The Implementation of Ethical Policy
in Multinational Corporations:
Relationships Between Headquarters and Subsidiaries

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Abstract

The implementation of ethical policies in multinational corporations can lead to a great deal of tension between the centre, the headquarters, and the periphery, subsidiaries. But the efficiency of the ethical policy depends on the consistency of its worldwide implementation. To prevent conflicts between a particular subsidiary and the headquarters, and therefore to increase the performance of an ethical policy, the potential sources of conflicts need to be identified. To optimize the implementation, the sources of creative solutions to ethical issues will be highlighted.

Key words: multinational corporations, international business ethics, conformity, creativity.

La mise en œuvre de la politique éthique dans les firmes multinationales: relations entre le siège et les filiales

Résumé

La mise en œuvre des politiques éthiques au sein des firmes multinationales peut provoquer des tensions entre le centre, le siège, et la périphérie, les filiales. Or, l’efficacité de la politique éthique dépend de l’homogénéité de son application mondiale. Pour limiter les conflits entre une filiale et la maison mère et assurer ainsi la performance de la politique éthique, les sources de conflits potentiels doivent être identifiées. Pour optimiser la mise en œuvre de cette politique, la capacité créative de la filiale face aux problèmes éthiques doit être prise en considération.

Mots clés: firme multinationale, éthique des affaires internationales, conformité, créativité.
Introduction

In a foreign country, the actions of the subsidiaries are embedded in a particular social and cultural environment. The history of the country, its institutions, and its regulations have an impact on the daily operations. Managers are faced with local competitive pressures. The rules of the game are shaped by the institutional and cultural background of the country. To get the “licence to operate,” the subsidiary needs to consider the specifics of the host country.

As part of a larger entity, the subsidiary is embedded in an organizational context. The subsidiary takes benefits from resources of the whole firm but has also some duties and responsibilities towards the parent company. The affiliation to the headquarters brings constraints as well as opportunities. As part of a network of different actors, the subsidiary is not an independent player.

Sometimes faced with contradictory demands from the local environment and from the global firm, the subsidiary’s top manager plays a crucial role. The combination and conciliation of global corporate objectives with local opportunities and constraints will lead the subsidiary to adopt a particular behaviour.

In this paper, the ethical policy is examined in the context of global corporate policies. Indeed, ethical issues in international business represent a complex question. Traditional literature on Multinational Corporations that focuses on the relationships between headquarters and subsidiaries is mature enough to be mobilized to capture some of the specific problems to ethics.

Some important assumptions underlie this paper. First, the reasons that lead Multinational Corporations to adopt codes of conduct and the way they formulate their ethical policy are not analysed in this study. The assumption is made that the vast majority of Multinational Corporations are, in the discourse, referring to the same general principles and agree to follow the recommendations of international organizations such as the OECD (Organization for Economic Co-operation and Development), the ILO (International Labour Organization), and the World Bank. It is postulated that there is homogeneity in the values chosen by Multinational Corporations. This study does not intend to analyse the hypocrisies of firms in terms of ethics. The way firms manage their ethical issues is largely driven by external preoccupations. The stakeholder approach emphasises the role of customer, of government, of NGOs, of press, of rating agencies and of stockholders sometimes to a greater extent than to the role of internal actors such as unions, employees or subunits. Ethics is often considered as corporate affairs managed by a staff expert in communication. The external discourse bound to external stakeholders could be different form the internal discourse addressed to subsidiary managers. In this study, however, it is assumed that there is a high commitment, strong leadership and a willingness from the headquarters to implement internally the publicly displayed principles.

The objective of this paper is to provide a better understanding of the internal difficulties headquarters face while implementing its ethical policy. What are the organizational features that facilitate or hurdle the implementation of the ethical policy?
I. International Business Ethics

At a macro level, various stakeholders pressure the firm to effectively implement high ethical standards all over the world. The recent proliferation of ethical policies in Multinational Corporations was a strategic response to the increasing loudness of voices against globalization and to criticisms from civil society. Under the scrutiny of civil society, human rights violations, bribery and environmental pollution are no longer permitted in subsidiaries located in developing countries. Firms need to reduce the gap between the official ethical discourse at the headquarters and the local ethical behaviour of their foreign subsidiaries.

Literature on international business ethics is largely driven by the question of which values should a Multinational firm adopt. In this paper, the focus is on what happens internally when the firm has decided to conform to a particular norm or standard and wishes to apply an ethical policy. Cultural differences have been highlighted as a huge obstacle in the translation of values from one country to another. The notion of ethical dilemmas highlights the difficult choice managers have to make when there is no obvious good and right solution to a problem.

- What versus How: the content or the process?

The question of the appropriate values to adopt when the firm goes abroad has largely dominated the field of international business ethics. Normative ethical theory focuses the debate on the search for universal rights. The question of homogenization in customer tastes, for example in the field of international marketing, accompanied the globalization process. In the field of morality, the globalization process brought the concept of universal rights.

Scholars such as Donaldson (1989) or DeGeorge (1993) propose a list of fundamental rights that are intended to be universally accepted. However, these “hypernorms,” as Donaldson and Dunfee (1999) call them, suffer from their high degree of abstraction and are subjected to the criticisms of imperialism. On the other hand, a relativistic perspective legitimises abuses from Multinational firms when they exploit the differential between home country’s standards and host country’s standards.

The choice of whether to engage or not in a proactive social issue management and the motivations to do so reflect the choices top managers make and the orientation they gave to their organisation. The mission and the purpose of the firm through the commitment of people are one part of business strategy. The process (the “how” question) by which this strategy is accomplished needs appropriate organisational mechanisms. The relationships between the multinational legitimacy in terms of ethics and the internal organizational structures of the firm require special research attention.

- Individual versus collective perspective

Ethics is a multidimensional concept which is spatially and temporally contextual. Kohlberg (1969), a social psychologist, described the different moral stages an individual goes through. When an employee makes a decision, his moral reasoning is both influenced by external forces, such as institutional, cultural and organizational context and internal forces such as his own level of moral development, his background and experience. The final decision an employee makes results from a trade off between all these forces. The collective perspective on ethics intends to guide, to control and help managers in their actions and their moral
reasoning (Weaver, Trevino and Cochran, 1999). To elaborate the best response to an ethical issue, the employee should refer to appropriate guidelines, should ask the ethical staff for advice, use confidential 24 hours hotlines, and submit his doubts.

But what happens if the individual preferences, in terms of the appropriate conduct to follow, are not conforming to the expectations of the collective ethical policy? Conflicts can appear.

II. The efficiency of the ethical policy

The reasons that lead the company to adopt an ethical policy could be largely different from one firm to another. Some companies such as The Body Shop, Ben & Jerry’s have long been recognized as pioneer firms in terms of social responsibility. For other firms, such as Shell, the involvement in corporate citizenship resulted as an outcome of important crisis or accident. Some firms are proactive, building a competitive advantage on their good social image, where others are more reactive, preventing attacks and protecting their reputation.

The performance of the ethical policy is difficult to assess. Research and rating agencies provide sometimes contradictory evaluations. Measuring the consequences of a good social responsibility policy is difficult to quantify.

Chance can intervene in the life of organizations since nothing can be fully controlled, especially on intangible assets such as reputation and social capital, hence preventing deviance from a standard cannot be fully guaranteed.

- Consider the following fictitious example

A large American multinational firm, called Zanurex, operates in Spain through a foreign subsidiary. This subsidiary is a production facility that employs less than 50 employees. For some reasons, the subsidiary manager decides, voluntarily or involuntarily, not to follow the norms recommended by the Health, Safety and Environment Program of the parent company. The subsidiary does not apply the security measures intended to protect employees from toxic emissions. No unions represent the employees. Employees, local persons, work without protection in the chemical plant whereas they are manipulating dangerous products. One day, a medical visit organized by an independent NGO diagnoses cancer for 20 employees of this plant.

One month before, Zanurex was ranked first on the best company to work for published by Fortune 500. Indeed, the company was a pioneer to promote social responsibility and was engaged in a strong ethical policy for several years. In the last Environmental and Social Report published, another European subsidiary, the Poland plant, was considered as an example. It engaged in a partnership with the WWF, a NGO, to reduce the toxic emissions of the plant. With the help of this actor, expert in environment and pollution, the Poland subsidiary managed to decrease toxic emission by 40% while improving the productivity of the plant. Hundreds of millions were spent by the ethical staff, based in New York, to promote high ethical standards. Stakeholders were involved in the formulation of the business principles. Special reports were published and independent audits in sensitive countries were driven by the best auditing companies. A new Environmental Management Systems was just set up in the company to gain reactivity and to increase internal transparency. Lastly, the main...
preoccupation of the ethical officer was the relational problems noted with some foreign subsidiaries that show reluctance to adopt some of the company principles.

As the firm was promoting the best practices and adopting the highest standards in the chemical industry, it was proud of its business principles and of its image of good citizenship. Despite the high level of involvement of the headquarters, local operations in one little subsidiary located in a country which was not considered a sensitive one, destroyed the entire reputation of the firm in a few days. Indeed, the crisis took very large proportions. The share price lost 20% in one week. Employee moral decreased. Social rating agencies decreased their evaluation. The chairman of the company, in a interview, reported: “That is not fair: Zanurex follows very high ethical standards. To promote Social Responsibility was at the top of our agenda. Ethical reasoning has driven all our decisions. Our company is too severely punished by this drama. We still do not understand how this drama in Spain could have happened”.

That could be a real story. The challenge of the implementation is crucial. This example highlights several points.

Intangible assets such as the reputation of the firm are fragile. The firm can suffer from the actions taken locally by one of its subsidiaries. Good actions undertaken in one subsidiary do not compensate the bad actions of others units. The consequences of a poorly implemented ethical policy are potentially very threatening. The headquarters bears the negative externalities of the actions of all its subsidiaries. With the phenomenon of globalization, information can be transmitted instantly with the use of modern communication channels and what happens locally can have repercussions on the global corporation. One accident in a subsidiary can alter the reputation of the whole firm and suddenly destroy all the efforts done previously. As a multinational firm operates in a global industry (Porter, 1986), the degree of interconnectedness between the different entities increase. As Norhia and Ghoshal (1994) showed, the global firm is a network comprised of multiple unique subsidiaries. Each has a particular role, which is more or less important and strategic. As Hout, Porter and Rudden (1982) explained, the actions taken in a subsidiary can result from a global competitive move from the multinational corporation. It is not only the headquarters that bears the externalities of the actions of one subsidiary but it is the entire network of subsidiaries. As the actions of subsidiaries are not isolated, they need coordination and integration. Subsidiaries need to conform to the same rules and need to agree with what the rules are in the global area.

To avoid a badly implemented ethical policy, conflicts between units and headquarters and between units themselves must be avoided.

The efficiency of the policy depends on its adoption by all the subsidiaries. Behaviours need to conform to the headquarters’ recommendations and guidelines. However, there is not a strict limit between those subsidiaries who refuse to align to the firm’s interests and those who follow headquarters’ recommendations. Instead, it is more like a continuum. Indeed, business principles from headquarters cannot be specific enough to be universally used in the same manner. This is a main difference with other global policies such as the worldwide implementation of a new information system, a global account management system, a quality standard management system, or a new human resource policy. Often, the ethical policy is a collective tool to use in combination with individual reasoning. It sets a climate intended to control the actions and to inspire managers in their choices. If managers adhere to the values of the company, then they need to enact them into their daily operations and actions.
Interpretations by managers play a critical role. How could the recommendations of the headquarters be best followed? The deontological perspective is illustrated by Kant’s concept of “categorical imperative.” This perspective on ethics considers that the morality of the process and the respect of ethical values are critical at each stage of the process whereas utilitarianism gives greater emphasis on the output through a cost / benefits calculation. The way top managers in foreign subsidiaries understand and perceive the ethical policy is important because they have to translate the values into actions. Carroll (1979) broke up the corporate social responsibility concept into four dimensions: legal, economic, ethics and discretionary. The discretionary dimension is probably the most challenging one because it is the most difficult to define, to evaluate and to be operationalized. However, it is probably the most interesting one because it is where managers can undertake innovative actions. This type of output created can be unique and inimitable.

It is proposed that a good ethical company is a company that performs very well at this stage of the process of implementing ethics. First, the process needs to be homogeneous and the implementation of the ethical policy needs to be free of stowaways. In their actions, foreign subsidiaries need to find congruence, convergence and coherence around the central values of the firm. Then, the performance of the ethical policy, as a whole, depends on the degree of value added each subsidiary creates in the implementation of this policy. The way the subsidiary manager combines global standards with local demands when conflicting sets of ethics appear, constitutes a grey zone. It is in this “moral free space” (Donaldson and Dunfee, 1999) that creativity and innovation can express themselves. Moral free space is the situation when “one finds norms that are inconsistent with at least some other legitimate norms existing in other economic cultures” (page 9). The authors represent as follow the different situations:

**FIGURE 1. Categories of Authentic Global Norms under ISC**

[Diagram showing categories of authentic global norms]
According to the authors, hypernorms include fundamental human rights. “The values they represent are by definition acceptable to all cultures and all organizations” (page 8). The more we move away from the centre of the circle, the more the firm will encounter difficulties in the implementation of the ethical policy.

The capacity to elaborate the best solution, partly contingent on the local environment, depends on the decisional slack allocated to subsidiary managers. However, one can wonder how much slack is optimal to permit and encourage innovation in ethical responses? Norhia and Gulati (1996) examined the relationship between organizational slack and innovation. They found an inverse U-shaped relationship. One can imagine that too much autonomy given to the subsidiary favours the adoption of the lowest ethical standards without inciting the subsidiary to innovate whereas too much control can freeze the flexibility required to adopt highest standards while proposing a solution relevant to the specificities of the local environment.

Paine (1994) distinguished two main strategies for ethics management: the integrity-based approach to ethics management and the integrity strategies. “[Integrity] strategies can help prevent damaging ethical lapses while tapping into powerful human impulses for moral thought and action. Then, an ethical framework becomes no longer a burdensome constraint within which companies must operate, but the governing ethos of an organization” (page 2). This perspective goes beyond the compliance-based program since “the goal of these programs is to prevent, detect, and punish legal violations” (page 1). The integrity based approach is more ambitious than the compliance based approach in the sense that it focuses on the environment, the climate and context to build in order to favour the ethical behaviour.

One may assume that the creativity and innovation is possible only under an integrity based approach to ethics.

- Heterogeneity in subsidiaries’ behaviours

The point of departure of this research is the observation that, faced with similar ethical issues and in the same context, subsidiaries could behave differently and provide various and different type of responses to ethical issues. The observation of NGOs and media reports on the ethical violations by the foreign subsidiaries in developing countries of large Multinational Corporations, gives some examples of the variance in the local actions of subsidiaries. The author identified four distinct cases. Each case is illustrated with an example in the field of human rights, and about child labour.

- **Case 1**: The subsidiary does not follow the recommendation of the headquarters.

This case is clearly a failure of the implementation of the ethical policy.
Example : The subsidiary employs workers that only conform to regulatory demands of the host country, as far as it is locally legal and accepted.

- **Case 2**: The subsidiary follows the recommendation of the headquarters.

The implementation of the ethical policy, considered in the context of global policies, is a success.
Example: The subsidiary respects the minimum age recommended by headquarters when it is higher than the host country’s laws on minimum wage. Child labour is banned whatever consequences having an unemployed child could have.

- **Case 3**: The subsidiary follows the recommendation of the headquarters through innovative and creative solutions.

The success of the implementation of the ethical policy is based on the ability of the subsidiary to elaborate innovative and creative solutions to ethical dilemmas. Example: The subsidiary respects the minimum age recommended by the headquarters in its plants but goes beyond the strict application of this general standard by controlling working age in subcontractor’s plants. To do so, the subsidiary creates creative partnerships and works with NGOs.

- **Case 4**: The subsidiary does not follow the recommendation of the headquarters but develops creative and innovative solutions to solve local ethical dilemmas

If the ethical policy of the headquarters is based on an integrity perspective, its implementation is a success. In terms of the compliance based approach, the implementation is a failure. Example: The subsidiary accepts to provide work and wage for children but provides teachers and devotes some hours a week for teaching classes for these children.

To classify these four situations, the author propose two dimensions:

1. **The degree of conformity to headquarters**

On one extreme, the subsidiary can do exactly what the headquarters wants and on the other extreme, the subsidiary can do exactly what seems to be right for the local environment. This dimension measures the extent to which the ethical policy is implemented versus the extent it is adapted.

2. **The level of value added and the creativity and innovation**

The subsidiary can work very closely with headquarters and be highly involved in the implementation of the ethical policy. On the opposite, it can just do the minimum. This dimension reflects how much effort, how much involvement the subsidiary has in the implementation of the ethical policy.

The four cases described below can fit into the following behaviours: the “good soldier”, the “parochial”, the “maverick” and the “champion”. One can therefore represent the four cases into this schema:

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1 The author thanks Julian Birkinshaw for his help in the construction of this typology
The crucial question at this stage of the paper is to understand the antecedents of these dimensions and the variables that have an influence. In other words, what are the factors that impact the degree of conformity to headquarters and the factors that influence the creative capacity of the subsidiary?

### III. The sources of conflicts and the sources of creative ethical solution

The first dimension the author propose deals with the issue of alignment and convergence of interests between the headquarters and the subsidiary. Indeed, the question of conformity constitutes an agency relation between the agent, the subsidiary, and the principal, the headquarters. The Agency Theory (Jensen and Meckling, 1976) could be mobilised to provide some explanations to the ethical behaviour of the subsidiary. However, this could be only a partial explanation since the multinational corporation is a specific form of organization that require to go beyond the simple vertical top-bottom approach often used in organization theory. The network of subsidiaries and the intra-firm interdependence such as the lateral relationships between subunits need to be analysed to better understand the phenomenon of foreign subsidiary control (O’Donnell, 2000). Two types of factors are expected to play a role in the prevention of conflicts: factors specific to the mechanisms of control elaborated at the headquarters and factors specific to the structure of the multinational corporation.

Three main factors have been generally studied to explain the role or the behaviour of the subsidiary. Birkinshaw and Hood (1998) present three mechanisms that interact and which are responsible for the evolution of the subsidiary role. The first determinant is the “head office Assignment”. This concerns the “decisions made by head-office managers regarding the allocation of activities to the subsidiary” (page 775). Then the second type of factors concern the “subsidiary choice” which includes “decisions made by subsidiary managers regarding the
activities undertaken by the subsidiary”. Finally, the “local environment determinism” is the “influence of environmental factors on decisions made by head-office and/or subsidiary managers regarding the activities undertaken by the subsidiary”. The literature on the adoption of organizational practices by the subsidiary (Kostova, 1999; Kostova and Roth, 2002) often relates to organizational variables from these three perspectives.

Scholars in Organization Theory studied delegation issues, the formalization of policies and the degree of centralization of decision making in complex multidivisional firms. Indeed, relationships between the centre and the periphery require appropriate mechanisms of coordination, integration and control. This literature mainly focuses on the tools used by the centre to manage the hierarchical relation. To fit the multiple organizational designs, various management styles and organizational configurations have been described following the strategy-structure paradigm and contingency perspective. Authors in International Management often go beyond this literature to take into account the complexities of the Multinational Corporation. Agency Theory is not sufficient to understand the various relationships in the interdependent network of subsidiaries where multiple centres can coexist and in which each subsidiary hold a unique and differentiated role. The interests of each units could be different from the interests of the whole corporation in terms of legitimacy (Kostova and Zaheer, 1999), for example. The capacity to prioritize the firm interests before the local interests of the subsidiary has been analysed by Kim and Mauborgne (1993). The concept they develop of procedural justice insists on the quality of the relationship between the centre and the periphery. If the process by which subsidiaries managers are treated is perceived by them as fair, they will tend to accept sacrifices and they will more easily conform to headquarters’ recommendations.

The second dimension proposed in this paper refers to the involvement of the subsidiary’s top manager into the implementation of the ethical policy. It require a subtle analysis since the quality of the output resulting from an innovation process is not easily controllable. Specific features of the personality, the origin, the age, the background and the experience of the top manager are expected to have an impact on the “creative entrepreneurial capacity of the leadership” in the subsidiary. The existing resources of the subsidiary and the quality of the relationship with the headquarters could have an influence on the quality of the implementation of the ethical policy.

Conclusion

This paper is an attempt to better understand the internal difficulties headquarters face while implementing its ethical policy. It highlights some of the crucial challenges the implementation constitute and intends to capture and explain the heterogeneity of local actions in terms of ethics in a multinational corporation. The author proposes four different subsidiary’s behaviours in terms of ethics. Two main dimensions are used to build this typology: the degree of conformity to the headquarters’ recommendations and the extent of value added created by the subsidiary in the implementation of the ethical policy. This research focuses on internal organizational variables rather than on institutional or cultural variables. The impact of local environment factors are not analysed. But further research is needed to investigate the impact of organisational variables that emerged at the end of this paper.

2 The author borrows this expression from Julian Birkinshaw
Bibliographie


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