under question. The new information technology has also changed the public need for CPA services. For example, whereas traditional audited financial statements were issued three or four months after the closing of the client's fiscal year, the new technology has made it possible to provide the information on

line and in real time. As mentioned earlier, the profession has responded by developing the *WebTrust<sup>sm</sup>* service to respond to this need.

Perhaps the most significant ethical challenge to the profession is the question of independence. It has been alleged that auditors systematically violate the Code's independence rule. The Code is clear in its direction of the need for independence, not only in fact which is unobservable, but also in appearance which can be observed by third parties. The auditor may, in fact, exercise independence from the client even if he or she has financial interest in the company. However, to assure independence in appearance, the auditor is prohibited from having any direct interest such as stock ownership in the client or significant indirect interest such as ownership of stocks in the client by the CPA's close relatives.

Critics argue that independence rules must also be addressed in cases of providing conflicting services to the client. For example, how can an auditor be independent of his or her client in conducting a financial audit if the auditor is also the one who had provided advice in the development or purchase of the client's accounting system? Similarly, the profession has been criticized for taking inadequate responsibility for detecting fraudulent financial reporting by clients in situations where auditor's self interest has been on the line. These allegations have resulted in Congressional investigations of the profession. For example, Senator Metcalf investigated the profession in 1976 (US Senate, 1976) while Senators Moss did the same in 1978 (US Senate, 1978). (A detailed discussion of these investigations and the profession's response to them is beyond the scope of this chapter; they are stated here to show the significance of the issues.)

The profession's response has been to set up commissions to investigate these issues, and to provide recommendations, based on which new pronouncements could be issued. For example, in response to Senators Metcalf and Moss investigations, the AICPA established The Commission on Auditors' Responsibilities in the mid-1970s (The Cohen Commission, 1978). The recommendations from this commission led to the establishment of another commission later to investigate fraudulent financial reporting (The Treadway Commission, 1987) and later to yet another commission (COSO, 1992) that made a long list of recommendations. As a result of the recommendations of these commissions, the profession has taken significant steps to enhance its guidance for practitioners by issuing new pronouncements. The revised Code of Conduct issued in 1988 (AICPA, 1988) tightened the Code requirements by eliminating some ambiguous and controversial sections. Specifically, the new Code allows for advertising by CPAs that was prohibited by the earlier code. In the same year, the Auditing Standards Board issued a package of nine new *Statements on Auditing Standards* (dubbed expectation gap standards) to provide better guidance to the auditors in their conduct of the financial audit. More recently, the Auditing Standards Board responded to the Treadway Commission (1987) and COSO (1992) reports by issuing a new *Statement*

*On Auditing Standards No. 82* that requires auditors to plan the audit so that if fraud exists, it can be detected (Auditing Standards Board, 1997). In the past, the profession steadfastly denied responsibility to plan the audit for the purpose of detecting fraud although it maintained that if fraud was indicated in the course of the normal audit, it would be investigated.

Other contemporary ethical issues confronting the profession include confidentiality, public confidence, and serving the public interest.

*Confidentiality* - The CPA is entrusted with a large amount of information from the client. The

auditor is prohibited to share this information with others, except in response to court order and other exceptional situations. For example, the auditor can provide financial ratios to industry trade groups so long as specific client information is not revealed. However, the auditor cannot use confidential information for self or other financial interests such as trading stocks based on the insider information gathered in the course of the audit.

*Public confidence* - The profession allows CPAs to advertise, but through its ethics rulings limits the type of advertising to those that enhance public confidence. For example, contingent fees and commissions are not allowed for referral of attest function services (i.e., audits, compilation and reviews), but allowed for management advisory services. Contingent fees and referral commissions were prohibited altogether until 1988 when under pressure from the Federal Trade Commission, the AICPA council voted to change the rule (Mintz, 1990). Nevertheless, critics argue that advertising has helped change public accounting from a profession to a business (Mason, 1994).

*Serving the public interest* - As stated earlier, the profession only recently has begun to accept responsibility for planning the audit for detection of fraud and other illegal acts (Auditing Standards Board, 1997). More needs to be done to clarify the CPA's responsibility to the public. For example, should the CPA engage in whistle-blowing when an illegal act or fraud is detected to have been committed by a client? As critics argue, at the present time, "the resolution of conflicts between an accountant's client, on the one hand, and the general public, on the other, is usually balanced in favor of the client. The legal system supports this outcome, at least for the time being" (Epstein & Spalding, 1993, p. 271). Others argue that the source of this problem is the weight that is placed on confidentiality at the expense of public interest (Collins and Schulz, 1995).

### Conclusion

The accounting profession has developed an elaborate Code of Conduct complete with a continuing education and an effective enforcement program. However, more needs to be done to make accountants more responsive to public expectations to enhance public trust. While the profession has been forthcoming in its responses to Congressional hearings and private commission recommendations in the past two decades, more is needed to continue building a more trustworthy profession. This is especially urgent in light of the speedy change that is fostered by the age of information technology.

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## THE I CHING: AN ANCIENT CHINESE HANDBOOK SUITABLE FOR ACHIEVING CORPORATE RESPONSIBILITY

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**Abstract:** Use of the *I Ching* as a guide to business social responsibility can be recommended. Roughly speaking, the *I Ching* presents 64 states of yin and yang intermingled in different combinations of each. One state is pure yang; another is pure yin. The 62 other states have some part yang and some part yin; some have more yang, and others more yin. Each combination of yin and yang is a movement of the Tao, or the Way of Heaven. Human ingenuity cannot master the Tao by suborning it to human purposes, but must instead align with the Tao to experience success in the physical world. Business seeks such success in the physical world because it works with tangible things – such as raw materials – and produces material wealth. Business is, therefore, especially sensitive to movements in the Tao. Free markets can also be said to follow movements in the Tao. Such markets are not pre-determined, but flow from the ebbs and flows of human desires and efforts. Prices, for example, are not set in free markets by willful organizers, but result from interactions of different and independent orientations towards needs, desires, wants and values.

**Keywords:** I Ching; corporate responsibility

A well-known story set in ancient China illustrates how the natural forces of market pricing can be used as a policy device to advance a public goal. During the Chou Dynasty, the Duke Huan, of the feudal state of Qi, said to his Prime Minister Guan Jung: “I love purple cloth, but it is too expensive.” The Prime Minister replied: “Leave everything to me. Do as I say. The next time someone approaches you wearing purple cloth, hold your nose in distaste.” Apparently, the dye substance that was used to color clothing purple left an unpleasant smell. The Duke did as he was advised, until his courtiers feared he no longer liked purple cloth. So they sold all their purple cloth in the market. The price for purple cloth dropped sharply, and Guan Jung bought it for a song and gave it to his Prince.

Using similar understandings of pricing, Guan Jung invented the “ever normal granary” to help stabilize grain prices. When harvests were plentiful and the price of grain was low, he had the state buy grain and store it. When harvests failed and the price of grain rose high enough to hurt the common people, Guan Jung had the state sell grain from its warehouses. In the 1930s, American Secretary of Agriculture Henry Wallace copied this ancient Chinese practice in helping American counteract the price effects of the Great Depression. He was, in a simplistic way, following the Tao of grain prices.

It can be argued that the Tao is more attuned to business social responsibility than to the abuse of markets and injustice in economic arrangements. Such injustice and abuse more often than not results from the imposition of human willfulness and arrogance, and not from respectfully following the free

movements of prices and customer preferences. Thus, each 2 state of affairs associated with a hexagram in the *I Ching* can be interpreted as providing guidance to good practices in business social responsibility.

The Tao is the process of creation while moving forward through time. Creation is generative and fulfilling; so is the Tao. Creation is also a process that brings about change. As its constituent forces work their way through time, creation (or the Tao) culminates into new life, benefits, expansion of opportunity, mutual and reciprocal interactions, and growth and prosperity. Thus, it makes more sense to identify the Tao with business as a positive and constructive force in creation, rather than as a negative, adversarial force of one-sided selfishness that adds to entropy.

To be sure, creation cannot provide mastery to each and all. There is still death, pain, and suffering for living creatures; and there is frustration when human egos cannot synchronize themselves with the forces at work around them, when human ambition would have the world as its puppet, as a potter shapes the clay.

### **Casting the *I Ching***

The easiest way to have the *I Ching* reveal which state of affairs most approximates the movement of the Tao at any given moment is to use three coins, preferably copper pennies.

First, you decide which face of the coins – heads or tails – is to reflect yin forces, and which will reflect yang forces. Most often, heads is used to reflect yang. In the hexagrams of the *I Ching*, yin forces are represented by broken lines, and yang forces by solid lines.

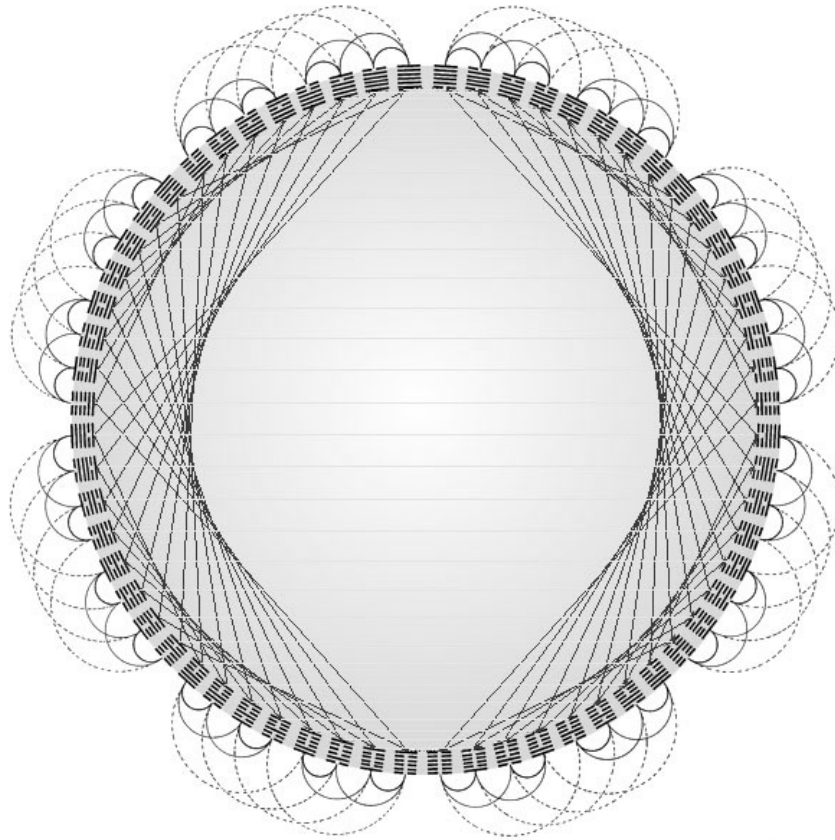
To determine which line of the hexagram to be discovered is yang and which is yin, the faces of the coins are given numbers. Heads are given the number of 3, and tails are given the number of 2. Thus, three heads reflect the number 9 – a yang line – and three tails reflect the number 6 – a yin line.

- Two tails and one head is a 7, a yang line.
- Two heads and one tail is an 8, a yin line.

The three coins are thrown six times – once for each line of the hexagram. Place the coins in cupped hands and drop them. Count the number produced by the combination of heads and tails showing – 6, 7, 8, or 9. Draw a solid or broken line corresponding to the yang or yin value shown by the three faces of the coins. That is the bottom, or first line, of the hexzgram.

Repeat the process five more times, drawing an additional line after each throw of the coins. When the six lines of the hexagram have been determined, look up the hexagram and consider what ideas are associated with it in the commentary below.

This commentary discusses the 64 hexagrams of the *I Ching* in the order associated with the mythical king Fu Hsi, where the cycle of yin and yang is first encountered with the hexagram for complete or full yang, which is Ch'ien or 1. The hexagrams are then presented in a sequence which leads on to full yin, and then back to full yang, where the cycle begins again.



**Figure 1.** Cycle of Hexagrams

The great circle of the 64 hexagrams starts with the hexagram Ch'ien, a representation of full yang energies in motion. Thus the hexagram consists of six solid lines – the maximum combination of yang moments and potentials.

The cycle can be said to start with innovation, such as a first stage entrepreneurial company or venture. It then moves through the stages of early market penetration and setting up an internal organization to the hexagram in position 17, or Shih, which symbolizes a company that has order and organization. Then the cycle moves into putting that structure of capital assets – financial, human, social – to work in producing goods and services. The apex of productive success is reached in hexagram in position 33, or K'un, which is also full yin, and therefore a hexagram with six broken lines. The cycle then continues past K'un into stages of 4 more mature development and profitability. This phase in the life cycle of a business meets the challenges of market successes and failures: competition, ups and downs, and rewarding participants in the venture. When the cycle reaches the hexagram in sequence (T'ung Jen), the *I Ching* begins to present the challenges of full maturity and the exhaustion of possibilities inherent in the initial business model, as the circumstances in which the business venture must seek profits are changing and becoming less and less supportive. In this phase of the cycle, the business or the business venture needs to either re-invent itself, or else dissolve.



***Ch'ien (1)***

In the situation, persist. Effort and determination are called for. The intentional and directed application of forces and energies is appropriate. Move forward towards the goal, guided by aspirations. This is the spring planting for an abundant harvest later. This is the symbol for the entrepreneur in the full throws of creative engagement with new ideas, new products, and new markets. It is a necessary stance when raising capital for a new venture. Embracing the big picture is advised. No time for petty maneuvers. All energies are bound together. Things are to be used; action is to be taken in a straight line – no sideways or circular plans or movements.

***Kou (44)***

These circumstances are still vitally enmeshed in entrepreneurial activity and adventure. The general operational approach under these circumstances is to join with others, to find partners, to couple. One must see beyond personal biases and needs and one's personal situation in order to engage with others. Success can't come to an individual acting alone.

The venture is more important than individual desires and hopes for personal advancement. There must be intellectual engagement to profit from the situation – a focus on specific purposes and undertakings, not a helter-skelter search for potential customers or investors. Seeds must be planted that will take on enduring forms of growth and profit. One must be pliant, flexible, and adapt to the views and needs of others, so that they may be brought into the venture.

Activity should be on a broad scale – not cramped and limited, but spread out in all directions to claim new possessions. Orders must be as sweeping in intent as a morning breeze. There needs to be an emphasis on outreach, marketing, communication of purpose, and intent to others who must be welcomed. Customers must be solicited, examined and selected for fitness. Employees need to be inspired, recruited from afar, examined, and selected for fitness. Finally, investors must be educated and cultivated.

***Ta Kuo (28)***

This hexagram points to circumstances in the entrepreneurial development of a new enterprise that builds on an initial introduction of the product or service. The principal task at hand is to exceed: to connect to a big idea, and to push the guiding idea of the business beyond ordinary limits. One needs to secure the highest beam holding up the roof of the enterprise: its core business model and commercial purpose. One is to impose direction on events and not be driven by them. Vigorous action and effective initiatives are required. New approaches, products, and etc. are to be hatched, and people excited and stirred up.

To address customers, marketing and advertising should be implicated, such as: demonstrations of the product; development of service features and qualities; venturesome introductions into new markets; and determined seeking of more customers. Money must be spent towards building the brand. Employees and suppliers need to be encouraged and inspired. Investors also need feedback and praise for taking risks with the business. Reminding everyone just what the business can deliver is the key to profitability under the circumstances.

***Ting (50)***

This hexagram points to the circumstances of a business or a business undertaking, while in its entrepreneurial phase, needing to focus on the quality of what it does. It is a time for cooking, not for talking about the meal to come. Materials at hand need attention. Inputs – materials, labor, R&D – need to be transformed into the product or service to be provided to customers. The focus of management right now is to be more internal than external. What is new, fresh, and the best should get management's attention. Employees and suppliers need to be focused on their roles and responsibilities in providing the business with its needed outputs. Old ways and habits of thought must be let go; new work relationships must be put in place.

***Heng (32)***

This hexagram points to the circumstances of when a business or a business venture begins to enjoy market success with its new product or service. Now, management needs to focus on bringing production to full growth in order to provide for an enduring set of procedures, methods of production, and working relationships. Teams are to be built for the long haul. Efficiency of work demands priority concern. Customers are to be treated with solicitude by employees with clear management directions. Roles and responsibilities need to be set forth on a more permanent basis.

***Sun (57)***

As the business or business venture becomes more secure, this hexagram indicates giving priority attention to fundamentals: the foundations for continuous success in providing goods and services to customers; providing employment for workers; and earning profits for owners.

Management must look at the business from the bottom up, not top down. It is not a time for sending orders down a command-and-control hierarchy. The views, experiences, advice, and guidance of those with line responsibility must be taken into account. The business must also be viewed from the customer's perspective: is it delivering on its brand promise?

The interests of customers and employees need to have priority over the hopes of owners and the egos of managers. There will be profits if management can take a wide-angle, long-term view of the situation and set the business on a firm foundation. What deviates from this approach – selfish short-sightedness – must not be tolerated. What does not contribute to a harvest must be pared away.

***Ching (48)***

This hexagram points to the need for management to further transform an entrepreneurial business or business venture towards a more mature enterprise. The approach is to go deeply into the core of the business, moving away from external concerns such as marketing and community relations in order to focus on internal structures, guidelines, and organizational requirements. Getting the structure right begins to assume importance.

Management should think of what is needed in an institution: policies and procedures timelines, manuals, legal clarity, HR policies and procedures, standards, etc. Management must not become self-satisfied with early customer or product successes, but must step back and look to the entire organization as a machine carrying the business steadily and smoothly into the future.

***Ku (18)***

This hexagram advises that the situation of the business or business venture requires vigilance to trim away the aspects, people, procedures, habits, and arrangements that are not proving themselves to be high-quality contributors to a successful organization. Unexpected setbacks arriving from early decisions need to be faced and re-organization undertaken. Early supporters and partners may no longer be playing vital roles and are becoming distractions or are contributing dysfunctionally to the organization.

The business or business venture must return to its core vision. The seeds of success need nourishing; they will bring profit in the future. Limits and boundaries need to be set for the business. It cannot become all things to all its stakeholders. Priorities must be set and kept. The identity and profile of the business must be simple and powerful. What is right at hand and next in line needs attention, not dreams from the past or dreams of what might be.

***Sheng (46)***

This hexagram indicates that at this point in the development of a business or a business venture, moving forward step-by-step and not by leaps and bounds is recommended. Steps must be put in place; fundamentals of organization may not be jumped over. Management must take a 360-degree view of the business and address all facets of operations and necessary inputs. Matters must be reduced to order; discipline is required. Procedures need to be in place and followed. It is not a time for innovation or experimentation.

Actions must be correct; shortcomings and excesses must be rectified. Human resources must be assembled and organized into teams and functional units. The priorities of the organization take precedence over the idiosyncrasies of individuals, no matter how formerly important they were. Business activities need to be consolidated. Key people are to be relied upon to play their parts in the organization. The skills of many must be combined and hoarded as an asset of the company. Suppliers should be closely integrated and employees tightly supervised, but also with flexibility to adapt to what circumstances will bring. The core team is to be assembled and then turned loose to implement the business plan.

***Sung (6)***

The concern highlighted by this hexagram turns the focus towards responding to shortcomings that the organization may have overlooked in its formative, entrepreneurial endeavors, when it was defining its brand and seeking initial capital and market penetration.

The enterprise is entering a new phase of growth and development, and settling in to routine success. Customer complaints and dissatisfactions now must be sought out and attended to. Employee claims and objections to methods and procedures, and work rules and schedules, need to be considered and sorted out. The core of the business or the business venture is sound and will lead to profits, so management must have no hesitation in moving the enterprise forward with crisp dispatch. Inside and outside aspects of the business need to be aligned. This demands response to customers, suppliers, investors, community concerns, and the environment.

The business is at the stage of institutionalizing itself for the long term. There are tensions with stakeholders that must be confronted and not overlooked. One-sided plans, opinions, preferences, and considerations must be rejected. The good of the whole seen from a long-term perspective is what is most important.

### ***K'un (47)***

At this stage of development for a business or a business venture, looking inward to build longterm institutional strength takes precedence over other approaches to decision-making. Limits of structure are to be accepted. One is to focus on the kernel, separating the wheat from the chaff in order to get down to the core drivers of success in delivery on the business model. The model itself does not need attention, but modes of implementation do. The well is deep and will provide water.

It is necessary to pause and take stock of how best to run the business. Employees and suppliers, including suppliers of capital, need the most attention from the board and management. But top leadership must also be seen and heard giving orders and setting internal priorities. Quality control becomes a key function. Words alone – spin and empty promises – will not correctly respond to the situation. Functions are to be marked off from one another and structures reinforced. The organization provides for the destiny of the individual contributor – customer needs, management promotions, employee returns, etc. There needs to be resolve on the part of management and the board, a flow from the top of personal commitment to the entity.

### ***Wei Chi (64)***

The enterprise or venture under the circumstances reflected in this hexagram is on the edge of important success in its mode of organization. It now needs to wait to accumulate experience and build up organizational energies to function smoothly in the future. Management's mode of thinking needs to be focused on conserving people, resources, capital, and brand equity, in order to put everything into routine and hold the business or venture in a steady state. The excitement of starting a business or a venture is almost fully dissipated. Careful, circumspect actions are advised. Functionality is a key requirement for decision-making. No new plans or strategies are needed. The business takes on an aspect of a smoothly running machine.

### ***Hsieh (40)***

This hexagram points to the need, at this stage in the evolution of a business or a business venture, for analyzing and understanding how the business functions, and how it might function better. Problem-solving within the business structure and operations is recommended in order to deliver or harvest better results. Production of goods or services is ripe with results. Not standing on ceremony that could prevent getting to the heart of how the business runs is advised.

This is a time for adjustments and restructuring; for taking a few steps back, and then coming forward with new clarity of mind. A sense of purpose needs to be imposed on events, and matters must be taken fully in hand with resolve and determination. The center of attention is on what work is really getting done – what are the real accomplishments? Obstacles must be confronted; people must be recruited anew, and minor faults set aside with forgiveness.

***Huan (59)***

This hexagram points to difficulties in the cycle of business success, from the initial vision through the mature exhaustion of the model. The circumstances that this hexagram alludes to are those of an established production function that has some dysfunctions or grinding in the turning of its gears.

In particular, management must confront and overcome illusions and misunderstandings among customers, employees, suppliers, investors and communities. The business is not fully integrated with its surroundings, perhaps due to excessive self-satisfaction, or preoccupation with short-term considerations to please internal constituents. Whatever is blocking a clear understanding of the real issues before the business must be cleared away. Authority may be mistaken and working only from illusions about the situation. There is a need to rouse employees to action and stimulate customers. Marketing a structured function comes back into play, where the established brand values are articulated and distinguished.

New formalities and ways of running the business should be considered to allocate roles and responsibilities under the code of conduct of the company. Perhaps internal auditing or a compliance program is needed to monitor ongoing activity and keep the business aligned with its principles. Board involvement is recommended to have a corporate respond to its central authority.

***K'an (29)***

This hexagram advises that circumstances are conducive to giving the green light to the organization to move into high gear within its given modes and forms of work. Risk is to be assumed without reserve. It is a proper time to act with confidence.

Personal commitment is required for success. The buck can't be passed. Employees and suppliers are to be motivated to do their best. Higher levels need to give instructions, while lower levels need to step up to repeat performances. Management should perfect rules to insure that production becomes habitual and constant. The approach of management, however, should not be hidebound, but use rules to teach and instruct subordinates. Higher and lower ranks need to be set up and put in hierarchical order.

***Meng (4)***

This hexagram indicates that organization structure and function is approaching its apogee; the business is about as well-structured as it will ever be. The organization, rather than individuals is driving business results. Individual egos need to be kept in their respective places and not be permitted to interfere with the common good. Boundaries between specialized functions are in place and holding. Centralized systems produce results. The organization responds to whatever emerges from top management rather than to inputs from other stakeholders; top management concentrates on getting results.

***Shih (7)***

Under these circumstances, putting affairs in order is the principal task. Providing structure, setting priorities, assigning tasks, aligning tasks with goals and objectives, and creating reporting relationships – all of these are required at this time. Functional units must be formed; affairs may not be left to drift with chance and circumstance.

The leader must assert command and control and provide a pattern for conduct. The grounds for measuring expected conduct must be set forth and followed. People – employees, suppliers, and owners

– must be coordinated into a functioning process of the production of goods and services. Hard, concrete results will come from a flow of work and effort that does not put people at cross-purposes.

The leader must persuade and be certain of purpose and direction in order to bring cohesion to the group. Human capital must be gathered and hoarded. There will be some anxiety of failure. What has priority must be distinguished from what is superficial or distracting. Comparisons and selections must be made; decisions should flow from sorting out alternatives and aligning similar things, such as people and processes, with one another.

### ***Tun (33)***

The situation under these circumstances is to rely upon the organization. There is now a need for the actor to step back from personal engagement and let others perform their tasks.

One must make a sacrifice in order to gain success. One must establish personal harmony with the movements of others and not try to direct and determine outcomes. The demands of one's ego need to become obscure and not get in the way. One needs to take up residence in a position with role responsibilities, and be guided by known and habitual ways and approaches. Innovation is not called for, nor is restructuring or reordering existing modes and methods of operation. Customers are not to be disturbed or challenged; employees are to be trusted to perform as told and as expected. The leader is to be distant, with no feelings of anger, envy, superiority, or disappointment.

### ***Hsien (31)***

This hexagram reminds managers that the business or business venture is moving from a status of focusing on internal organization and formal structures and procedures to an emphasis on the execution of its work processes in order to produce results for customers.

Under this hexagram, managers are advised to coordinate all parts of the system that makes for success and profits; in addition, different stakeholders need to be brought into resonating interaction to promote the firm's success. The business, guided by management, needs to reach out to customers, suppliers, investors and the community. Relationships of mutual dependence, like that of parents and child, or husband and wife, need to be cultivated and nourished with attention and service.

Delivery of quality is the key to success. The needs of others are accepted as a given without arguments or resentment. The business seeks to do right by its stakeholders, while polishing away its imperfections. It has a vital sense of purpose, and its energies are flowing strongly. It assists and encourages its stakeholders to find itself in harmony with its surroundings, while blending and combining different inputs and integrating its outputs into the lives of its customers to provide welcomed goods for the community.

### ***Lü (56)***

This hexagram indicates the opportunity to grow and expand the reach of a business from its organizational base. Its capacity for producing goods or services can overflow without difficulty. It will connect easily with stakeholders. The inside and the outside cling together and enjoy mutual dependence. The times are propitious, and meeting responsibilities will lead to good results. Discipline is necessary and insists on proper conduct.

***Hsiao Kuo (62)***

This hexagram indicates that circumstances demand practical application of business systems, hands-on management, personal dedication and caring. The organization can't run on autopilot. Personal engagement by management and employees will put decisions to the test of market success or failure. Details will dictate results. Higher ranks can't rest on their positions and their formal powers, or needed stakeholders – customers, creditors, employees, suppliers – will go elsewhere. Courtesy towards others on the part of management is necessary under the circumstances. Thrift and moderation should be employed.

***Chien (53)***

This hexagram indicates that circumstances favor gradual and steady penetration of customer demand. The mission of the business or business venture is coming toward fruition, with responsibilities assumed and authority put into action. The firm is not coming up against limits but has scope for action, and its brand equity is secure and recognized within its appropriate niche. The firm should attend to its core and expand it as demand grows. Management should have a steady moral and intellectual presence in the business or the venture.

***Chien (39)***

This hexagram provides a reminder that all is not smooth: the business or the venture is limping along. It moves haltingly and is hampered by stakeholder resistance or recalcitrance. Important stakeholders have been misjudged or misunderstood. Separating what is essential from what is merely apparent and only covers the surface of interactions becomes necessary.

Some are cunning and crafty. What stands in opposition to growth demands attention. A holistic approach is recommended so that adjustments can be made and clarity restored. Management needs to get to the bottom of things without disturbing the structure and currently settled expectations. Work drives the situation and functional responses hit the mark.

***Ken (52)***

This hexagram indicates the presence of circumstances that limit the reach of the firm or the venture, given its present organizational structure and business model. There is no need to continue walking. Those who put up roadblocks will not be driven off. Management is not in control of the situation.

Reflection is required to plan the firm's next move. Stakeholders must be brought into view. The company and customers, management and employees, owners and the board – one or more of these relationships is likely to be out of sync and subject to discord and uncertainty. A cycle of activity is coming to an end as sustaining and constructive reciprocity evaporates.

***Ch'ien (15)***

This hexagram indicates the presence of pride leading to complications in the situation surrounding the company. Humility is advised. Brand power, customer loyalty, employee productivity, and access to credit are taken for granted. It would be better for the firm or venture to be unpretentious and complementary, rather than showy and arrogant in its commercial terms. Danger lies in investors making

demands and customers and employees becoming angry. Perhaps it is a CEO who does not bother to work as a team leader, but asserts his or her personal dominion over the firm, offending others and causing them to withdraw cooperation. Management is well advised to float long with circumstances and travel light. Circumstances are in flux. Circumstances are not conducive to simplistic commands and controlled solutions. A service attitude towards work is advised. With proper consideration, initiatives can be undertaken successfully. Forethought is required, and personal indulgences should be avoided.

### ***P'i (12)***

This hexagram indicates the presence of serious opposition to firm success. Stakeholders are unfriendly, and profit evaporates. More flexible adaptation is advised. The firm or venture is not penetrating into the circumstances of its customers, employees, and suppliers.

The advantages that come only from have a good organization have been maximized. New approaches will be needed. Competitors offer stiff competition; customer loyalty is in question. They might find new preferences. Thrift is advised, as is casting out what does not contribute to success. Salary reductions may be in order if productivity does not keep up. Management has no basis for feeling satisfied or puffed up. Its structures, policies, manuals, and procedures do not provide for a well-governed firm.

### ***Ts'ui (45)***

This hexagram reveals an approach to restoring growth and profitability to a business or a venture. Stakeholders are to be brought closer to the firm through appeals to common interests, or having a share in a common goal. The firm thinks about doing things right, focusing not on impersonal markets or employees as replaceable parts to a machine, expendable and inherently of little individual value, but on key stakeholders. The business or venture should seek win-win partnerships, making short-term sacrifices to put such joint commitments into place. Power and force may not be used to compel cooperation. Rather, giving way gives rise to successful action. Feelings of respect and service should be invoked with customers and employees. One-sidedness in approaches to stakeholders needs to be corrected. A long-term perspective that sees things in their essential reality is highly recommended.

### ***Chin (35)***

This hexagram indicates the presence of favorable conditions that will permit flourishing. Management, therefore, needs to benefit customers in specific ways. Marketing will be productive if the brand communication is inspired and animated. Firm leadership must be fully engaged in the outreach efforts, reaching out to address the basic needs of stakeholders and enlighten them as to how they can benefit from the firm's goods or services. Employees deserve a bit of indulgence and flexibility in working conditions.

### ***Yü (16)***

This hexagram advises using an emphasis on foresight and prudence under the circumstances. Thinking ahead and preplanning for contingencies will create a readiness that will come in handy. Actions to counter competitors are especially advised. Counter-punches should be thrown. Brand equity needs to be



defended. The firm can take pride and satisfaction from having a good strategy and a business plan set in place in the past. Energetic market activity, motivation of employees, and seeking new capital: all are recommended at this time.

### ***Kuan (20)***

This hexagram directs management's attention under the circumstances to careful observation. The focus is on present conditions, not past achievements. Management must rely on its credentials and poise, paying respect where respect is due and keeping in accord with stakeholders. Market conditions are shifting from new needs and motivations. Employees are to be confirmed in their various roles and responsibilities, keeping in place the foundations of the organization and the modes of collaboration that support production. The firm can be self-confident in the face of changes and evolutions in the situation. It has a center of purpose and activity that is in accord with stakeholders.

### ***Pi (8)***

This hexagram connotes circumstances that ask for organizational planning to categorize people, opportunities, and responsibilities by their essential qualities. This is a particularly strong guideline for selecting suppliers. The firm should not be cheap or try to cut corners with suppliers. The original nature of inputs is important, not packaging or substitutes for the best in class.

Managers must put themselves last and not take center stage. While employees may be nervous or upset, managers need to confirm organizational structures and habits, and consolidate and reinforce past practices. Management's mode of interaction should reflect qualities of giving way and adhering to others as part of a joint venture, by being compliant and agreeable. At this time, the stakeholders, rather than the company, have the best sense of direction and judgment. They can be relied upon.

### ***Po (23)***

This hexagram indicates the need to strip away the unessential and the un-useable. Too much structure, employees, organizational overhead, administrative burden and office politics will drag down organizational output. Management, not bureaucratic imperatives or past rules and regulations, should drive decision-making. Opportunities need to be filled with responses.

The firm or the venture needs to go back to essentials – back to its early, lean days of innovation and entrepreneurship. Formalities and encrusted, ritualized relationships within the organization need to be swept away or dissolved so that energy can emerge from people in the firm and suppliers in order to respond to market conditions and new strategic demands. Natural patterns of demand and opportunity should be sought, rather than use of advertising to manipulate customer desires with hype and illusions.

### ***K'un (2)***

The focus now must be on productive activity and arriving at goods and services to be consumed. Business plans are in place and the organization is in order so that management focus is on output. Careful and thoughtful attention and personal engagement in getting results are called for. Nourishing inputs and watching over pots as they boil will bring a harvest of results. Firmness in holding to the framework of the working machines is required. Efforts and application will produce concrete results. It

is not a time for talking or marketing but for a display of honest work ethic. Procedures and principles must be followed. It is not a time for innovation, experimentation or argument.

Profits and advantages can be expected. Benefits will be received from customers; hands are helping hands. There is harmony between the company and its customers who benefit mutually. It is a time for customer focus and taking care of those who will receive the firm's goods or services.

### ***Fu (7)***

In these circumstances, the action requirement is to reconsider after reaching a high point of productive activity. A process of penetrating outward by issuing forth from high productivity is advised. This means checking with customers, reviewing procedures with employees looking for improvements, and ensuring community satisfaction with what the firm is doing.

The emphasis should shift to partnering and having excellent peer relationships in a joint venture approach to business. Products and services are in hand, so the focus should be on finding those who are most suitable for acquiring them. Under the circumstances, the chief skill is an anticipation of what is coming, especially opportunities fit for use of the firm's output. Analysis of aspects of the situation and looking at the parts that make up the whole is recommended. Stepping back to ensure a thorough understanding of how things work will bring future success.

### ***I (27)***

This hexagram indicates that circumstances call for consideration of owners above other stakeholders. It is now right and proper for owners to benefit from the business and to be nourished with the results of its financial success. Disposable wealth is in hand and should be shared. It is possible to feed those who need nourishment.

The leaders of the company should speak modestly about their accomplishments and further demonstrate this by sharing the results of their success with others. The second stakeholder constituency to be given priority in these circumstances is employees. Like the owners, they too depend on the company for financial sustenance. They also need to have the purpose of their relationship with the business – wages and income – validated and confirmed.

The hexagram does not provide guidance on the proportions of financial return that should be shared with these two stakeholders. But a reference to the need to be "correct" under the circumstances might well indicate that a sense of propriety and responsibility would require substantial attention paid to the employees' expectations. A "correct" and proper superior is solicitous of those who depend on his or her skills and judgments. One can similarly infer from this hexagram that the time is also appropriate for the business to be charitable and contribute to community needs and requirements.

### ***Chun (3)***

The hexagram implies that the business or business venture has reached a moment of financial success. It is time to collect on the potential that has been brought into being by entrepreneurial activity. There is sustained growth, and accumulation of income, gross sales, net margins, scale of enterprise, and etc. Expansion can be considered timely. Risks can be taken without reserve; there will be great success. The enterprise is flowing on a high tide of market relevance.

However, there is a caution included in the hexagram. Senior managers, and individual decision-makers need caution and should keep to maxims of essential goodness. They are advised to keep everything in its proper place and not be overcome with ambitions, greed or any other form of excess. Benefits of the business are to be considered in a mature and sober fashion that does not lead to indulgence.

#### ***I (42)***

The hexagram indicates that the business or the business venture has achieved a steady state of success. Production of its goods or services is steady and solid, and market penetration is secure. There is, however, an advantage in tweaking operations and reviewing the business to look for changes that will improve outcomes. In particular, employees can benefit from motivation and stimulation so that they don't fall into routine and lackluster performance due to taking for granted the current situation of profitability.

At the same time, the business should expand and seek new markets in new places to build its customer base. It has not yet reached the maximum point of possible market penetration. Vigorous efforts of personal commitment are called for in the leadership to structure increased growth through diversification.

#### ***Chen (51)***

The hexagram infers that the business or business venture has reached a point where new vigor is required. Actions are appropriate that will "shake up" the business and engender new support. All stakeholders should be engaged, consulted, and cultivated. Communications should be fun, loud, and dramatic with lots of discussion. The enterprise must impress others with its presence, its potential, and its realities.

However, there is a note of caution provided by the hexagram, which is concern for the accountability to owners. Management should not become too conceited or take too much for itself. Management alone did not bring the enterprise to where it is today; the enterprise required contributions from owners and employees also, and could not have succeeded without customer choices and loyalty. Thus, to protect the firm as a collective and cooperative undertaking, management must appropriate the owners and those others who also have power over whatever sustains the enterprise.

#### ***Shih Ho (21)***

This hexagram indicates that the business or business enterprise has reached its point of maximum profitability. It has bitten down on all possibilities and swallowed them. It has brought its potential to full growth by developing a viable business model, building an organization to implement the model, producing the required goods and services, and selling them. It has arrived at a proper place. It needs to comply with the laws and other requirements. It has internal coherence. The implication for stakeholders is maintenance of the status quo.

#### ***Sui (17)***

This hexagram suggests that the business or the business venture should consider moving forward in a new direction. It should follow new market opportunities or new ideas in order to fit in with current

conditions and opportunities and not remain stagnant. It should leave behind the dying past, even if it has to go in alone, without reliance on peers. Management seeks to enter, penetrate, and go through to new situations and opportunities where repose and sustenance await.

This effort implicates the organization in devising new plans; it also implicates consumers, customer research and reaching out to investigate new or different conditions. It implicates employees who must be motivated, exposed to new plans and ideas, and trained to deliver the new goods or services. There would naturally be a role for the board of a corporation to review, adopt and support the new plans and ventures; owners would also need to be kept well-informed of the initiatives and be stimulated to support them.

### ***Wu Wang (25)***

This hexagram suggests that management of the business or business venture, as it seeks new opportunities for growth and profit, avoid foolish, wild, reckless, incoherent undertakings that will risk disorder for the business and its stakeholders.

Others outside of the enterprise are not acting responsibly or reliably, so caution is called for. Mistakes can happen outside the enterprise due to ignorance or negligence, which can impact business operations. Direction must be imposed on the situation so that people will cooperate and consort with the enterprise. This implies actively seeking close alignment of customers, employees, suppliers, owners and creditors with the goals of the enterprise. Forces from the outside impose on the management's task of promoting internal cohesion and taking action to center activities on the core business model. In this way, growth is destined to occur, as if higher powers were looking out for the business.

### ***Ming I (36)***

This hexagram indicates for management the advantages of insisting on difficult, repetitive work. Poor performers must be separated from productive ones. It is necessary to be loyal and disciplined to obtain results. Management should step back from center stage and supervise of the work of others instead. This is not a time for high flyers; plow horses are more fitting for the tasks at hand. Those who know their roles and execute them well are most desired. Within the organization, natural talents should be allowed to flower and be put to use where most fitting. Outside the organization, a stance of flexibility and adjustment is recommended.

### ***Pi (22)***

This hexagram suggests paying renewed attention to marketing, PR, brand enhancement and communications towards all stakeholders. Embellishment in the presentation of the business or the business venture, in addition to displays of valor and success, are recommended. The effort is to be self-directed and not dependent on approval from others, nor go along with trends and fashions. However, the way the enterprise presents itself should not be done off-hand, nor be improvised or brought about in an impromptu moment of inspiration. Stakeholders near and far can be brought into alignment with the business and support it by using structured communications, similar to a musical arrangement of notes for harmony and tune. There should be the courage to break off relationships and asset legal rights to sustain the vision and purposes of the enterprise. Important outsiders in every

direction are observing, and influencing them will lead to constructive transformations of the business.

***Chi Chi (63)***

This hexagram suggests that management should make an important move that carries some risk. It should cross over to a new position in order to expand the business. The effort should take small steps at first – be tentative, and only do what is necessary. Precautions are needed, as well as thoughtful consideration of the future and its alternatives. There will be tension associated with the process of moving forward. The enterprise should not go beyond its core capability and continue on a trajectory that flows from past efforts and achievements.

***Chia Jen (37)***

This hexagram suggests that cooperation at this time will help the firm succeed. Cooperation suggests paying close attention to the needs, interests and capabilities of employees and suppliers. The management philosophies made famous by the Quality Moment (Six Sigma, etc.) are to be commended for consideration by the business or the business enterprise. The hexagram suggests paying close attention to those who are “within” the enterprise, as if they were all living in the same “house.”

Management is in a position to lead with meetings, consultations, expressions of goals and objectives, and responding to ideas and suggestions.

It is important that talents and capabilities are in alignment, and those materials, inputs, plants and machinery be supportive of organized team efforts. Complementarity of inputs is essential. Roles and responsibilities need to be interdependent.

***Feng (55)***

This hexagram suggests that the business or business venture is fully successful – prolific, and rich in talents and property. All stakeholders are contributing appropriately. They are where they belong and are loyal and reliable. The business or business enterprise is fully centered. But competition is strong. Management should be resolved to compete hard and challenge competitors, even in court. Sustained efforts with stakeholders are recommended to get their blessings for the enterprise.

***Li (30)***

This hexagram indicates that the enterprise is succeeding, having congregated necessary stakeholder inputs into a coherent business. The business, however, needs to be put to the test. Its ability to produce and breed new wealth should be shown, not just talked about. There is a risk of it falling behind and coming up short. Strong leadership from the top is suggested, one that will radiate its profile and its abilities outwards towards stakeholders in all directions.

***Ko (49)***

This hexagram suggests re-branding the business or the business venture. The presentation of the business needs renewal. A plateau of accomplishment has been reached, and in order to reinvigorate its prospects, the business needs to molt into a new skin. Such a step is part of a larger cycle of growth and transformation in order to adapt to changing circumstances and take advantage of new relationships. The

repositioning will remove difficulties that have accumulated. The changes introduced will trigger better circumstances. Setting new rules and regulations by the board of a corporation or by the senior management of a company will create regularities and ensure prosperity.

Employees need to be mutually supportive and generative, and nourish the business. Their loyalty and moral stature in assuming responsibility for business outcomes will be necessary for success. If this comes to pass, the business or business venture will become stately and noble: a blue-chip investment for owners and a respected, established company for managers and employees.

### ***T'ung Jen (13)***

In such a time, the attention of the management must be placed on moving towards high morale and fostering willing cooperation. There will be profit for embarking on a significant effort and taking an initiative with stakeholders. The firm must radiate concern and engagement outward from its core towards those around it. There must be conscious intent to secure an enduring union of needed parties. Whoever is suitable should resonate to the firm's goals and needs. Clarity in stakeholder relationships is advised.

The company cannot be partial to itself or any one set of stakeholders; it must be correct and poised with respect to all. It must be objective and not biased, driven by one-sided emotions or points of view. The firm must take the initiative to interpenetrate with stakeholders; it must reach out to achieve.

### ***Lin (19)***

In this situation, closing in to secure a sale is recommended. Acting sympathetically to approach them will bring success. A culmination of proposals should receive attention. Others can be stimulated and relationships nourished. Inking the contract with customers, employees, and investors is in the offing and needs attention.

Attention should be given to the nitty-gritty, the details where the devil is lurking. Personal activity to drive the process forward is required. Others are not to be used in one's place. However, observing from a distance and keeping to a proper place without resorting to false emotions, guile, or ingratiation is advised. Advising, teaching, and pointing out aspects of possibilities and the facts, are all well suited to achieving success.

### ***Sun (41)***

This hexagram suggests that the business or business venture, to continue its success, needs to delay gratification or reject selfish and overbearing choices. It similarly suggests that, within the business or business venture, owners of companies, the boards of corporations, CEOs and senior managers too should not overreach or become too selfish. Sincerely keeping a balance among all stakeholders will be advantageous. Keeping to original terms and conditions is recommended. Delay would be wise, as would be letting go some control. The competent leader adjusts so that previous difficulties become easy and light. Owners, boards, and top managers restrain anger and turn away from their appetites. Rather, they associate and go along with others who are moving with the force of time at their backs. This hexagram does not indicate which stakeholders should be given this preeminence, so one may conclude that any or all important constituencies supporting the business may deserve such consideration.

***Chien (60)***

This hexagram suggests that stakeholder relationships are confused or disordered and need to be put in better form by making limits clear and using contracts. This situation could implicate owners, creditors, employees, suppliers and contractors, or perhaps government and the community is pressing demands on the business or the business venture. Matters are to be distinguished and separated. Wheat is to be separated from the chaff. Obstacles are to be broken up and illusions dispelled. When this is accomplished, the business can shine in all directions.

Management must cut away, tailor, shape, and structure relationships with stakeholders. This is done by setting rules and limits and making intervals between initiatives and activities. But deliberation is required, and there is tension involved in the process of ordering. The ways of others are becoming exhausted so that matters may come to center on the needs of the business or the business venture. The business or business venture will be in its appropriate place. The business or business venture will go on to penetrate markets and other stakeholder situations with no harm to persons or property.

***Chung Fu (61)***

The hexagram indicates the need to bring the business model – its core – into accord with the circumstances, especially stakeholder interests and concerns. Sincerity and truth are especially needed now with stakeholder relationships. Determined action is recommended – swim ahead and put the business model to the test. Important matters of core values and moral concern are to be articulated and distinguished from other matters. Fashions and temptations are to be resisted by not seeking to fly high. Management is advised to be deliberate; use litigation if necessary, and take its time. There is no hurry.

***Kuei Mei (54)***

This hexagram indicates that the business or business venture is running into external resistance or internal entropy, leading to mediocrity, lower performance and reduced outcomes. A conversion or change of status is therefore recommended. This might be a merger or an acquisition, or become acquired by another company.

It could mean a shift in ownership: going public or going private, or just a sale of control. The enterprise needs to find a place where it belongs and should not stubbornly, one-sidedly, or impulsively insist on imposing its preferences on stakeholders. It is necessary for the business or the business venture to make this change slowly, step-by-step. Strategic thinking is required on the part of top management. Conditions are not supportive for continuation of business as usual, and customers and employees are restless. Being appropriate, not over-bearing, flexible, walking as with a limp, and self-renewing are all recommended actions under the circumstances.

***K'uei (38)***

This hexagram indicates tension between the enterprise, the stakeholders, and current conditions. Certain stakeholders or demands must be avoided or put at a distance. There is mutual exclusivity, and the business or business venture must keep to its own ways and be at an arm's length. Perhaps termination of relationships – with customers, employees, or suppliers – is advisable. Or, a particular market should be abandoned, or product line dropped. The business should focus on strategies opposite

from what it has been doing. Familiar people and habits are no longer fit, and have exhausted their contributions to the enterprise. Management should seek to harmonize and equalize different considerations and continue with divisions and separations as necessary.

The business or business venture needs to be liberated from ties, dependencies and attachments to reach its own point of brand illumination. The business or business venture, as well as management within the enterprise, needs to be firm, resolved, and manly enough to take advantage of circumstances.

### ***Tui (58)***

This hexagram indicates that the business or business venture has the opportunity to find, acquire, and open new markets or engage in joint ventures. It is time to open up opportunities, enter situations and take advantage of them. It is also a time for modification of the core business model, and for responding not to internal direction but to external opportunities. The business must be on the lookout everywhere for possibilities, as the foundations of success are concealed.

Management should rely on partners and consultants in the process of discovery and innovation. The core of the business should remain solid, but relations with the outside should be flexible, with everything on the table for consideration. Giving way, following, and being agreeable, all lead to reaping a harvest. To reach the highest goals, it is important for management to be in agreement with stakeholders. They must be encouraged to forget past labors and heavy burdens.

### ***Lü (10)***

This hexagram advises the business or business venture, and its managers, to proceed step-by-step. The tiger should watch over its tail and not bite people. After accumulating wealth, the firm is advised to have self-control and submit to regularities and formalities. Its virtue is in holding up a wall and carrying the weight of the business. Building the future brick by brick will culminate in secure conditions. If the business or the business venture and its managers jump too quickly to the top, they will find distress and become disheartened. Employees and suppliers must be set right, and their willingness put in agreement with the enterprise.

### ***T'ai (11)***

This hexagram indicates that the business or business venture should stop to spread its profits and wealth among stakeholders. It should distribute its accumulated surpluses widely, to employees, owners, and the community. Wealth is to be used, not hoarded. Social justice is to be advanced by private action. What is right is to be supported and reinforced through mutual efforts in civil society. There is to be leadership on the inside of the enterprise, and fulfilling generativity on the outside. Giving way to stakeholders will bear fruits for the enterprise. Whatever lives a long time will nevertheless dissolve. This might indicate a dissolution or winding up of the company because its time has come to an end.

### ***Ta Ch'a (26)***

This hexagram indicates that for success to continue, important things, resources, and people must be assembled and brought together. Whatever that is world class, noble, and of high worth and worthiness, should be gathered in. The effort should impose itself on circumstances and time with a sense of purpose



and enterprise. Timidity and mediocrity are to be thrown out the window. What is to be ingested is to be acquired cleanly, without entanglements. No side letters or hidden reservations or contingent obligations should be tolerated. Good research and record keeping are needed before deals can be confirmed.

The business or business venture needs to enhance its brand equity through achievements that are noticeable and influential. This could be recruitment of new board members, advisors, or consultants of renown. However, flamboyancy is to be avoided, and superficial networking and gladhanding will not attract and bond talent of sufficient worthiness and eminence.

### ***Hsü (5)***

This hexagram advises the business or business venture and its managers to be alert, to pay attention, and to wait for the right moment. Internal attention must be turned to what is necessary. Management needs to reach out to stakeholders to capture their confidence and secure conformity through alignment with their immediate needs and concerns. Decisions are required to separate wheat from chaff. Resolve is needed to step forward and be decisive. Stakeholders who are immature or too demanding do not deserve nourishment of their needs and concerns. Their influence on the business or business venture will diminish, or their efforts will come to exhaustion. Management needs repose and peace of mind, and to wait calmly for future developments. It can occupy core purposes and procedures with reassurance, with ordinary, daily activity sufficient for desired achievement.

### ***Hsiao Ch'u (19)***

This hexagram advises that the business or business venture is approaching culmination. Its cycle is coming to a close. The flow of its activities is blocked, and there is exposure to danger. A way forward is suggested by associating with people of good character and quality while avoiding charlatans, pontificators, glad-handers, and sycophants. Considerable and thoughtful reflection is advised. Customers and employees need to be protected within limits. The core is where growth will occur. But the way forward may dissolve and not last for much longer.

### ***Ta Chuang (34)***

This hexagram indicates that invigoration of the business or business venture is possible through inner conviction. Regular formalities and familiar structures are appropriate, not innovations or appeals to outsiders. Competition is serious and demands a vigorous response. Customers must be excited and stirred up. A sense of purpose and integrity of motive and feelings will be helpful. Taking all points of view into account and looking in all directions will be essential. If there is no action, small-minded people will take advantage of the vacuum so created. Threats need to be confronted head on and turned aside. Previous troubles will disappear and fences will be broken, permitting advance. Practical means of moving the business forward need to be secured.

### ***Ta Yu (14)***


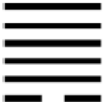






















This hexagram denotes conditions that may require changes. Management may need to bring matters to a close. Acceptance of having to relinquish the business or business venture may be required. Fate is playing a role under the circumstances. Stakeholder support may no longer be available. Their powers

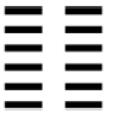






















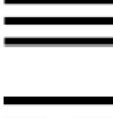









and abilities are solidly in place. They can persist in following their patterns of behavior. There is danger without and drudgery within, through no fault of the management or the business. Customers, employees, and suppliers are not under control.

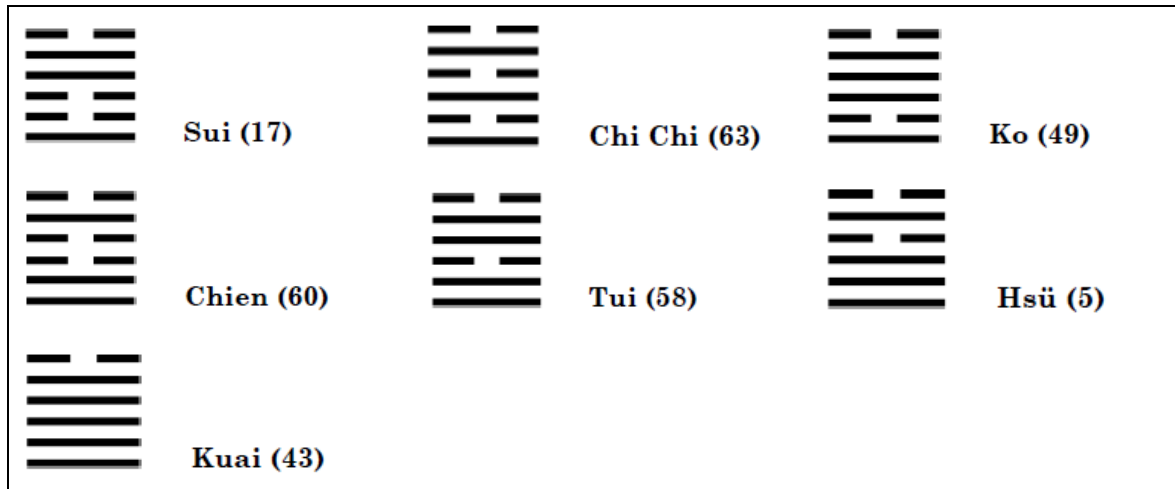
**Kuai (43)**

This hexagram denotes a time for parting of ways or division of energies. Stakeholders, parts of the business, etc., need to be separated; the flow of the enterprise will fork in different directions. Some parts will tend towards new leadership and entrepreneurial opportunities. Other aspects of the business need to be ground down and sharpened. Adverse stakeholders need to be pacified. There are no profits, and conflict approaches. The honor of achievement is fading and an enduring cycle is coming to an end. A climax of enterprise is necessary, with a break-up required. Encounters and meetings with stakeholders lead to both transitory relationships with some, and enduring ties with others. Management may respond best by broadly engaging and increasing salaries and benefits to employees.

**Table 1. Hexagrams**

	Ch'ien (1)		Kou (44)		Ta Kuo (28)
	Heng (32)		Sun (57)		Ching (48)
	Sheng (46)		Sung (6)		K'un (47)
	Hsieh (40)		Huan (59)		K'an (29)
	Shih (7)		Tun (33)		Hsien (31)
	Hsiao Kuo (62)		Chien (53)		Chien (39)
	Ch'ien (15)		P'i (12)		Ts'ui (45)
	Yü (16)		Kuan (20)		Pi (8)

	K'un (2)		Fu (7)		I (27)
	I (42)		Chen (51)		Shih Ho (21)
	Wu Wang (25)		Ming I (36)		Pi (22)
	Chia Jen (37)		Feng (55)		Li (30)
	T'ung Jen (13)		Lin (19)		Sun (41)
	Chung Fu (61)		Kuei Mei (54)		K'uei (38)
	Lü (10)		T'ai (11)		Ta Ch'a (26)
	Hsiao Ch'u (19)		Ta Chuang (34)		Ta Yu (14)
	Ting (50)		Ku (18)		Wei Chi (64)
	Meng (4)		Lü (56)		Ken (52)
	Chin (35)		Po (23)		Chun (3)



### Conclusion

The preceding interpretations of the 64 hexagrams of the I Ching reinforce an understanding of corporate social responsibility as an extension of the natural order of things. Human nature is a given paradigm; markets follow orderly laws of cause and effect; business is conducted in an environment of society, culture, laws and interpersonal ambitions. All in all there is a system of dependencies and feed-back channels in which enterprise must find its place for better or worse, for success or failure.

The I Ching was designed to mimic the forces of cause and effect in the natural order so that human decision-makers could be more successful in surfing the waves of circumstance which come and go beyond our control. It reveals a sort of natural law about life. If the I Ching can be adapted to responsible business habits, then perforce such habits are both helpful to business and reflective of a natural order.

Responsibility – a conscious awareness of natural interdependencies leading to the adoption of constructive habits, virtues, and mindfulness – therefore is a part of business, at its core. It is most definitely not interference in business decision-making coming from beyond the rightful scope of entrepreneurial and free market undertakings.

Second, if the hexagrams of the I Ching can be adapted to modern dynamics of corporate social responsibility and can provide constructive guidance in real business situations, then the art of the I Ching deserves great respect from all of us. What was divined in China thousands of years ago still has interpretative power and a truth value for us today. The insights behind the I Ching may well penetrate to some lasting human realities which we would ignore to our detriment.

## **EXPLORING MORAL ACTION: A CRITICAL REVIEW OF INTEGRATIVE MODELS AND SUGGESTIONS FOR FUTURE RESEARCH**

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### **Introduction**

With several ethical infractions being unearthed with alarming regularity, organizations today are under pressure to critically examine and identify sources of wrong-doing, and consequently reform their stakeholder-related practices. Help in deciphering the triggers behind (un)ethical conduct and the cognitive processes individuals use while evaluating dilemmas has come from researchers who for the last three decades have been attempting to determine why individuals behave unethically in workplaces. In an attempt to understand the complexities of moral action, this paper undertakes a critical review of key models of ethical decision-making. Investigations begin with Rest's (1986) model of moral action that explains the process of ethical decision-making and explores it further through subsequent descriptive studies. During the mid-1980's and early 1990's a number of theoretical models (e.g., Treviño, 1986; Jones, 1991) were built on the foundation of the model of moral action. These studies added a wide variety of constructs to Rest's model in assessing the process of forming ethical intentions and ultimately translating them into behavior. Several databases were used to provide detailed information on approaches to ethical decision-making. These databases included ProQuest, JSTOR, EBSCO, PsycINFO and SSRN from which numerous peer reviewed academic journals were accessed.

### **Model of Moral Action – Rest (1986)**

In his initial development of an ethical decision-making model, Rest identified four stages that were presented as a synthesis of research in moral psychology. It was then developed into a model that hypothesized psychological components underlying every moral act (Narvaez and Rest, 1995; Rest et al., 1986, 1999). The four basic components or steps of the model are as follows:

*Step 1:* Moral sensitivity or awareness is the ability to interpret cause-effect relationships in situations where a decision affects the welfare of others. Failure to understand the causal links can emanate from ignorance of an action's effect (e.g., not knowing that by buying a particular brand we are abetting the use of child labor), or ambiguous cues in the act itself (e.g., whether a loud argument is a lovers' tiff or domestic violence).

Several studies have noted that women tend to have greater skill at identifying ethical issues and that training and experience can improve individuals' ethical sensitivity (Treviño et al., 2006). The context and nature of the issue also influences ethical awareness with Jones (1991) stating that issues with high moral intensity are more vivid and salient, and therefore gain the individual's attention and consequently are more likely to be identified as ethical issues. Subsequent research has demonstrated that characteristics of a moral issue, particularly the magnitude of its consequences and the social consensus on it (Flannery and May, 2000; Frey, 2000; May and Pauli, 2002; Singhapakdi et al., 1996)

influence moral awareness (as well as ethical intentions).

Further, individuals can be more attentive to information based on their cognitive predispositions (Reynolds, 2006). Individuals who prefer to focus on the ends in ethical decision-making (utilitarians) were found to be significantly less likely to identify issues that involved only violations of behavioral norms as moral issues than those who prefer to focus on the means (formalists). The other influences on moral awareness include existence of a competitive framework, the use of moral language (the latter by triggering a moral issue schema) and social consensus (Butterfield et al., 2000).

*Step 2:* Once an individual becomes aware of an ethical issue, the ethical judgment process is likely to begin. Moral judgment or evaluation is the ability to make a decision based on a moral ideal. Moral judgment involves application of moral principles unlike following social norms which are generally learnt from society and copied while behaving. Being vicariously learnt, norms (such as dress codes or dining manners) do not require individuals to make a provision for evaluation or analysis. Moral judgment, on the contrary, is a cognitive-developmental attribute, in which an understanding of social arrangements is developed so that the individual can adopt modes of evaluation and behavior that shift focus from short-term individual needs to long-term societal needs (Kohlberg, 1976, 1984). The most prominent social scientific theory of ethical judgment remains Kohlberg's (1969) theory of cognitive moral development that avers that moral judgment develops with age and progresses through six stages. Individuals move through these stages in an invariant, irreversible sequence, because higher stages depend upon cognitive capacity that is unavailable at lower stages.

This idea of cognitive moral development is not without criticism. Critics point out that Kohlberg focused on rational thinking rather than feeling and caring as a process of decision-making and hence had a bias towards a justice-oriented view of morality that favored males (Gilligan, 1982, 1987). Additionally, there is little evidence to support the existence of higher-level moral reasoning among individuals (Modgil & Modgil, 1986; Wren, 1990). Research has found that most adults are at the conventional level, meaning that their thinking about what is right is largely influenced by rules, laws and significant others in their lives and at their workplace. Fewer than 20 per cent of American adults were found to reach the principled levels of Stages 5 or 6 (Rest et al., 1999), where actions should be more consistent with moral thought. It must also be noted that Stage 6 is considered a theoretically postulated stage only, because empirical evidence of it is rare.

These findings have clear implications for behavioural ethics in organizations. If most adults' thinking about right and wrong are highly susceptible to external influence, then the management of such conduct through attention to norms, peer behavior, leadership, reward systems, climate and culture becomes important. Treviño's (1986) Interactionist Model of ethical decision-making builds on this assumption that the influences of contextual variables on decision-making and behavior depend upon the individual's cognitive moral development, with those at the highest stages being less susceptible to contextual influences.

The correlates of moral judgment include characteristics of ethical issues, particularly the type of harm and the magnitude of consequences and dimensions of an issue's moral intensity (Frey, 2000; Jones, 1991; Weber, 1996). Work environment has also been associated with moral judgment with accounting students and practitioners having lower moral judgment when compared to other professions (Lampe and Finn, 1992). Moral reasoning has also been found to be lower when individuals respond to

work-related dilemmas compared to non-work dilemmas (Weber, 1990; Weber & Wasieleski, 2001). Another contributor of moral judgment is the role of specific individual preferences for relativism and idealism (Forsyth, 1980). Findings that older and more experienced managers reason at a lower level, and that individuals reason at a lower level in response to work-related issues compared to more general ethical issues, seem counter to cognitive moral development theory's proposed hierarchical sequence of moral development.

A number of researchers have considered how the limitations and failures of human information processing may influence moral judgment. This includes work by behavioural economists on cognitive biases. Another stream of investigation by psychologists has been on moral disengagement processes that help cancel out an individual's moral obligation resulting in intentions that support personal self-interest.

Research has established that cancelling out moral obligation can be enabled by disengaging morality from one's judgment. Bandura (1986, 1991) in his social cognitive theory postulated that individuals possess self-directing capabilities that allow them to exercise control over their thoughts, feelings and behavior. This self-regulatory mechanism offers a certain amount of stability in an individual's interaction with his environment. The process of self-regulation is accomplished through a series of sub functions which must be developed and mobilized for effective control to happen.

The first sub function is self-observation – the process through which individuals recognize and identify relevant aspects of their behavior. Such observation of one's own behavior provides the information necessary for setting standards for one's behavior as well as evaluating ongoing changes in behavior. By recognizing how she/he is behaving, the individual takes the first step towards change and improvement in conduct. Judgmental processes provide the individual with information on whether an action will be evaluated as positive or negative when compared against his/her internal standard of behavior. These internal standards are developed through social learning processes like role-modeling, and valuing certain qualities in others that are then used as benchmarks. Observations and evaluations therefore feed into the final stage of the self-regulatory process, i.e. self-reaction. Self-reaction evaluates one's own behavior depending on how it measures up to an internal standard (Bandura, 1986) and thereby influences future behavior. Individuals tend to pursue courses of action that produce positive self-reactions and avoid those that may produce self-censure or condemnation.

Bandura (1981) suggested that an individual's moral reasoning translates into action through the self-regulatory mechanism of moral agency that monitors and controls moral conduct. This regulation of conduct is achieved through the two anticipatory processes of social sanction and self-sanction. The deterrent power of social sanctions can be limited because many transgressions happen in private and hence go undetected by others. Yet, people continue to monitor and regulate their behavior even when there is no threat of external sanction through the anticipatory process of self-sanction. Self-sanctions therefore provide internally directed restrictions on behavior (Bandura, 1991).

In reality, the uses of social sanction and self-sanction operates interactively with the environment of the individual. As the interactionist perspective notes, moral conduct is regulated by reciprocity of influence between thought and self-sanction, conduct and a network of social influences (Bandura, 1991). As long as self-sanctions are more powerful than social sanctions, behavior is kept in line with personal standards. However, when faced with strong external inducements, self-sanctions may be

selectively deactivated to avoid conflict with internal standards. This deactivation enables otherwise considerate individuals to perform self-serving activities that have detrimental social effects. As individuals interchangeably use both self and social sanctions, it is often conducive social conditions rather than inherently evil people that produce acts of cruelty. Bandura noted that given appropriate social conditions even decent, ordinary people can be led to do extraordinarily cruel deeds. The process of moral disengagement (i.e. deactivating self-sanctions) is thus not instantaneous but a gradual one achieved through the release of self-censure.

*Step 3:* The third component, moral motivation also referred to as moral intention is the ability to prioritize moral concerns over competing issues. Moral motivation has been described as a person's "degree of commitment to taking the moral course of action, valuing moral values over other values, and taking personal responsibility for moral outcomes" (Rest et al., 1999, p. 101).

The triggers of moral intention have been found to be both non-conscious and intuitive (e.g., Haidt, 2001; Simon, 1992) as well as based on intentional, effortful, and controllable moral reasoning (e.g., Kohlberg, 1969). The other influencers of moral intention that have been examined include an individual's moral identity (Weaver, 2006; Weaver & Agle, 2002) and affect (Eisenberg, 2000). Affect denotes trait-based positive and negative emotionality, explicit felt emotions such as fear and joy that represent relatively intense reactions to events (Weiss & Cropanzano, 1996), as well as moods that are more diffused, less intense and of a longer duration (Frijda, 1986). Gaudine and Thorne (2001) and Rajeev and Bhattacharyya (2007) have addressed the role of emotions in stages (awareness, judgment, motivation, and behavior) of ethical decision-making.

*Gaps in research:* In this context, the role of moral disengagement in deactivating moral judgment thereby impacting moral intentions has not received adequate attention particularly in business ethics. Moral disengagement has been put forth as an initiator of corruption by both easing and expediting individual unethical decision-making when it helps advance organizational interests (Moore, 2008). It could facilitate organizational corruption by dampening individuals' awareness of the ethical content of the decisions they make. Additionally, it may contribute to the perpetuation of corruption, because if individuals who have a greater propensity to morally disengage are likely to make decisions that advance organizational interests regardless of the ethicality of those decisions, they may also be rewarded for those decisions through organizational advancement. Though this proposition suggests that moral disengagement plays an important role in activating and enabling corruption in organizations, they have not yet been empirically established.

Our understanding of the possible triggers of disengagement in organizational settings is therefore incomplete especially because moral disengagement as an attitude is indisputably interactive in nature (Bandura, 1999) and hence made possible by the organizational context/environment. Further, there is a need to understand how organizational processes facilitate or impede the progression of disengagement among individuals. While the purpose of ethical codes of conduct is to improve the moral sensitivity of employees and help them judge situations morally and finally take ethical decisions, the impact of attitudes like moral disengagement that may neutralize the effect of orientation into ethical codes has unfortunately received scarce attention in ethics research.

*Step 4:* The final component, moral character is the ability to transform intentions into actual behavior. Ego-strength, self-regulation, and self-efficacy all play important roles at this stage. For



instance, all things being equal, people with greater ego-strength are less likely to cheat on a test. People also maintain self-control longer when they focus on positive goals (Mischel & Mischel, 1976). Expectations of efficacy have been found to help people initiate and maintain coping behavior in the face of obstacles (Bandura, 1977) and translate their intentions into action.

The four components of Rest's model influence each other via feed-forward and feedback loops, with cognition, affect, and behavior all playing a role (Moore & Chang, 2006). Further, it must be underlined that moral awareness, judgment, intention and character are not general personality traits but internal processes that must be set in motion for external moral behavior to occur. Researchers have since proposed and tested a wide variety of constructs that influence Rest's four-step process offering integrative models that attempt to describe the components of ethical behavior and their functional dynamics.

### **Ethical Decision-Making in Organization: A Person-Situation Inter-actionist Model – Treviño (1986)**

By factoring in individual and situational differences that can impact moral evaluation and judgment, this model offered by Treviño (1986) introduces an inter-actionist perspective to ethical decision-making. In it, the stages of cognitive moral development as described by Kohlberg interact with individual and situational moderators to influence ethical behavior. Three individual variables namely ego strength, field dependence and locus of control can influence an individual's likelihood of acting on his/her assessment of what is right or wrong. This process of judgment is further moderated by situational variables emanating from the immediate work context and the organization's ethical culture. Finally, the role itself and its moral context can influence the cognitive moral development of the individual decision maker.

The inter-actionist perspective is important for several reasons. First, it clearly recognizes the complexity of ethical decision-making and the numerous factors affecting decision-making in managerial contexts. Second, while recognizing complexity, the model simplifies and groups the expected influences on ethical decision-making into individual and organizational factors. Third, while the theory offers a behavioral model, it clearly recognizes the importance of cognitive processes that precede and explain ethical behavior.

One of the few shortcomings pointed out is that the model fails to include the critical interplay of demographic variables that affect dilemma recognition (e.g. gender, age, organizational status, and previous experience with the ethical dilemma presented) with socio-cultural factors beyond the organization (Pimentel et al., 2010). For instance, gender is likely to have a more substantial impact on ethical decision-making in societal cultures marked by greater gender inequality (Franke et al., 1997), even if the culture of the organization is markedly egalitarian.

On the whole, the inter-actionist perspective offers a comprehensive approach to ethical decision-making in organizational settings that considers, to differing extents and foci, individual, organizational, and environmental factors that impact the evaluation and resolution of ethical issues. However, it does not consider the characteristics of the dilemma itself as a determining factor in ethical recognition, evaluation and decision-making, a limitation which was later addressed by Jones (1991) in his issue contingent approach.

Later, Treviño and Youngblood (1990) proposed and tested a multiple-influences causal model of ethical decision-making and behavior. Social learning, stage of cognitive moral development and locus of control were hypothesized to influence ethical decision-making with outcome expectancies mediating the relationship. Results revealed that ethical decision-making was influenced directly by cognitive moral development and locus of control of individuals while outcome expectancies indirectly impacted ethical decision-making. Further, vicarious reward influenced ethical decision-making indirectly through outcome expectancies. This model however did not find any evidence of the direct impact of vicarious reward or punishment on ethical behavior. Vicarious reward (seeing an ethical behavior being rewarded) influenced ethical behavior primarily through the mediating influence of outcome expectancies.

Vicarious punishment (observing unethical behavior being punished in one's organization) however, did not significantly influence outcome expectancies or behavior, even though "both manipulations were equivalent in strength" (Treviño & Youngblood, 1990, p. 379). The differences in the findings for vicarious reward and punishment may be on account of the fact that to impact behavior vicarious learning has to be noticed and remembered (Bandura, 1986). In the case of vicarious punishment with respect to their study, the authors suggest that the punishment may have been perceived as less harsh than expected and therefore could not be remembered and consequently failed to influence ethical behavior.

Ashkanasy et al. (2006) take the exploration of cognitive moral development and individual differences further by revisiting the "bad apples" (unethical behavior attributed to personal characteristics) and "bad barrel" (organizational or situational variables that trigger misconduct) perspective. They examine how managers' ethical decision-making is likely to be influenced by a combination of personal predispositions and expectations based on organizational cues. Expectations include exposure to unethical practices in the organization and instances when unethical behavior is condoned. They hypothesized that ethical choices would be positively influenced by managers' level of cognitive moral development (measured in three levels: autonomous, accommodating and pragmatic) and negatively by their expectation that the organization condones and even rewards unethical behavior. Further, the direct effect of cognitive moral development (referred to as CMD henceforth) on ethical decision-making was expected to be moderated by managers' belief in a just world and their expectations about the organization.

Results reveal that while the correlation between CMD scores and ethical decision-making was significant (and quite strong), the difference in the ethical choice made by autonomous managers (who have the highest CMD) and those of accommodating managers (who score average on CMD) was not significant. However, the ethical choices made by pragmatic managers (who have the lowest level of CMD) were found to be qualitatively different from the other two and were much more likely than the others to make unethical decisions. While all the three categories of managers were found to be more aware of and sensitive to information on reward systems, the pragmatic managers were most reactive to reward system expectations. Consistent with Kohlberg's (1969, 1976) theory, pragmatic managers were found to take advantage of the fact that the organization often condones unethical behavior. They based their decisions only on the consequences of their actions hence the realization that the organization condones unethical behavior gave them an incentive to behave unethically as well. The study thus provided key empirical support for the inter-actionist perspective by suggesting that individuals respond

to outcome expectancies differently depending upon their level of cognitive moral development. Managers who were autonomous and hence high on CMD made even more ethical decisions when they found themselves in an unethical organizational environment.

*Gaps in research:* If punishments were perceived to be less harsh than expected, they did not induce ethical behavior and absence of punishment logically encouraged unethical conduct. The realization that organizations do not punish unethical behavior is likely to impact employee attitudes and consequently their ethical decision-making. Future studies need to look into the vicarious impact of witnessing peers behave unethically and the condoning of such behavior by their boss on the attitudes of employees and the consequent ethical choices they make. Additionally, autonomous managers have been seen to react in accordance with principle-oriented moral reasoning (Rest & Narváez, 1994). It is reasonable then to raise the question whether greater sensitization and training in ethical codes of conduct (indicating an enhanced cognitive capacity to make a moral judgment) would make managers more ethical in their choices?

Another interesting extension of the inter-actionist perspective has been the inclusion of moral disengagement as an antecedent of ethical decision-making. Detert et al. (2008) advance our understanding of the individual antecedents and decision outcomes of moral disengagement. Six individual differences namely: empathy, moral identity, trait cynicism and locus of control orientation in three forms - internal, chance and power - were examined as antecedents that either increased or decreased moral disengagement, defined as a set of cognitive mechanisms that deactivate moral self-regulatory processes and thereby help explain why individuals often make unethical decisions without apparent guilt or self-censure (Bandura, 1986). Their result supported four individual difference hypotheses, specifically, that empathy and moral identity are negatively related to moral disengagement, while trait cynicism and chance locus of control orientation are positively related to moral disengagement. Two additional locus of control orientations (internal and power) were not significantly related to moral disengagement. One major finding was that moral disengagement is positively related to unethical decision making and plays a mediating role between the individual differences that were studied and unethical decisions.

*Gaps in research:* While Bandura et al. (1996) found high moral disengagers to be less pro-social and more prone to aggression and violent behavior, not many studies have gone into assessing the impact of moral disengagement especially in organizational contexts. Research on moral disengagement has been rather limited particularly in the context of ethical behavior. Though Detert et al. (2008) have found moral disengagement to be positively related to unethical decision-making their study was conducted on students and focused on individual characteristics that affect moral disengagement. There is therefore a need to examine which elements from an organizations context may act as antecedents of moral disengagement among employees and in turn affect their ethical choices.

### **Ethical Decision-Making by Individuals in Organizations: An Issue-Contingent Model- Jones (1991)**

In a significant step toward understanding the many components involved in ethical decision-making, Jones (1991) integrated existing theoretical models of individual decision-making, many of which, when considered alone, appeared incomplete. Noting that explicit consideration of the characteristics of the

issue itself was missing from all the models, Jones offered an issue-contingent model of ethical decision-making. Six characteristics of an issue were considered and collectively labeled as moral intensity, which must be considered while making an ethical decision. Jones' issue-contingent model introduces the notion of moral intensity of the issue to describe a set of measurable characteristics that influence different steps of the ethical decision-making process.

In the framework, the moral intensity of a particular issue which includes six dimensions: concentration of effect, probability of effect, proximity, social consensus, temporal immediacy, and magnitude of consequence will influence all stages of decision-making, rendering the transition between stages contingent upon particular characteristics inherent in the moral issue. In addition to shifting focus from individual and environmental factors to the nature of the dilemma itself, one of the most compelling aspects of this framework is its stepwise approach to decision-making, where each step from issue recognition to behavioral action is affected by individual, organizational, environmental, and issue-specific criterion.

While the moral intensity of an issue is a significant consideration in ethical decision-making, studies in decision-making have considered the differences in perception of "self" with that of "other" as impacting decisions. One such example is found in Kray's (2000) study of the decision-making processes enacted when one is an advisor contrasted with those processes used in making decisions for one. Another example can be found in a study of the desirability of consequences for self and for others (Cole et al., 2000). These studies illustrate that individuals may use different decision-making processes or make different choices based on whether they are personally involved or whether they are an outsider to the decision. Similarly, research has shown that individuals might make different decision choices based on whether they are in a business or non-business situation.

Specifically, Weber (1990) found that individuals use a lower level of moral reasoning when in a business situation than when in a non-business context. In this way, it is seen that an individual may incorporate different decision-making processes when working from the perspective of the organization than they would for their own personal decisions. Morris and McDonald (1995) suggested that future research should include different focuses of moral judgment (e.g., individual, organizational, and/or environmental contingencies). In the ethical decision-making literature, prior studies have considered moral intensity from the viewpoint of the subject (Harrington, 1997; Marshall & Dewe, 1997; Singer & Singer, 1997) or of others (Morris & McDonald, 1995; Singhapakdi et al., 1996; Weber, 1996).

*Gaps in research:* If moral judgment differs in situations of personal consideration from those of organizational significance, further clarification of the ethical decision-making process as well as the antecedents of the decision in both cases is essential. Does the ethicality of a decision depend on whether the end result personally affects the individual decision-maker or impacts his/her organization? Several ethical infractions are committed as they bring a benefit or gain albeit a short term one. So is the decision-making process affected by *a priori* assumption regarding the ultimate beneficiary of the decision? Future studies may take this enquiry forward by examining two orientations of ethical dilemmas (i.e. personal gain and organizational gain) in terms of their impact on unethical choices.

### **A Model of Ethical Decision Making: The Integration of Process and Content – McDevitt *et al.* (2007)**

While the abovementioned models provide a framework to understand ethical decision-making founded on the model of moral action, the process perspective of McDevitt *et al.* (2007) offers an integrated model that combines content variables and extends understanding of how they impact the decision-making process using Janis and Mann's (1977) Conflict Theory Model of Decision-making.

This model identifies antecedent conditions of conflict situations; explains the mediating processes used to make decisions, and suggests the consequences that may ensue. The emphasis is on the process and the content of the information search that a manager might complete when faced with an ethical dilemma. It offers a framework for organizations to develop policies and procedures that can enhance the likelihood of ethical behavior among managers.

The integrated process model brings together three main categories of variables namely antecedent conditions, mediating processes, and decision outcomes. Using the seven steps of Janis and Mann (1977) model, additional information is included. Specifically, the content variables are integrated under antecedent conditions and specify the categories of information that influence the decision. The model thus moves beyond individual variables to include organizational and external environmental variables in the decision-making process. By incorporating critical questions that are to be rated by individuals, the model facilitates assessment of the seriousness of the risk they pose, thereby impacting the decision outcomes. Each step in the process is prompted by circumstances and/or the need to consider additional variables. The decision outcome is the result of the process.

The model is divided into two phases of the decision process. In Phase I, less complex dilemmas can be decided, while more complex problems move the decision maker to Phase II. In Phase II a vigilant information search is required and more complex alternative solutions are considered. The mediating processes of Phase I begin with an assessment of the risk of choosing either the ethical or unethical action. If there is no threat to their jobs, no consideration of a lost bonus, and/or they are confident that their division performance was the best it could be based on the current market conditions, there is no conflict and an ethical outcome results. However, if their professional career objectives demand continued successful performance improvement, managers may see the risks as very serious, move on to the next question, and consider additional variables. The decision maker then moves on to the second question and address the risks of unethical action. If a manager has seen manipulation of operating results go unnoticed in the past, or perhaps be rewarded, assessment of the risks may be minimal. When managers perceive very little conflict, they can slide into an unethical decision.

If it is risky to pursue unethical action, the decision maker must decide if unethical action is justified in this particular situation. The information search can be expanded at this point to include additional variables. Managers may reconsider the role of management and their peers. They may be influenced by their feelings of role-conflict, an undefined organization ethic, or unrealistic company goals. If they can feel justified in this situation, they have prepared a good case of defensive rationalization that will result in an unethical decision. If instead, they cannot justify their actions, they must move on to Phase II or go back to Question I and reconsider their position. Phase II decisions are more difficult to face and complex to think about. Sufficient time is required to consider all relevant variables and affected parties.

*Gaps in research:* This model does offer an integration of both content and process dimensions of ethical decision-making. Its suggestion of mediating variables can be effectively deployed within the Rest (1986) framework. However, there are opportunities to further enhance the utility of this integrated approach. Firstly, the model does not take into account the impact of time on the decision process. Certainly, time constraints will limit the degree and extent of the search and personal reflection on the variables. The impact of time on the decision process, however, can be tested in future empirical research. Secondly, performance pressure, competition and need to out-perform colleagues may present additional constraints on decision-making. They also may help justify unethical behavior by using defensive rationalizations. The antecedents and consequences of such constraints need study. Thirdly, though the model suggests mediating processes for the assessment of the risk of choosing either the ethical or unethical action, it does not offer suggestion on what kind of attitudinal or personality variables could act as possible mediators. This may be studied in future and incorporated into the model.

This review therefore sums up Rest's four-step model of moral action model that hypothesized psychological components underlying every moral act and extends understanding of moral action through the various integrative models built on it. The inter-actionist perspective is then discussed to describe how the stages of cognitive moral development as described by Kohlberg interact with individual and situational moderators to influence ethical behavior. The discussion is taken ahead with Treviño and Youngblood's (1990) multiple-influences causal model wherein social learning, stage of cognitive moral development and locus of control were hypothesized to influence ethical decision-making with outcome expectancies mediating the relationship.

Cognitive moral development and individual differences are deliberated by Ashkanasy et al. (2006) revisiting the "bad apples" (unethical behavior attributed to personal characteristics) and "bad barrel" (organizational or situational variables that trigger misconduct) perspective which examined managers' ethical decision-making influenced by a combination of personal predispositions and expectations based on organizational cues. Another interesting extension of the inter-actionist perspective has been the inclusion of moral disengagement as an antecedent of ethical decision-making (Detert et al., 2008). With Jones issue-contingent model research attention is directed to characteristics of an issue collectively labeled as moral intensity, which must be considered while making an ethical decision. Finally, McDevitt et al.'s (2007) the process perspective combines content variables with the process of how they impact the decision-making.

While elaborating on the various perspectives on moral action, this review highlights the new possibilities presented by each of them. These research gaps when explored through future research are bound to offer insights that will improve our understanding of moral awareness, evaluation, intention and action.

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## BOOK REVIEW

### **On China**

*by Henry Kissinger*

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This is a singular book that only Dr. Henry Kissinger could have written. Dr. Kissinger titled the first chapter of his book “On China”, “The Singularity of China” to contrast this “civilisational state” (in the words of Martin Jacques, author of “When China Rules the World”) with American claim to “exceptionalism”. This is the belief that as the US was founded on democratic values, such as freedom and individual rights, it had the duty to proselytize these values to all of mankind.

What makes this book so singular in the view of this reviewer, is that the author provides at least four perspectives on US-China differences. These may have been written up by others separately, but only the inimitable Kissinger could have put together so cogently. Collectively, they make a powerful case for the need to develop a foundation of trust and to build bridges of understanding between erstwhile opponents such as the US and China which are surrogates for the different ideas that spring from the Socratic and Confucian traditions.

The four perspectives are the historical, the strategic, the diplomatic and the futuristic.

In terms of history, Kissinger teaches us how the Chinese narrative of its own mythic origin differs so markedly from foundation stories of Western states that usually trace their origins to a identifiable ruler.

As a political strategist, Kissinger is able to highlight the differences in the paradigm or mindset of people brought up in the logical rationalism of Western thought as opposed to the holistic view point of Eastern philosophers.

As a diplomat and one who was instrumental in America’s drive to recruit China to its side in its nuclear face-off against the Soviet Union in the 1960s and early 1970s, he gives us a ringside seat to history as it was being written.

Finally, as a futurist, he answers the question that worries all of humanity today – will a risen China challenge American supremacy resulting in a new collision that will engulf the world?

Let’s examine these four insights.

### ***Historical Perspective***

In the West, there is a founder of a nation. In China, its people had always existed in harmony with Heaven and Earth. Although they have acknowledged the Emperor, Qi Shi Huang, as the unifier of Chinese states, the consciousness of the Chinese people is that their race had existed long before unification in the mist of time. Moreover, its most prominent philosopher, Confucius, taught that ideals of good governance existed in the past and leaders could do no better than look to the ancients for examples of how best to govern even in modern times.

According to Kissinger, while US exceptionalism is about conversion, China's singularity is about attraction – an example for people to follow its ways voluntarily if they so wish. These differences bedevil relationship even today between not only the US and China but also all countries that subscribe to the Westphalian order. But while the American sense of mission can be measured in centuries, starting from the birth of the nation in 1776, Chinese consciousness of singularity has existed for several millennia. The consequence of their separate historical beliefs is that while the West is outward-looking, China, until its recent opening up in 1978, has had a preference to focus inward.

Dr. Kissinger makes the interesting observation that even in the height of Mao Zedong's frenzy to force his people to catch up and surpass the West, his Great Leap Forward and Cultural Revolution were internally-focused and only marginally affected other countries. He acknowledged though that the fear which had prevailed in both the West and in South East Asia of "Red China's" expansionism was real, possibly influenced by Communist doctrine that its dogma had universal application.

The truth, however, is that Communism, despite protestations by leaders of their commitment to its ideals, is no more than a passing phase in Chinese history. Communist tenets are more observed in the breach than in their practice! As China celebrates 90 years of the founding of the Communist Party on July 1, 2011, one should see this in the perspective of the millennium that it took for Buddhism to be recognised by the Chinese along with Confucianism and Daoism, as an integral part of the three philosophies which rule the lives of common people.

### ***Political Strategy***

In terms of political strategy, Kissinger makes this striking observation – that the thinking of a people may well be reflected in the intellectual games they play. He contrasts, for example, Western chess to the Chinese version, Weiji.

In the game of chess, he says, the objective is total victory. "The purpose of the game is checkmate, to put the opposing king into a position where he cannot move without being destroyed."

Weiji, on the other hand....."implies a game of strategic encirclement. The board, a grid of nineteen-by-nineteen lines, begins empty. Each player has 180 pieces, or stones, at his disposal, each of equal value with the others. ....The balance of forces shifts incrementally with each move, as the players implement strategic plans and react to each other's initiatives. ....The margin of advantage is often slim, and to the untrained eye, the identity of the winner is not always immediately obvious."

According to Kissinger, "What distinguished Sunzi from Western writers on strategy is the emphasis on the psychological and political elements over the purely military.

"Its maxim found vivid expression in the twentieth century Chinese civil war at the hands of Sunzi's student Mao Zedong, and in the Vietnam wars, as Ho Chi Minh and Vo Nguyen Giap employed Sunzi's principles of indirect attack and psychological combat against France and then the United States.

"Sunzi addresses the means of building a dominant political and psychological position, such that the outcome of a conflict becomes a foregone conclusion. Western strategists test their maxims by victories in battles; Sunzi tests by victories where battles have become unnecessary."

And Kissinger added in a telling aside, "...it was the way the North Vietnamese fought America (though Hanoi usually translated its psychological gains into actual territorial conquests as well)".

To those of us who lived through the turbulent era of America's Vietnam War, the book has still to be written as to how much the Vietnamese factored in opposition to the war in the US into their strategic calculations.

### ***Diplomacy***

As a leading player in the rapprochement between the US and China, Kissinger has had a ringside seat in the rise of a great power. The cynical may also say that his ringside seat also enabled him to observe the growing recognition by the predominant power of the day, of its limitations. Whichever view taken, he had revealing stories to tell of the secret manoeuvring that took place in the initial stages of negotiation. One incident was absolutely hilarious and could come straight out of a Woody Allen movie. At the time, American and Chinese diplomats did not speak to each other in public. But they did meet as guests at events hosted by third parties. In the Polish capital of Warsaw at a fashion show to which representatives of both nations were invited, the American diplomats were instructed to approach their Chinese counterparts to advise them of the next stage of proceedings. However, when the US team approached their Chinese opposite numbers, who were without instructions, the latter fled!

In another revealing aside, Kissinger tells of a meeting with Zhou Enlai, whom he greatly admired, in the height of the Cultural Revolution. Then he happened to mention in an innocent aside how much Chinese tradition continued to exert a positive influence on its people today. Zhou, to his surprise, reacted violently to this remark and delivered a tirade against old-fashioned ideas that held back the Chinese people from progress. Kissinger later explained Zhou's reaction as part of the role he was playing to support Mao's Cultural Revolution which was running strongly at the time.

### ***The Future***

Here, Kissinger acknowledges the current concern of Western political theorists who continue to remain sceptical about China's protestations that they have no secret plans for expansionism. In the view of these sceptics, China's current rise vis-a-vis the US is akin to Germany's rise to challenge the supremacy of Great Britain in the 20<sup>th</sup> century.

Kissinger addresses this sceptical viewpoint by quoting at length from the Krowe Memorandum. This was a document written by a senior official in the British Foreign Office, Eyre Crowe, in 1907, in which he said that as nations are not prone to announce their intentions for conquest in advance, once Germany achieved naval supremacy, this in itself – regardless of German intentions – would be an objective threat to Britain.

This is the seductive argument applied today for a pre-emptive action to be taken against China as it builds its armaments in space, on land and now at sea with a blue-water fleet.

However, Kissinger says in the Epilogue to his book, "Historical parallels are by nature inexact" and warned against experts not to "analyze themselves into self-fulfilling prophecies". He goes on further to say, "The existence of weapons of mass destruction and modern military technologies of unknowable ultimate consequences define a key distinction from the pre-World War I period. The leaders who started that war had no understanding the consequences of the weapons at their disposal. Contemporary leaders can have no illusions about the destructive potential they are capable of unleashing." In other words, would they have done then what they did if they knew what we know now?

***Pacific Community***

The solution, in his view, is the creation of a Pacific Community where both the US and China can take their seats along with other nations that make up the geographic area.

In this forum, both the US and China can work out their concerns which he defines as “...the Chinese fear that America is seeking to contain China – paralleled by the American concern that China is seeking to expel the United States from Asia.” A Pacific Community could “ease both fears”. They could participate in a joint enterprise for development along the lines of the Atlantic Community “one of the great achievements.....of the Second World War”. Together the United States and China would not only, as Zhou Enlai told him as they prepared their joint communiqué on re-establishing relationship “shake the world” but help to “build it”.

Whether we share Dr. Kissinger’s optimism or remain pessimistic about the rise of China, this book is an essential compendium for anyone interested in how the political, social and economic development of a quarter of mankind will **shape** the world.

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The China Credit Research Center was founded in October 2002 to assess public policy towards credit markets in China and provide independent support for policymakers in the development of a China's credit system.



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