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European Business Ethics Casebook

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European Business Ethics Casebook

The Morality of Corporate Decision Making

edited by

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In memory of Henk van Luijk
(1929–2010)

Preface

Case analysis is the cradle of contemporary business ethics. The established moral philosophers of the 1980s were so absorbed by fundamental issues that they could only make room for sketchy cases in passing. To make matters worse, these so-called examples usually had little to do with the real world: "Suppose you were to be left on a deserted island. . ."; "Suppose you would pass a pond in which two people were drowning and you only had time to save one?"; "Suppose a sadistic official in a outlaw state would offer you the choice of killing two people. . .". The pioneer business ethicists of the 1980s distanced themselves from both establishment and fundamental issues by analysing real life cases in a real life manner; i.e., with an interest in contributing to the solution of concrete problems. In doing so, they also distanced themselves from the dominant sociological and political thought on commercial life. At the time these disciplines were enchanted by system theory. This theory looks at the market as ruled by institutional forces. Consequently, there is hardly any room left for an analysis from the action perspective.

However emancipating all this was, almost 30 years later many business ethicists have come to realize the disadvantages and limitations of an academic methodology that focuses on case analysis, especially if its aim is to provide all too concrete answers to concrete questions like: is it permissible for company A to do x in these circumstances? Some will say that with this growing awareness the business ethics world has finally come of age. Nonetheless, the business ethics world would make a serious mistake if it would believe that it can and ought to take leave of case analysis as a core methodological device. Case analysis remains important and not only for educational purposes. It is crucial for the academic advancement of the discipline. It is exactly by means of the thorough analysis of cases that today's business ethicists re-establish contact with and learn to appreciate the fundamental issues that the established moral philosophers are struggling with.

Thus, paradoxically, today's business ethics may perhaps contribute most to fundamental ethics by stubbornly clinging to case analysis.

Despite its long history the need for comprehensive and well-informed case descriptions remains without abatement. Case analysis still is an excellent way of arousing people's interest in the moral aspects of commercial life as well as in business ethics as an academic discipline. And it can be used as a means to link business ethics to other academic disciplines and moral philosophy in general.

This book consists of two parts. Part I takes up three short chapters. In these chapters we provide an orientation of contemporary business ethics. We hope this context will be instructive for the analysis of the cases. The first chapter sketches a brief inside history of business ethics as an academic discipline. The second chapter touches on the skills needed to analyse and reflect on moral business ethics cases. In the third chapter we elaborate upon the important institutional turn that business ethics is going through at the moment. The institutional turn makes it clear that the organisation of morality will become a main business ethics theme in the years to come. It also shows that we must explore other themes, such as the theory on moral excuses.

The second part of the book consists of eight recent cases that were broadly discussed in Europe; in particular North Western Europe. It is characteristic of the international dimension of our contemporary world that many of these cases relate to global issues. But one way or another, European companies and the European general public were involved in all these cases. We have also tried to present a variety of industries, including pharmacy, ICT and construction. We have not only focussed on morally hard cases. We have also included a few cases that can better be categorized as problems of moral motivation. A morally hard case is a situation in which a moral agent must make a moral choice, but sincerely does not know what the morally right course of action is. There are good moral reasons for a specific course of action and good moral reasons against the same course. For example: must a company lay off child workers even if in the particular circumstances at hand, it clearly is in the best interest of the children to be employed? Morally hard cases call for reflection. A problem of moral motivation differs categorically from a morally hard case. A problem of moral motivation arises when a person knows what the morally right course of action is but finds it hard to motivate herself to act accordingly. In case of a problem of moral motivation a person has a good moral reason to do A but a good non-moral reason not to do A. For example: a person has a good moral reason not to break a promise but also a good non-moral reason to break it (e.g., because it is profitable). When a person fails to act on the moral reason,

immoral conduct ensues. We have included cases that mainly concern problems of moral motivation because these cases help us to understand why and how immoral conduct arises in commercial life.

Half-way through the production process of the book, Henk van Luijk indicated that we had to speed up the process. Now that his wife was about to retire, the couple wanted to move to France and live a few quiet years on the country side. In fact, they had already spotted the house they wanted to buy. But it turned out differently. Out of the blue, Henk fell ill and his health quickly deteriorated. He died early 2010. We dedicate this book to his memory.

Tilburg, The Netherlands — Wim Dubbink
Leuven, Belgium — Luc van Liedekerke

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Contents

Part I Theory

1 Business Ethics: Cases, Codes and Institutions 3
Henk van Luijk

2 Moral Competence 11
Henk van Luijk and Wim Dubbink

3 Institutions and the Institutional Turn in Business Ethics . . . 19
Wim Dubbink

Part II Cases

4 The Pharmaceutical Industry and the AIDS Crisis 37
Marcel Verweij

5 Heineken and Promotion Girls in Cambodia 53
Frans-Paul van der Putten and Rosalie Feilzer

6 Heineken and Promotion Girls in Cambodia, Part 2 69
Frans-Paul van der Putten

7 A Disputed Contract: IHC Caland in Burma 77
Frank G.A. de Bakker and Frank den Hond

8 The ICE Train Accident Near Eschede 99
Michiel Brumsen

9 A Question of Involvement: Unilever and Indian Cottonseed Production 113
Wim Dubbink

10 Rise and Fall of Silicon Valley in Flanders: Lernout & Hauspie Speech Products 145
Marc Buelens and Eva Cools

11 Construction Fraud 159
Johan Graafland and Luc van Liedekerke

About the Authors 179

Index 181

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Part I
Theory

Chapter 1
Business Ethics: Cases, Codes and Institutions

Henk van Luijk

Abstract No one had ever heard of business ethics until around 1970. Matters were very different 10 years later. Business Ethics had established itself in the curricula of many university programs in management and business studies, both in the US and somewhat later, in Europe. The achievement did not come about without labour. The new discipline was frowned upon from many sides. Looking back, we can discern three phases in the development of business ethics. In the first phase case discussions dominated the discipline. The case method was a welcome change from an academic practice that had stayed aloof of concrete problems for too long on the one hand and was caught up in abstract system theoretical reflections on the other. The second phase meant a shift towards organization issues and CSR. The third phase is the future. It is to be hoped that the discipline retrieves the workmanship of morally analyzing cases and finds ways of linking this to a thorough investigation into the institutional dimension of business ethics.

No one had ever heard of business ethics until around 1970. People had their own opinions on business practices in specific cases – good, dubious, totally reprehensible – and, of course, when they were in business, they sometimes wondered what the most responsible decision might be under given circumstances. The places (usually pulpits) from which an appeal came to do good and abandon evil also regularly addressed trade practices. But there was little question of systematic attention for ethics in business life, let alone that there was a clearly demarcated field of study known as business ethics.

Matters were very different 10 years later. Colleges and universities in the US and, somewhat later, in Europe included a course on business ethics in their curricula, sometimes required, often as an elective. Manuals and specialised periodicals followed in their wake as did congresses and

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Henk van Luijk is deceased.

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associations devoted to the subject. The Society for Business Ethics was established in the US in 1980 and the European Business Ethics Network followed a half decade later. A new specialisation was born.

But not without labour. Not everyone welcomed the young discipline. Neither the business community, nor fellow ethicists stood with open arms. We see three reasons for this reticence. The first was social. Business ethics sprouted largely from dissatisfaction with society. In the slipstream of the 1960s and 1970s, political leaders and authorities were the permanent targets of social criticism. The business community did not escape this unscathed. It was regarded as instigator behind much of the harm to people and the environment and as the natural ally of those mainly concerned with saving their own skin and furthering their own interests. This critical tone and its rejection of the business community resounded repeatedly in the new field's early years. The business community was not amused.

The second source of reticence was scholarly. Ethics as officially taught and studied at universities had long stayed aloof from daily practice, preferring to concentrate on fundamental, yet abstract, question such as "What is the nature of a moral statement"? What does it mean to say that something is morally necessary, or morally unacceptable? Is that a statement of fact, a subject opinion, an exhortation, commandment or a prohibition? In this last case, on what authority is this propounded? Important questions, doubtless, but daily practice needed something more direct. It wanted guidelines for handling practical situations and problems. Is a government allowed to use offensive cruse missiles as deterrent to contain opponents? Do a woman's rights take precedence over those of an unborn child? Does someone addicted to alcohol or tobacco have an unlimited right to medical care? What are we to think of cigarette production and cigarette producers? As society became more complex and the questions more urgent, many fields felt the need to develop applied ethics. Official ethics gradually recognised this need, yet its practitioners still did not welcome the newcomers; despite those applications' making the field more accessible, ethicists feared that these also made it more trivial. Business ethics had an additional hitch. It is quite understandable that momentous dilemmas can occur in matters of war and peace, life and death, but can we say the same about drafting the most advantageous income and expenditure statement? The ethicist that gets mixed up in such matters becomes profit's servant. She links ethics' reputation to the market's price.

The third cause was that business ethics silently shifted its view of the market to a different angle. Up to 1970, when (and if) scholars studied market activities they did so from macro-sociological, political and theoretical perspectives that treated the market as part of the social system. These

analyses often originated from a Marxist view of society, which assumed a critical view of the market. Business ethics shifted from the macro level to the meso and micro levels by taking the company and its representatives as methodological starting point. Traditional scholars thought that in doing this business ethics legitimated what was considered an essentially pernicious system.

Business ethics was not born under a lucky star. That made its later growth into a young adult with attendant promise and uncertainty all the more striking. It is worthwhile to describe the growth phases that led to this state. In addition to providing insight into the discipline's recent history, this will offer a better view of the questions and problems facing the modern free market and of the ways business ethics can help. In what follows we discern two clearly distinguishable phases and the contours of a third still largely on the horizon.

Case-Discussion Phase

The classroom was business ethics' first habitat. Classroom methods were the first ones the new discipline used. Case analysis is one didactic instrument frequently used in management studies and other practice-based programs. Students were asked to develop arguments leading to a position regarding an every-day situation or occurrence. The situation could be real or fictitious. A real situation is recognisable and prescriptive; a fictitious one has the advantage of being able to be refined as desired with venomous details that block escape routes. All with a view to ultimately reaching a lucid stance. This may not be the only possible stance, and certainly not the only correct one, but it will be well thought out and reasonably defensible on moral grounds, in the instance of a case in business ethics.

A careful analysis of several diverse and morally pertinent business cases will make people more alert to the ethical aspects of situations that arise daily. More often than is apparent at first glance, they learn to see that a responsible business decision also requires attention to the ethical aspects of the issue. That is a gain because it enhances the ethical quality of decision-making. In addition, case analyses strengthen ethical competence and skill. Ethical questions are open to reasoning. They rise above one-dimensional "I think" statements: "I think that is unacceptable!" Why?" "Because it is, that's why". Rather than that, we get thought-out arguments that make people think and that may prove convincing. The timidity that often overcomes people when they must make a moral judgment disappears in a candid discussion.

But the case analysis method also had a weak point. A student at Harvard Business School, the cradle of the case study method, drew attention to the problem when he proudly stated that "We treated more than 180 cases this semester". That is the problem. The trees hide the forest. An accumulation of business cases, however telling each may be individually, is more likely to lead to intellectual indigestion than to greater culinary skills. But it took business ethics some time to discover this. It first needed to detour through a new phase in its development.

From Case to Code

The business community's initial resistance to the dreaded interference of business ethics ebbed gradually. The meddling turned out not to be so bad. Ethicists had their hands full with accumulating their own expertise. Most of them were not out to nail a company to the wall every time a new scandal broke. They had learned from the business community that incident management had a poor yield. Advancement was better served by understanding than shouting.

But this understanding did not materialise from thin air. In its early years, the European Business Ethics Network, mentioned above, requested an Advisory Council, consisting of several CEOs of international companies, to act as bridge between practice and academia. One of the members was a somewhat elderly chairman of the board of a large Italian company. He seemed rather silent for an Italian. His main contribution consisted of one repeatedly uttered sentence: "But what are your saleable goods?" What do you, ethics specialists, have to offer that is to our advantage? It was a disconcerting question. From it, scholars learned that the law of supply and demand also applied in business ethics.

Once they discovered that, things moved quickly. The field proved to have specific questions. The corresponding answers were skilfully constructed and brought to market one by one. Moral codes proved especially popular. Business codes sprouted like mushrooms to join a plethora of professional codes, industry codes and civil service codes. In the Netherlands, this development reached its public-relations apex in the Tabaksblat Code (the Dutch corporate governance code). An integrity thermometer to take a company's temperature was also on offer along with a game for tackling moral dilemmas with financial and reputational profit and loss reckoned in. "When you tackle your case this way, you end up with a pile of money, but dent your reputation". Screening methods used a series of standards to sift companies that, depending on the result, could then be included in or barred

from ethical investment funds. Attention focused on a company's culture. "What elements of a company's culture need to make a code truly effective? Were people to be measured against their strict adherence to rules, or should emphasis fall on their own moral responsibility? How does one reinforce the moral competence of management and staff? Can courses in ethical problem solving help? Or is everyone knowing, yet refraining from speaking out, part of the business culture?"

The question regarding business ethics' saleable goods was actually an invitation to implement business ethics. Once there is sufficient interest to make ethics and social responsibility points for discussion in a company, the next step is to turn interest into action and implementation. This required supportive instruments. Ethicists accepted this challenge: "Show that you have these instruments, show that they help, that they work".

But ethicists were not the call's only recipients. The suppliers' market grew in numbers and skill. Organisational sciences entered and began cultivating the field of business ethics. Organisational sciences came into play whenever an organisation needed to change whenever it had to set out on new paths. How to direct a company that is entering a new phase? What risks does it encounter, what perspectives are open to it? This practice goes by a range of names: change management, transition management, risk management or reputation management, but the constant pattern in all this is that the present situation is subjected to a strength/weakness analysis and then a target situation is defined with the greatest possible precision, including potential hindrances and ways to eliminate or usefully circumvent them. Specialists in organisational studies and business ethicists became one another's privileged partners.

But, certainly in Western Europe, there was still another element, a terminological one this time. The term business ethics was looked upon suspiciously from the start. Business people too often felt that pretentious critics "who never risked a penny of their own in business" stood them up against a moral yardstick. That is not the way to make friends and influence people. However, the situation changed strikingly when the term business ethics made room for corporate social responsibility or CSR. Overnight, many felt attracted and displayed a will to join discussions and even participate in their own way. CSR proved able to do what business ethics could not: convince the business community gradually that while profit and continuity may be indispensable, ignoring the triple-p (people, planet and profit) of social, environmental effects and business dealings would be like building a company on quicksand. When you think that a general definition of ethical conduct includes "taking into account the rights and interests of all those who can reasonably claim to possess them and making sure that they are included in

your decisions", in other words when you give people and planet a place in all your plans, the distance between corporate social responsibility and business ethics narrows.

But it was not merely a question of different terminology. Since the 1970s, a series of cultural and institutional shifts have played a role in the background. Two of them are

- the cultural shift in dominant market morality. The old ethics in which the entrepreneur's actions were ethically correct when he obeyed the law and made a profit withered away. In its place an ethic came into existence in which the entrepreneur must render account directly for his/her conduct.
- the institutional shift in which NGOs work directly with the business community rather than invoking links to the government when trying to bring about social change.

These two developments sensitised companies to moral criticism and stimulated them to take it seriously, yet it also led them to analyse this ethical criticism in financial and economic terms.

The inclusion of organisational and operational matters within business ethics and the shift towards CSR implied clear gains for the young field. It has made the morality of business more accessible and manageable. There is no need to explain to entrepreneurs that they must take into account critical attention from customers, media, citizenry and government, each having its own specific social expectations. The definition of CSR based on the triple-p, and the elaborate ethical and social criteria used to evaluate companies' social qualities delineate the field clearly. Companies have a bad day when they seem to sink in the Dow Jones Sustainability Index of respectable companies. At the very least, the broad range of workshops and training courses sustains awareness that moral competence and moral leadership can be acquired and must be maintained and that they are not simply inherent.

But there is also loss, practical and theoretical. A practical loss is that CSR is felt to be less demanding than developing well-considered and elaborate moral stances when faced with business dilemmas. As long as a company is able to maintain a mix of the three p's, it will normally assume that it satisfies standard ethical requirements. Manageable compromise replaced the non-negotiable fastidiousness associated with business ethics. There remained matters to discuss, of course, but there was no attempt to squeeze blood from a stone. One characteristic of this attitude is a persistent but unfortunate suggestion reflected in some statements on CSR, being that "Corporate social responsibility is voluntary but is not free of obligation". That incantation is intended to shore up ethical reputations while staving off ethical

demands. Of course, CSR is not always imposed by law, but that does not make it ethically optional in the sense of not obligatory. Ethics knows no optional obligations. CSR apparently does. That is a substantial difference. Motivation also becomes shallower in the transition from ethics to CSR. The fundamental objective of much of what goes under the name of corporate responsibility is the company's reputational damage control, keeping down costs when a court case drags on, getting a step ahead by anticipating legislation that will pass sooner or later and, all by all, profiting from being known as respectable and environment-minded. Each of these motives is defensible and ethically legitimate, but not really stunning. All attention goes to sensible – not ethically well-considered – actions. We may well fear that the transition from ethics to CSR will pay for its great accessibility with a loss of profundity.

This also applies to theory. The joint venture of business ethics and organisational sciences has made change management the main expertise, even of practising ethicists. Methods and techniques take precedence over critical analysis, because the latter is not the prime foundation of market demand. The two specialisations have carried a backpack full of step-by-step plans and models to a plateau from which they see a broad field of operation, but little that is new. They can only ask "Do we stay here or continue on? If we continue on, where to and how?"

The Future: A Phase for Broadening and Deepening

From the very start, business ethics portrayed itself as a special branch of ethics, all with the best of intentions, but without much other expertise beyond general ethical tradecraft. Then it somewhat overenthusiastically joined the fast action in the market, where it imperceptibly adopted the language of change management. Now it must shed its first and second naiveté and develop the deeper expertise of analysis and reflection.

To advance from a plateau one first must descend some distance to familiar territory before ascending to new heights. What does that mean for business ethics in its present state of development? It has several meanings. Without detracting from the importance of responsible business conduct, it means above all that we must once again concentrate on conspicuous business cases, must resume the slow work of ethical analysis. Which moral judgement is defensible in specific cases? What is a well-informed moral assessment and how should it be developed? In other words, what are the technical requirements of a proper moral judgement? But we must also ask whether the business community is willing to put energy into developing

ethical judgments and what society may expect of business. Questions that pop up are e.g. “how far do a company’s responsibility and duty to help extend?” What should market participants include in their task package, what tasks should the government shoulder? These are substantive issues with an unmistakable moral purport. The return to case analysis pursued here is more than a means against shallowness. It is also a way to draw attention to new dilemmas and issues that society and the market will have to face in the future and for which the step-by-step plans offer no solutions or on which they have reflected too little. Think of sequential responsibility and cessation of business activities. When is enough, enough? The present volume offers the basis for reflection on these issues in the form of recent European case studies.

Chapter 2
Moral Competence

Henk van Luijk and Wim Dubbink

Abstract In our modern, complex society an ever stronger appeal is made upon each person to make proper moral judgments and act on them; this also goes in commercial life. Viewed positively, this is caused by the emancipation of the citizen and the individual. Viewed negatively, it is a consequence of the growing individualization of modern society.

This growing appeal demonstrates the practical moral relevance of analyzing cases. Analyzing cases can help to strengthen a person's capacity to reflect on moral issues. Moral reflection relates to the ability to recognise a moral issue when it arises in practice and then to deal with it in a deliberate and articulate manner. Still, moral reflection is not all that counts in real life – it may not even be the most important thing. A moral person also needs moral competence. A morally competent person takes her conclusions seriously, makes them part of her mental and moral life. It shifts attention from cognition to willing and acting. Moral competence presupposes self-reflection and self-control. The degree to which a person will need her moral faculties in the course of her life is partly a matter of luck. However, a person, unlucky enough, having to make tough calls in her life, cannot argue that she ought to be excused for her moral failings because of her lack of luck.

In a discussion on Dutch construction fraud, an experienced attorney very familiar with the business community said, "Ethical awareness in the construction industry is close to zero". People found his comment was shocking. Is the whole building trade really made up of cheats and scoundrels? No, that is not so, and that is not what the speaker meant. His assertion was much more interesting. He observed that the construction industry saw no need to submit its own actions to an explicit moral judgment. "We builders

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do our work to the best of our ability; we know how things work; we know the customs in the trade and keep to them, because that works best. There is not much else to say." The comment is interesting because it contains two messages. First, they do exist apparently: normal functioning adults that are seldom if ever concerned about the ethical side of what they do. Second, one often encounters this attitude as characteristic of a specific group or industry. Thus, in the coffee and tea trade, the rules of conduct are, or at least long used to be, much kindlier than in the petrochemical industry; people are more on their guard with a second-hand car salesman than with desk clerks in a public library. Apparently moral sensitivity is unevenly distributed. Apparently you can expect a greater feeling for ethics in one branch or social group then in another. Is that bad, and if so, can it be corrected?

Is that bad? Either way it is a fact of life that people do not keep their moral flame burning constantly high. A pilot light is often good enough for when it is needed, with the risk, of course, that the breeze of unexpected moral confrontation may abruptly extinguish it. That is unfortunate, but is it also a turn for the worse? It is becoming increasingly so today, for society and for individual citizens. In an increasingly complex society in which authority is fading, laws remain a step behind, religion becomes debased and contacts fragmented, morality – as separate competence – is becoming more necessary as prescriptive and cohesive factor. More than ever, people feel caught in a wave of individualisation that continuously forces them to make autonomous decisions, including in ethical matters. In many cases people find that positive, because it gives them room to live and be responsible for their lives in the manner they choose. It becomes negative when, at the same time, ethical reflection is minimal, social ties become ever more complex and room for individual initiative is cluttered with moral opportunism turning sometimes this way and sometimes that, with no discernible direction. At such times, a dearth of ethical competence can be painful.

Can it be corrected? Is it possible to reinforce moral reflection, to increase people's moral competence? Of course, and we need to look into that. A book offering several case studies with moral implications as avenue of approach for an exercise in taking an ethical stance, as this one does, may leave no uncertainty about what is needed for a mature moral position. First we must identify and define moral reflection and moral competence.

Reflection on and Competence in Ethical Questions

Moral reflection relates to the ability to recognise a moral issue when it arises in practice and then to deal with it in a deliberate and articulate manner.

It is a largely cognitive skill supported by moral alertness and sensitivity, because ethical problems only become apparent to those interested in them. Yet interest alone is not enough for proper moral reflection. You have to take the trouble to analyse problems by tracing the their roots, the moral principles at issue and by determining which rights and interests of which specific persons and parties must feature in the decision. Next you must investigate the possible positions and the arguments for the various options and then decide what ultimately ought to weigh most heavily. It is a long drawn-out procedure, but one worth the effort, because it can provide a grasp on what at first seems to be an intricate tangle of considerations and claims and it can lead to a stance that you consider satisfactory and others consider convincing.

The good news is that moral reflection can be learned. Over the years, rich experience has accumulated in developing step-by-step plans that lead people through dilemmas (Van Luijk 2000; Karssing 2000; Bolt et al. 2003). The signposts may be different, but the route is essentially the same: delineation, analysis, argumentation, consideration and conclusion. This road appears passable and, when well-travelled, undeniably advances the cognitive skill of moral reflection. The rest of the news is that moral reflection alone is not enough. Reflection is good, competence is better.

Moral competence adds action to moral reflection. Being able to analyse, argue and draw conclusions when faced with a moral issue does not in itself make someone morally competent. This person must also be able to make the shift to willing and acting. A morally competent person takes her conclusions seriously, makes them part of her mental and moral life. She identifies with them in an act of mental appropriation. In a conclusion on a situation in which an actor actually played a part, the competent person reasons: "I see it like this, and I and my significant others are convinced there is good reason for this, so I'll do it". That is her attitude. When reaching a conclusion about a case in which she was not actually involved, the competent person truthful attitude is: "That's what I would do if I were in the same situation". Morally competent people suit actions to words. They identify with the case and the insights it produces and act accordingly. They say what they mean and mean what they say. This demonstrates the gravity of a moral viewpoint. An outsider's viewpoint is never sufficient in ethical matters. One cannot say that "He or she must act in this or that way under those circumstances, but when I am in those circumstances I have another option". People passing a moral judgment on another also commit themselves. This means that moral competence presupposes two things: *self-reflection* and *self-control* (Doris 2002). Moral self-reflection implies linking your conclusion ("this is how one should act") to your motive and subsequent actions

("so I shall do it, because that's how I want to be"). Self-control is a guidance mechanism that ensures that your will to do what you feel is right does not weaken. Self-reflection and self-control are necessary and sufficient conditions for moral competence. After all, ethics is about serious matters and makes serious demands.

Moral reflection can be learned, in part it is a skill that can be practised. You can even take exams in it and, if you pass, earn a diploma as trained analyst in moral matters. But what about self-reflection and self-control? Can you learn or improve self-reflection (being willing and able to adopt what you consider required, as motive for your own behaviour) and self-control (your inner defence line against weak will)? How do you acquire moral competence? Earlier on, when we mentioned moral reflection, we encountered several conditions that a moral judgment must satisfy to quality as a well-made judgment. There we discussed procedural requirements such as precision in stating the problem, attention for the rights and interests of all parties, careful argumentation that takes counter-arguments into account, unbiased deliberation and an unambiguous conclusion. Here we are speaking about factors that affect character building. What makes one a morally competent person?

Can moral competence be engineered or influenced? If so, by whom or what? Is a person the sole influence on her moral competence? Cannot other people or surrounding circumstances impact on a person's moral competence? This is basically an empirical question that psychologists and sociologists study. It teases out the operation and weight given to the circumstances or personal disposition that turn someone into a moral personality. But a normative question follows quickly on its heels. What level of moral competence may we expect a person or organisation to have? How far does a person's or company's moral obligation extend? What may we reasonably expect in ethical terms from a properly functioning adult, from a participant in market transactions, from a company? That is what ethics asks. Let's take a closer look at each of these.

What is the source, what are the sources, of morally competent behaviour? How does it happen that people act ethically? Opinions differ, as do experiences. One important view in moral psychology stresses personality, the character that prompts someone's action. This virtue approach says that people's actions reflect what they are; a person's action flows from her dispositions. Carl is quiet at a party because he is shy; Carla is successful in her profession because she is disciplined; Conrad is not open to persuasion because he is resolute. Dispositions that produce morally competent action are called virtues. Someone who is virtuous does not let circumstances

catch him off guard. Moral conduct is a question of personality, disposition, character, virtue. Character explains conduct.

Other moral psychologists object to a character-based explanation of moral conduct (Doris 2002). Situationalists explain moral behaviour by appealing to a person's circumstances. They cite experiments that show that character offers less purchase and predictability than is often presupposed. One such from the 1960s is the famed Milgram experiment on tractability and obedience; Milgram and others have reproduced it numerous times. Subject A was told that he was participating in a study on how punishment affects learning. He had to administer a word association test to subject B. He could hear B but not see him. Each time B made a mistake, A was to administer an electric shock. As the errors accumulated, the shock became more forceful. B groaned distressingly to the point of mortal terror, but the experimenter told A to continue for the sake of the experiment. What A was not told was that B was part of a plot. He pretended. Nearly every psychology manual contains detailed descriptions of the experiment. Psychologically all subjects were reasonably well-balanced individuals. It is disconcerting that while a third of the subjects refused to administer an increasingly strong shock, two-thirds obeyed instructions to the bitter end. Conclusion: when under pressure, everything becomes fluid, even character and resolution. In scientific terms, character's influence on conduct is grossly overestimated.

Another objection concerns virtue theory's generalising character, which suggests that whoever has one virtue has them all. She is honest, so she will also be loyal and courageous. That would make character building very effective. Reinforcing one element directs all. But the facts contradict this optimism. A dutiful civil servant can be an unfaithful husband. Fragmentation is as frequent as consistency when it comes to disposition and personality. Utterly virtuous people stick out from the crowd. But do not people often display an outspoken stability in their responses, which makes their conduct reasonably predictable? Does that not point to virtue and character as morality's main substructure? Not necessarily. Often repetitive conduct will prove to be linked to systematically comparable situations. Opportunity, not character, makes the thief.

Moral psychology's situationists find support among sociologists who study the circumstances in which social conduct occurs and who are thus professional situationists even though some of them also stress the negative effects of nasty character traits and a dubious company culture. Business cases are excellent objects of research into the factors that influence the behaviour of individuals, groups and organisations. How could anyone even think of launching the Challenger space shuttle after repeated and express

warnings about the dangers of a cold-weather launch? What went wrong to cause the ferry accident with the Herald of Free Enterprise in Zeebrugge seaport? Sociological analysis produces a multitude of factors running from technical defects and bureaucratic glitches over unadulterated greed and craving for status to collective pressure from the organisation's culture in the sense that "What is right in the corporation is what the guy above you wants from you" (Jackall 1988; Punch 1996). Sociological studies led to very revealing, sometimes disconcerting insights, but there were also weak spots. The search tended to concentrate on the dark pages, while morality is not restricted to difficult moments and contestable decisions, either in business or elsewhere. A description of possibly influential factors gains force when it surpasses the mere incidental. It should organise and reveal links rather than just providing an inventory.

We need not try to settle here the controversy separating personality psychologists and virtue ethicists from empirical moral psychologists and sociologists. Such an attempt would probably end on an indulgent middle road in which the situationist had to recognise that earlier experiences, genetic features and character traits do influence conduct and the personalist will have to appreciate that situations and circumstances have an extraordinarily great impact on behaviour and decisions. While such broad statements make few enemies, they also cultivate few friends. Much more important for the purposes of this book is being able to resist the lure of either of the reductionist views. A view that denies virtue its proper place is as unfruitful as a view that only vindicates virtue. A view that denies the impact of institutions and circumstances is as out of touch with the reality of human existence as one that turns human beings into playthings of circumstance.

Moral Luck, Praise and Blame

People with strongly opposing views fight over basic assumptions but at some level they usually also are in agreement with each other on basic assumptions. That is why they are so well able to discuss their disagreements. This also holds for the virtue ethicists and the sociologists. It is striking that both assume that our moral actions are linked to systematic causes that we can understand and control, even if the causes differ by being internal (virtue) or external (environment). But what about the moral meaning of chance circumstances? These are matters that one cannot foresee and can scarcely direct because chance plays a dominant role in them. Yet they

can influence whether conduct is ethical. Does chance have moral consequences? Ethics discusses this last point under the heading moral luck or luck in circumstances (Nagel 1979; Williams 1981). They do not mean that an ethical life can make a person happy, however true this may be. The point is more trivial. You can be lucky from an ethical perspective in that circumstances turn out to your advantage. There is personal luck, e.g. you are healthy, talented, well off, socially gifted and have a pleasing character. All these factors can spark others' jealousy, make them think, "Who couldn't stay respectable under those circumstances". There is also physical and institutional luck, e.g. your company/organisation operates in an environment with a temperate climate, an advantageous location, high economic and industrial development, a stable government and political constellation, a properly functioning legal system, a reliable system for maintaining law and order and fair social provisions. Those operating there are clearly lucky, certainly in comparison with many others. Does this luck have moral consequences? Does it create specific moral obligations? Moral luck also has to do with watching other people or companies come under nearly irresistible pressure. You do not know what you would do under the same circumstances, but luckily, you do not have to confront them. War turns some people into heroes and unmasks others as lackeys or malingerers. The lucky ones do not live in a war zone. Of course, the more worldly wise will warn you to "Make no mistake, doing business is war". But its easy to see the bombast in this. It is more prudent to count your blessings, acknowledge your good luck and realise that morality does not arrive on the wings of chance but must always be won against hotbeds of resistance.

We do not consider a lucky star and favourable circumstances to be the result of ethical merit. Being lucky will not earn you moral praise. But will you, likewise, earn no blame when unfavourable circumstances knock you off balance? That is less obvious. People tend to quote Jean-Paul Sartre, who once said that "The question is not what circumstances have made of us. The question is what we make of what circumstances have made of us". In other words, each person ultimately writes his/her own life story. Modern-thinking Western individuals nearly take that for granted and certainly see it as an encouraging, even heroic, idea. Sartre voices the idea of our inalienable and indestructible inner core as source of our decisions and guardian of our freedom. But can we always count on this inner core and are we always accountable for it? That is the question. As human beings we cannot cease believing in this highly personal inner core, at least not without surrendering fundamental ideas of, and denying our essential experience of, what it means to be human.

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Chapter 3
Institutions and the Institutional Turn in Business Ethics

Wim Dubbink

Abstract Business ethics is in the midst of an institutional turn. This carries over into many dimensions of business ethics, including the organisation of morality. What institutional measures must be taken to ensure that the human representatives of the corporation do not act morally wrong or reprehensible – thereby causing corporations to act morally wrong or reprehensible? The theories on the psychological and sociological causes of human misconduct within the corporation are insightful but still fragmented. We suggest installing order by considering the basic reasons explaining why human agents morally succumb in an organisational context.

The institutional turn also has important consequences for the moral analysis of wrong and reprehensible conduct, in particular the validity of moral excuses. It seems that we must conclude that immoral conduct can result from decisions that are all too human and perfectly explainable. We certainly do not have to presuppose sheer evilness on the part of the agent. However, the institutional turn must not lure us into thinking that an immoral deed can be excused simply because it can be explained from a sociological or psychological perspective. There is a categorical distinction between a moral justification and a moral excuse and the conditions under which moral excuse fully exculpates a person are still stern.

Let us take a look at a Hollywood TV series, one that follows the standard formula. The A-Team is a good example. The A-Team is about a group of Vietnam veterans mistakenly accused of war crimes committed under the

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command of Colonel John "Hannibal" Smith. The group supports itself by helping people in need, especially elderly men or couples with beautiful daughters of a marriageable age. Every episode follows the same pattern. Some needy person contacts the A-Team because he urgently requires help in escaping the machinations of a wealthy, powerful person who is after his land/business/orchard/daughter or any combination thereof. The A-Team agrees to help this needy person, which usually requires constructing some strange kind of car/tank/machine to ram through a door or wall.

Armed with this vehicle, the A-Team sets out after the rich, powerful person, gains access to his home and engages in fisticuffs. The villain decides to flee and there is a happy ending, in which the beautiful daughter plays a role. The A-Team series contains, implicitly, a clear view of the origin of "morally bad states of affairs" (i.e., injustice). Morally bad states of affairs arise as a result of people's evil deeds. The series has an equally clear view of the origin of evil deeds. Evil deeds are perpetrated by people with evil character traits, such as greed, tyranny or jealousy. Furthermore, far from resisting these character traits, the villain wallows in them.

The views on the causes of morally bad states of affairs and the origin of people's immoral behaviour as depicted in The A-Team series are diametrically opposed to the interesting development in business ethics over the past decade. Business ethics is in the midst of an institutional turn. There is a general recognition that the origin of moral action has institutional roots and that its explanation must be sought in these roots. Human behaviour (moral or otherwise) does not occur in vacuum; rather, people's actions are structured or mediated by their institutional context (Scott 1981; see also Powell & Dimaggio 1991).

The idea that action is *mediated* by institutions falls midway between two other, more extreme, views on how human beings act. One alternative is that action is *fully* determined by institutions; the other is that individual agents are completely free to act. People endorsing the former idea assert that people's actions are totally determined by heteronomous forces. Choice and free will, then, are extraneous or illusory. At the other end are those who think that people act with all their options open, in complete freedom; they believe that choices are in no way predetermined. The idea that action is mediated by institutional forces takes a central position between these two extremes. It conceptualises human action as the consequence of a choice, but at the same time recognises that in every situation there are strong forces at work which make one option much more attractive than any other. Deep or radical views on the way institutional forces mediate action will maintain that the framing of the choice situation itself is mediated by cultural forces.

The notion of institutionally mediated action refines what it means to act freely. It is certainly not contradictory to the idea of freedom of action. These two ways of viewing human action are compatible. An average or normal individual acts rationally in letting institutional powers determine his/her choice. A typical example of institutionally embedded action in the marketplace is that people buy products at the lowest price they can find. Various institutional market forces – competition being one – usher human choices in that direction. A different example is that people on the market usually keep their promises. Here, again, many institutional forces are at play. Think of socialisation, in which people develop a conscience, of the presence of the judiciary as an institution, and of social forces, such as the fear of exclusion should others discover that one has behaved unacceptably.

Institutions and Institutes

So, what is an institution? Ever since the late nineteenth and early twentieth centuries, academics have been interested in institutions, although early sociologists like Emile Durkheim and Max Weber did not always use that term. They referred to systems of shared values, norms and convictions that were identifiable in, and that regulated, the social behaviour of groups, classes, religious communities and unions. Economists also turned their attention toward the notion of institutions quite long ago. One example was Gustav Schmoller's nineteenth-century German Historical School, which stressed the social context of economic processes. The laws of supply and demand were not the sole determinants of economic relations and transactions. Schmoller emphasised that the idea of free enterprise owes its success to more than just conformity with the market and high economic efficiency. The market is rooted in an aggregate of political, cultural and social institutions that has a profound influence in terms of channelling economic behaviour.

While the idea that institutions are important is a broadly shared view, this has not resulted in a univocal use of terminology. Some people use the term "institution" in reference to the informal structures of society (Fukuyama 2006), while others use it to refer to formal aspects of the societal structure, such as the police services and the judiciary (Rawls 1999). Similarly, sometimes we use the term to refer to a material entity, like a building with an impressive entrance and all. In such cases the term "institution" is actually identical to the term "institute", as when we refer to the International Labour Organisation (ILO) in Geneva as an institution. But at other times the term is used to refer to intangible objects, such as culture or a particular

way of thinking. The concept of an institution has multiple meanings; that much is clear. Recurrent elements in the various ways the concept is used are that institutions are long-term, polyvalent social structures consisting of symbolic elements, social activities and material sources. They are relatively immune to change and transferable to subsequent generations. They provide solidity within social systems. And they monitor and restrain behaviour, while also creating opportunities for, and supporting, activities.

Scott (1995) made an important contribution to this discussion by pointing out that institutions are built – to varying degrees – of regulatory, normative and cultural-cognitive elements. Where the emphasis is on the *regulatory* aspects, usefulness, rules and sanctions come to the fore (e.g., as market constraints). Economists interested in institutions tend to focus primarily on regulatory aspects. The *normative* aspects of institutions are in play when reciprocal social obligations, binding expectations and accepted suitability of behaviour are emphasised. The early sociologists were partial to normative institutions. Anthropologists and cognitive psychologists tend to find themselves attracted to the *cultural-cognitive* elements of institutions as these become manifest in modes of thought, implicit truisms, cognitive patterns and frameworks that sustain meaning, discernment and insight.

Scott's categorisation can be supplemented with a classification in terms of the *levels* on which institutions operate. It is quite customary to distinguish between the micro, meso and macro levels, which correspond to the individual, organisational and societal levels. While this division is often helpful for clarifying matters, there is also the problem of its lack of specificity. An alternative classification, which does greater justice to the place and function of institutions within our historical context, distinguishes among the levels of the *world system*, the *political society* in which one lives, the *organisational field* in which one operates on the basis of shared cultural-cognitive and normative frameworks (e.g., the educational system), the individual *organisation*, and finally the *organisational subsystem* (e.g., staff, line management and leadership).

The Dimensions of the Institutional Turn

The institutional turn carries over into many dimensions of business ethics. One of these is the relationship between business ethics, political theory and macro sociology. One of the most striking aspects of business ethics as it developed in the 1980s was its radical break with the system-theoretic view of the market dominant at the time. Under that tradition, the action perspective was almost completely absent. Actors' conduct was merely the

outcome of institutional variables and there was no hope that actions by single individuals could make any difference. This view fitted in well with a modernist, liberal political theory that made sharp distinctions between the political and the economic, the public and the private sphere.

Nascent business ethics flouted that dominant tradition by making a radical choice for a case-oriented approach. This approach gave pride of place to the action perspective of human conduct. A typical case might focus on the question of what Company A should do when faced with dilemma B. The individual conducting business suddenly became the focus of attention and the system perspective would usually be completely absent in analysing the case. The institutional turn acknowledges that focusing exclusively on the action perspective also has its limitations. It challenges business ethics to develop thinking on morality in the domain of the market that does justice to the need to take into account both the action perspective and the system perspective.

Two other dimensions of business ethics for which the institutional turn has been relevant are the organisation of morality and the theory on moral excuses. We will elaborate on these two dimensions in somewhat greater depth, as these seem particularly relevant for the analysis of cases. Case studies often spin out of situations in which an economic agent acted morally reprehensible or even morally wrong, thereby creating a morally bad state of affairs (i.e., burdening third parties with bad consequences).

One preliminary remark may be in order. It may seem a bit odd to focus on the behaviour of *human* agents when we live in a world in which corporations are the dominant agents, also acting morally right or wrong. Still, regardless of how important corporations are, they can not, by their very nature, act without a human being's agency. That is the crucial distinction between a robot and a corporation. This means that corporate moral misbehaviour cannot arise without at least one human agent acting morally wrong or reprehensible, with negligence perhaps being the most common form of morally wrong behaviour. Hence, even if we were solely interested in explaining and modifying *corporate* misbehaviour, we still would have to focus our attention on understanding *human* behaviour within the corporate context.

The Organisation of Morality

The institutional turn greatly heightened interest in the ways that morality can be organised within organisations. It has led to a recognition that the relationship between a human agent's deeds on behalf of the organisation

and the impact of the organisation's deeds on third parties is usually only indirect. There is a breach between the severity of the consequences of organisational actions and the severity of the agent's deeds that gave rise to those consequences. The institutional mediation works as a lever magnifying the consequences that result from an agent's deeds. The mechanic who either made a mistake or conducted an act of sabotage at the chemical factory in Bhopal, India, thereby releasing an enormous cloud of poisonous gas, was clearly in the wrong, technically and morally. Even if he was not a saboteur, as has been suggested, he should never have agreed to perform maintenance work while the safety system was not up to standard, as was usually the case. At the same time, these misdeeds were not in proportion to their consequences for third parties.

Still, the fact that there is no evil genius at the controls behind many immoral deeds in the marketplace does not make the consequences any less severe. This generates attention for the organisational aspects of morality. That attention has led to what we might refer to as a more technical approach to the immoral deeds of organisations and the reprehensible and immoral deeds of people within organisations, an approach less concerned with moral categories like responsibility and culpability and more with taking simple but effective precautions with regard to the reprehensible immoral conduct of human agents in an organisation. The starting point for this technical approach is that it is much more important to ensure that the consequences of organisations' deeds do not impact third parties than to be able to ascertain afterwards exactly who bore responsibility and blame for what. An ounce of prevention is better than a pound of cure. The focus of the technical approach falls on two questions: What specific institutions within organisations give rise to morally unacceptable effects? And what institutional design for organisations is best able to prevent these effects?

Recent years have been productive for the technical perspective. A multitude of institutional mechanisms to explain immoral behaviour within organisations has been uncovered. There is, for instance, the influence of aspects of the formal institutional structure, such as misdirected wage-related stimuli (Paine 1997). Many studies also draw attention to the impact of organisational culture and other informal aspects of the organisational structure (Vaughan 1982), institution-based communication problems – e.g., a strong hierarchy that hinders bottom-up communication (Waters 1978) – and a lack of moral education among employees (Trevino & Weaver 2003).

However valuable all this theory may be, it also has its limitations; it is very fragmentary. Given the current state of the theory, we cannot offer practitioners much more in terms of advice than to say that in some cases organisational culture can explain immoral deeds, while in other cases the

formal structure or some other cause plays an important role. This article is not the place for engineering a great synthesis. We will merely try to create a modicum of order by abstracting from the institutional mechanisms and consider the basic reasons given to explain why human agents go along with institutional pressure and consequently succumb morally in an organisational context.

There seem to be four basic motives (i.e., four types of human agents in the danger zone). Several authors (e.g., Boatright 2004) stress that some people are pretty much nothing more than economic actors, who can do nothing but respond to economic stimuli. Morality as a distinct reason for action is either a weak force or lacking entirely. This means that these people will only do the morally right thing if there is also a non-moral (i.e., economic) reason for doing so. It also means that they will succumb morally as soon as the action dictated by economic stimuli diverts from the morally right course. Moral failure in the banking crisis is sometimes explained by this model. The bankers did not comply with morality because it simply was not economically rational for them to do so. Other authors point out that some people are unable to free themselves from a natural tendency, or culturally determined norm, to follow orders at whatever cost (Bauman 1989). Still other authors point out that some people working in organisations are morally immature. Their education included reading, writing and arithmetic but left them stuck at a stage of moral development that is not commensurate with their age or responsibilities (Trevino & Weaver 2003). The last group of people has a natural or culturally determined tendency to sidestep responsibility whenever they have the chance.

This bleak summary of human ineptitude demonstrates its value primarily when we ask how we can prevent actions by or within organisations from having a morally unacceptable impact on third parties. If we want to take full precautions, then we must design organisations to accommodate the fact that in morally demanding situations, at least some of the people within an organisation will act like those spurred by purely economic calculations or like morally immature actors or like someone who takes advantage of every opportunity to sidestep responsibility. Over the last 20 years, business ethics' answer to the question of how to take this into account has grown enormously. The business ethicists' initial answer on how to prevent immoral conduct was to develop a code. It became quickly clear, however, that a code on its own had little effect. "Coding" proved to be much more suitable. Coding is what happens when an entire company, from top to bottom, is made aware of the importance of morality, of establishing specific rules and of the ease with which these rules can be broken in an organisation (Kaptein & Wempe 1998). These days, coding is

making way for the more comprehensive idea that organisations need ethical management programmes. These comprise several components, such as drafting a code, appointing ethics managers, providing permanent, or at least periodic, schooling, clearly delineating responsibilities, establishing unambiguous rules and control systems, and protecting whistleblowers (Crane & Matten 2004; see also Trevino & Weaver 2003).

The Organisation of Morality: The Future

The challenges facing the organisation of morality can be divided into those related to refining the diagnosis of immoral and reprehensible conduct by agents in an organisation and those related to refining the precautionary organisational design (therapeutic suggestions). Diagnostically speaking, the greatest challenge is to work out a unifying sociological theory of moral action. Prerequisites for this are determining how the various explanations (like culture or formal structure) relate to one another and determining the conditions under which they are valid. The moral presuppositions for these explanations will also have to be included.

Therapeutically speaking, the greatest challenge is to align two theories regarding prevention that have been drifting farther and farther apart. At one end, many authors still reason along the lines of improving codes, coding and ethical management programmes (Trevino & Nelson 2004; see also Trevino & Weaver 2003). These authors keep looking for clever new institutions that would be useful, or even indispensable, in preventing immoral behaviour within organisations. At the other end, we have a handful of authors who are critical of this line of thought (MacLagan 1998). They do not disagree with the idea of prevention but object to the implicit assumption of the dominant prevention strategy. This assumption is that increasing the level of monitoring and supervision will some day lead to an organisational design less prone to inducing agents to commit reprehensible or morally wrong conduct. The opposing authors have important moral and strategic objections to this assumption. From a moral perspective, they have observed that the ultimate goal of ethical programmes should be for people in organisations to adopt a more moral stance. To their minds, the greatest danger of ethical management is that people will simply factor ethics into their plans as if it were one more variable in a formula. The means would then defeat the end. From a strategic perspective, these authors observe that despite all efforts, ethical management programmes always fall short when their implicit strategy is one of ever-increasing supervision. Surveillance alone will not get organisations to toe the ethical line.

Accordingly, these authors argue that organisational design should devote more attention to enhancing the moral autonomy of human agents within the organisation. Compliance with an ever-growing number of rules and procedures should not be the objective and is not going to work. Moral autonomy – at least that of some people – ought to be given room to manoeuvre. Freedom of speech for people within organisations and reciprocal critical examination are often mentioned as key instruments for attaining this goal. Seen in this way, the organisation that encourages its employees to search honestly for and disclose skeletons in the closet – with due regard for procedure – will be the organisation that does the most to prevent immoral behaviour. As yet, though, not many organisations dare to put their trust in their employees' moral autonomy in such a radical fashion. Controlling the workforce and enforcing compliance is considered the safer option.

Moral Excuses

The institutional turn has important consequences for the analysis of morally wrong and reprehensible conduct, in particular the validity of moral excuses. The acknowledgement of moral excuses implies that we distinguish between the immorality of a given *act* and the immorality of the *agent* performing it. When a person puts forward a moral excuse, she tries to show that she should not be held morally accountable, in full or in part, for the morally wrong deed she committed because of certain morally significant circumstances. When a moral excuse is accepted as valid, people acknowledge that there are indeed reasons to separate the deed from the person involved. The person should not be held fully accountable for the wrongness of the deed. Consequently, she is either not blamed at all or blamed less for the morally wrong deed. Some typical exculpatory conditions are ignorance and compulsion. We do indeed we find it unreasonable to blame a person for the unforeseen and unexpected consequences of a deed; in a similar vein, we exculpate a mother, at least in part, for not protecting her children from a incestuous father if it turns out that she was terrorized herself and kept in isolation in the house without the social capital needed to stand up against her husband.

The institutional turn in business ethics is relevant for our thinking regarding excuses because it greatly increases our ability to understand the behaviour leading up to immoral deeds as the actions of a normal person ("one of us") under particular circumstances. Sensitivity to the normality or prosaic nature of the conduct leading up to immoral deeds is a primary, and crucial, condition for the applicability of moral excuses. Hannah Arendt's

analysis of the life and character of Nazi criminal Adolf Eichmann (1963, see also Bauman 1989) has, of course, greatly contributed to this sensitivity. Arendt introduced the concept of "the banality of evil". Evil does not originate in inherently evil people; it originates in normal – but ambitious – people led astray by an institutional structure. Arendt's conclusions have been criticised and are controversial because she applied her analysis of the normality of evil to the incomprehensible context of the Nazi government. Could it really be that totally normal people were operating in a totally normal way where evil of such magnitude was concerned?

Interestingly, the present-day marketplace may well present a better context for examining the notion of evil reduced to banality. Businesses are geared toward profit, not evil. Their evils are seldom intentional; they are usually the by-product of an allowable, morally neutral action. Indeed, descriptions of morally wrong or reprehensible behaviour in the marketplace contrast sharply with the horrifying stories of morally bad states of affairs throughout European history, such as those of Cortez, who ravaged the indigenous populations of South America, killing women and children just for the fun of it. Whereas we find it hard not to attribute pure malignancy to such people, we are usually struck by the normality or prosaism of the agents involved in contemporary business ethics cases (though there are still some cases where the coarseness of the agents' calculated heartlessness makes a normal person's hair stand on end, viz. Bernie Madoff).

In most cases the business ethicist is tacitly grateful that she was not at the wheel. It is all too uncertain whether she would have acted any differently under the given circumstances. Morally wrong and reprehensible behaviour arises in the grey zones where ordinary people have to make their decisions. Not that improper behaviour is totally unexpected or that those concerned are taken by surprise in most business ethics cases. There are often signals ahead of time and an awareness of minor abuses. But there are also strong forces compelling people to just go along with it. People do not want to lose their jobs; they have ambitions that they don't want to upset; they don't want to be ostracised by the group; they are easily intimidated – just to name a few. What makes matters worse is that people have a strong tendency to underestimate both the risk, on the one hand, and their power to change the course of things, on the other. At the same time, they tend to overestimate their ability to influence a structure or process at the very last minute, just before things really go wrong (as in a Hollywood movie).

A case that illustrates all this quite nicely is the shipwreck of the *MS Herald of Free Enterprise* off the coast of Belgium in the 1980s. The immediate cause of the ship's capsizing was that it left the port of Zeebrugge with its bow doors open; as a result, it quickly took on water and sank even

before it was well clear of the harbour. The ship's captain doubtless committed a variety of juridical and moral errors. However, he and his colleagues had repeatedly raised the issue of the departure procedure with management, especially the fact that there was no mechanical indicator to show whether or not the bow doors were open. The management thought this would be too expensive and offered the captains a simple choice: sail or resign. It was left up to an assistant to keep watch and make sure that the doors were shut. To make matters worse, the management relied on a positive feedback system for this. In the interest of time, the departure procedure required the captain to leave on schedule unless he was told there was something wrong with the bow doors. On the day in question, the assistant had fallen asleep and the captain set sail because he had not received any notice not to do so.

What all this teaches us is that immoral conduct can come about from decisions that are all too human and perfectly explainable, without any sheer evilness on the part of the agent. It is therefore only natural to consider the possible validity of moral excuses in most business ethics cases. In fact, nothing seems more natural. In the aftermath of the financial crisis, bankers and financial experts came up with one moral excuse after another: "everybody was doing it"; "bankers are no worse than anybody else" and "the rules and monitoring agencies failed, too".

It is exactly because there seems to be such a natural overflow in terms of emphasising the institutional aspects of human conduct and acknowledging the validity of invoking moral excuses that it is imperative that we qualify our thinking regarding moral excuses. The first important comment is that the institutional turn should not lure us into thinking that an immoral deed can be excused simply because it can be explained from a sociological or psychological perspective. Moral evaluations must be kept separate from sociological and psychological explanations. Just because we understand everything does not mean we ought to condone it. All the institutional turn shows is that it happens to be relatively easy to place normal people in situations where they will ultimately decide to do something immoral. In many institutional contexts, moral behaviour may require extraordinary courage and alertness. This is something we must take to heart in developing theories on organisational design. Still, we must persist in making a sharp distinction between situations in which someone's behaviour is quite understandable (but no more than that) and situations in which someone can justifiably appeal to a moral excuse. In the case of someone whose behaviour is quite understandable, we may well conclude that we would have done more or less the same thing. But in doing so, we are saying more about our own assessment of our meagre strength of character than about the validity of a moral excuse.

The second important comment is that we must guard against the tendency within commercial life to use moral *excuses* as moral *justifications* of conduct. A morally justifiable deed is a deed that is morally right. Agents performing morally justifiable deeds do nothing wrong. Sometimes when we are called on to judge an unusual act, we sometimes conclude that the deed was nevertheless justifiable: given the circumstances and complexity of the situation, the person acted correctly, even if it seemed odd at first instance. One example might be a mother who kills her fully paralysed child, who she knows did not want to live like that. By contrast, a morally excusable deed is still wrong. Price-fixing, environmental pollution, human rights violations are all morally unacceptable. Hence, even if the agent performing the deed ought to be excused, the deed should be viewed as reprehensible and not to be repeated. If deeds like that are structurally prompted in a domain of action, there is something wrong with that domain. What is more, the agent who has been excused usually bears a strong responsibility to make sure it does not happen again. That is part of the deal of being excused. If a person is excused for lack of knowledge in one particular instance, she ought to make sure that she knows everything she needs to in a second instance.

The distinction between a justified action and an excusable action is also important because excuses rarely *fully* excuse a person. The bank employee handing over money to a bank robber at gun point may be the rare example. We tend to absolve her completely from blame. However, in most cases, the excuse only partly excuses the agent. Hence, the agent is not morally off the hook because of the excuse. She still acted morally wrong to some extent and ought to face the consequences, in terms of guilt and a responsibility to change (e.g., become more knowledgeable) and to preclude a repeat of the circumstances that led her to perform the morally wrong act. Once again, business people seem to have a tendency to interpret the slightest, partial excuse as a full excuse that absolves them from blame. The bankers' reactions to the financial crisis serve again as a nice example.

Furthermore, we must guard against the tendency in today's business practices to think excuses are valid far too easily. There are only a few reasons that can possibly count as valid excuses and the conditions under which they apply are limited. Many arguments that are presented as moral excuses are actually quite lousy or should only apply under very strict conditions. They may help us understand a decision, from a sociological and psychological perspective, but they are morally insignificant. Examples of such arguments are that a decision was necessary for making or preserving one's career, that others were also to blame, that "everybody was doing it" or that "the government did not ensure proper regulation". Even "ignorance" cannot be used too quickly in the business context – much less quickly than

many upper-echelon managers who get into trouble think. They often claim to have known remarkably little of the things that went on in their companies. Still, in many situations – especially in organisations – morality does not depend on what someone actually did or did not know. The morally relevant issue is what a person was *supposed* to do or *should have known* given her role.

One important reason that business ethics, in particular, must be on its toes in terms of guarding the limits of using moral excuses is the justifiability of the free market as a social institution. If we want to avoid the conclusion that the market has an inherent proclivity toward evil, we will have to assume that ordinary people are normally able to withstand the pressure put on them by the discipline of the market, even if it tests their strength of character. Difficulty in legitimating the market as a sphere of action increases in direct proportion to our abandonment of this assumption. If immoral deeds are to be excused all too easily in the market, it will become hard to reject the conclusion that the market is an evil institution itself – or at least an institution unfit for coordinating human conduct. In terms of political theory, that is a huge problem. No political theory can legitimate the market if it has an inherent proclivity to evil. It is irrational for a society to permit an inherently immoral sphere of action to persist.

Moral Excuses: The Future

Looking toward the future, there is still some interesting work to be done in terms of the thinking on moral excuses in commercial life. There remain many uncertainties and ambiguities about the validity and meaning of specific excuses and the possibilities for using them. A case in point is "compulsion" as a moral excuse. When we define compulsion very narrowly as "use of physical force", then there is little question of compulsion in a market context. The major form of compulsion on the market is economic compulsion but that does not involve physical threats. Still, it seems unreasonable to exclude this type of compulsion completely. Sometimes people can fall under such heavy economic pressure that their actions can be excusable – at least in part. Think of a farmer in an emerging country who shoots an endangered animal because it is the only way to get food for his family.

At the same time, recognising economic compulsion as a moral excuse poses an enormous danger. The market is by definition a domain where institutions (competition and rewards) put people under economic pressure. Markets ought to be competitive and ought to discipline agents, on the one hand, while constantly inciting them to pursue profit, on the other. Where is

the borderline between acceptable compulsion and enticement (which can not be cited as an excuse) and unacceptable compulsion (which may be grounds for moral excusableness)? What should we think of the situation that mechanics working for Sears found themselves in the 1990s (see Paine 1997)? The management had made their wages largely dependent on their personal turnover. That gave them a strong incentive to decide to replace parts in cars brought in for repair sooner than was strictly necessary; not to do so would have meant a big cut in pay. Is this a case of compulsion? Can the mechanics correctly invoke a moral excuse to cast off some of the blame? Or is it merely an enticement in which case that would not be allowable? The answer requires a moral theory on market compulsion that we do not possess. The same kinds of questions can be posed about a case in which a person knowingly and willingly overextends her budget to take out a heavy mortgage to buy a house. Is it reasonable for such a person to use her precarious financial situation as an excuse for going along with the ride because she cannot take the risk of being dismissed, when her company puts pressure on her to compromise moral standards? Is that compulsion or a case of tying a noose and then inserting one's head in it? These and other questions prepare us for the case analysis in the following chapters.

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Part II
Cases

Chapter 4
The Pharmaceutical Industry and the AIDS Crisis

Marcel Verweij

Abstract Since 1996 AIDS patients can be treated effectively with combinations of antiretroviral drugs. From the beginning this treatment has been very expensive and therefore unaffordable and unavailable for millions of patients in developing countries. As a result, pharmaceutical companies have been criticised because for their price policies and for holding on to patents that ultimately impose constraints to access to lifesaving treatment. On the other hand, pharmaceutical companies have developed various programs as part of their corporate social responsibility policies. Some of these programs indeed aim to expand access to treatment for AIDS patients. Examples are price reduction programs, donations, but also decisions to refrain from enforcing patent protection in developing countries. The question remains however to what extent pharmaceutical companies have moral obligations to make their lifesaving products affordable for people who need them. The problem is illustrated with policies of one of the leading pharmaceutical producers, Roche.

Fatal Illness, Expensive Medicines, Wealthy Pharmacists?

During a demonstration in March 1987, an activist group called ACT UP (AIDS Coalition to Unleash Power) managed to halt trading on Wall

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Street for a few minutes. The demonstration drew an enormous amount of attention. ACT UP's most important objective was to speed up patients' access to experimental AIDS medicines. The focus was on a medicine called AZT, the only AIDS inhibitor available at that time. Shortly after the demonstration, the American Food and Drug Administration (FDA) announced that it would speed up its procedure for approving new medicines. In subsequent years, ACT UP played an important role in the struggle to increase availability of and access to anti-AIDS medicines. Highly visible, non-violent actions successfully exerted pressure on the pharmaceutical industry to lower the price of AIDS inhibitors.

AIDS treatment has improved dramatically since 1987. A cocktail of antiretroviral drugs (ARVs) can effectively control the illness, allowing AIDS patients to live reasonably normal lives. Although there is no cure in sight, persons with HIV, who consistently follow a strict course of treatment in which they take various medicines several times a day, can keep the illness under control with a very low virus level in their blood. However, this treatment is not destined for all AIDS victims around the world. The treatment is complex and expensive; it is accessible and affordable for health care insurers in many Western countries; it is not available or affordable for most patients in developing countries. A large majority of all people with AIDS is deprived of AIDS inhibitors.

The AIDS crisis in Africa and Asia is giving a new dimension to the pressure on companies to provide better access to medicines. On one side, criticism is levelled at GlaxoSmithKline (GSK), Merck Sharp & Dohme (MSD), Roche, Novartis and other large multinationals that sell their medicines at high prices despite their wealth and profitability. On the other, the World Health Organisation (WHO), UNAIDS and many non-governmental organisations (NGOs) work with these same pharmaceutical companies to set up programmes aimed at increasing access to anti-AIDS treatment and lowering prices in developing countries.

Roche

The most important manufacturers have drastically lowered their prices in recent years. They sell their antiretroviral drugs in developing countries at prices that are up to 90% lower than the price in developed countries. In 2004, Roche took a step that none other at that time seems to have taken. Roche announced that it would not take out patents in least

developed countries for existing and new antiretroviral HIV therapies. It would also refrain – in those countries – from taking action against generic versions ("copies") of its products.[1] This offered developing countries a legal option to manufacture generic medicines or to import them from India, Brazil or other countries subject to less strict patent regulations. Roche contributes in this way to increasing access to much-needed AIDS medication.

This case study focuses on how this course of action should be viewed from an ethical perspective. If we accept that lowering prices and maintaining a flexible approach to patents does, indeed, help more AIDS patients gain access to the medicines they need, that would seem to be morally praiseworthy at the very least (CoreRatings 2003). But one could also posit that Roche is simply doing what is to be expected of a company with its expertise, abilities and profitability. This would then have nothing to do with benevolence but with a moral *obligation* – a duty to help or an obligation to do good. Roche considers its course of action one part of its corporate responsibility. But this understanding leaves open whether we can consider this to be a strict obligation. If, when viewed from the perspective of benevolence, Roche or another pharmaceutical company has a duty to increase access to medicines, that means that this obligation also applies to other pharmaceutical companies – at least to the extent that they are in a similar position. A strict obligation raises many ethical questions: How far does it go? Is lowering prices or waiving patent rights sufficient? There is also the question whether an obligation to help might not be stretched so far that it demands that the company make too great a sacrifice. In short: Does an obligation rest upon Roche and similar pharmaceutical companies to help this group of patients and, if so, how far does this obligation extend? We should also note that while the central issue here concerns the moral duties of a pharmaceutical company, there is no doubt that combating AIDS is not only, and not even in the first place, the business community's responsibility. An effective response to the AIDS epidemic is only possible when many parties contribute (national governments, UN, WHO, NGOs, civilians). As we will see, this also plays a role in the arguments for the pharmaceutical industry's moral duties.

[1] Roche, "Removing Barriers; Increasing Access", brochure, www.roche.com

AIDS: More than an Illness

HIV (Human Immunodeficiency Virus) is the cause of AIDS (Acquired Immune Deficiency Syndrome). This virus destroys the immune system, which leaves a patient susceptible to numerous types of infections and varieties of cancer – illnesses against which healthy people are normally well protected but which are ultimately fatal for AIDS patients. HIV is transmitted through unprotected sex, transfusion of infected blood products and sharing needles when taking drugs. Infected mothers can also infect their babies during pregnancy, birth and breast-feeding. In the early 1980s, AIDS seemed to touch mainly homosexual men in the West. However, in time HIV proved to spread more broadly and rapidly in developing countries in Africa and Asia. There, unprotected heterosexual contact and mother-child transmission are the most important avenues for spreading the virus.

By 2004, nearly 40 million people around the world were infected with HIV. In 2004 alone, 3.1 million people died and nearly 5 million became infected. Most of these live in Africa. In sub-Saharan territories, 28 million people are thought to be infected with the HIV virus. The percentage in some countries is extremely high. In Botswana, an estimated 40% of the entire population is seropositive. Life expectancy in these countries has fallen sharply (UNAIDS 2004).

The high morbidity and mortality in southern Africa is not merely a public health crisis. Since fatalities are mainly among young adults, children are growing up orphaned. The working-age population in these countries is falling sharply. Infection, illness and death are affecting the age category that is most essential for the labour market. The public health crisis is becoming an economic disaster that is pushing emerging economies in southern Africa into a still deeper crisis. The struggle against the AIDS epidemic is coming up against a variety of problems. Pro-active HIV prevention (information, safe sex, proactive testing, etc.) is needed, but difficult. Having HIV is often a taboo, unmentionable between partners. This makes practicing safe sex difficult. The Roman Catholic Church and other religious organisations reject the use of a condom during sex. Often no condoms are available. Poverty forces women into prostitution, where unsafe sex is the rule. In some countries, the spread of AIDS goes hand in hand with war and rape. Sometimes people even deny that AIDS results from sexually transmitted HIV infection.

At the same time, the total number of people with HIV has remained relatively stable in most developed countries. At least, the epidemic is under

control there. The number of new cases is relatively small and most patients respond to treatment with antiretroviral drugs. These medicines do not cure, but they effectively slow the virus' reproduction and thus its destructive impact on the immune system. However, AIDS inhibiting therapy is complex. Treatment normally consists of a cocktail of three drugs, each of which combats the virus in a unique manner. The complexity lies in the number of medicines that must be taken daily at set times according to a fixed schedule. Furthermore, regular monitoring is needed. As soon as effectiveness declines, a different combination of drugs is required. The fixed schedule is extremely important: if the therapy is not followed meticulously, the virus can become resistant to the drugs used. The therapy is also expensive. In the Netherlands, a cocktail of antiretroviral drugs for an AIDS patient can cost €10,000 per year. Standard health insurance reimburses the cost of the treatment, making it accessible to patients in the Netherlands.

The situation is different in developing countries. In Zambia, Congo, Burkina Faso and similar countries, the per capita health care budget is under $55 a year.[2] Few, if any, are able to afford regular treatment at Western prices. It is true that pharmaceutical companies sell AIDS inhibitors to developing countries at sharply lowered prices; but even then, these drugs remain beyond the means of most patients. In developing countries, only 7% of all people infected with HIV have access to AIDS inhibitors (UNAIDS 2004).

Patents, WTO and TRIPS

One important element in the discussion on the accessibility of antiretroviral drugs is that these medicines are patented. The objective of patenting is to allow inventors and companies to market their discoveries, but this often leads to high prices for patented products. Allowing every competitor to produce generic versions of new discoveries would undermine the economic motive for research. Patenting innovations gives the "owners" a temporary monopoly that allows them to profit from their discoveries. The patent recognises and protects the innovator's intellectual property. Although, in granting monopolies, patents place restriction on the "free market", they are primarily intended to promote the development and dissemination of innovations. That is why international patenting regulations (Trade-Related

[2] For the year 2002. In comparison: The Dutch average expenditure on health care is $2,554 per capita. www.who.int/countries. Last viewed October 25, 2005.

Aspects of Intellectual Property Rights, TRIPS) fall under the jurisdiction of the World Trade Organisation (WTO), the organisation that monitors (free) trade agreements and regulation.

The AIDS crisis sparked much discussion on the specific consequences that TRIPS regulations had on public health. After all, as long as pharmaceutical companies could enforce their patents, the medicines were seldom if ever available for developing countries. TRIPS regulations allow patents to run for 20 years. Only after that may others manufacture a generic version – which would have a drastic effect on the price. However, the TRIPS agreement states that the government of a country with a public health crisis can compel a pharmaceutical company to licence a local manufacturer to produce the medicines needed. The patent holder must, of course, receive reasonable compensation (royalties) for the medicines that can then be produced more inexpensively. As of August 2003, countries that do not have production facilities are allowed to import such medicines from countries that have wrested this licence. Nevertheless, developing countries and pressure groups sometimes complain that although the ability to obtain compulsory licences may exist on paper, Western countries exert pressure not to use this option. The United States, for instance, imposes extra restrictions on bilateral free trade agreements.[3]

For several years, Brazil and India have been major producers of generic version of antiretroviral medicines. India is also a major exporter of these drugs to countries with many AIDS patients. Both countries have legislation that diverges from the TRIPS regulations; their legislation permits producing copies of patented medicines under certain circumstances. Until recently, Indian legislation allowed only production processes to be patented. That law did not forbid producing copies using slightly altered production methods. In Brazil, a patent expires when its developer does not produce the drug in Brazil within a few years. Brazil also makes energetic use of compulsory licences.

All things considered, we can say that the options that TRIPS regulations offer for compulsory licences and import have not led to large-scale accessibility of anti-AIDS drugs for people in developing countries. One possible response is to criticise WTO and TRIPS and to seek innovation in patent regulations. A group of scientists around philosopher Thomas Pogge is working on a proposal. They are attempting to develop a parallel patent system in which pharmaceutical companies receive income based on how

[3] Free Trade Agreement Between the USA and Thailand Threatens Access to HIV/AIDS. Treatment, Oxfam Briefing Note, July 2004. http://www.oxfam.org/eng/pdfs/bn_USThai_FTA__HIVAIDS.pdf

their drugs affect global health. As of 2010, the projected *Health Impact Fund* is still to be established (Hollis & Pogge 2008; see also Pogge (ed) 2008). Meanwhile, whether pharmaceutical companies could do more, or even should do more, to increase access to these medicines remains controversial. That is why pressure groups and other stakeholders address their criticism to the pharmaceutical industry as well as to the WTO.

Criticism of Pharmaceutical Companies

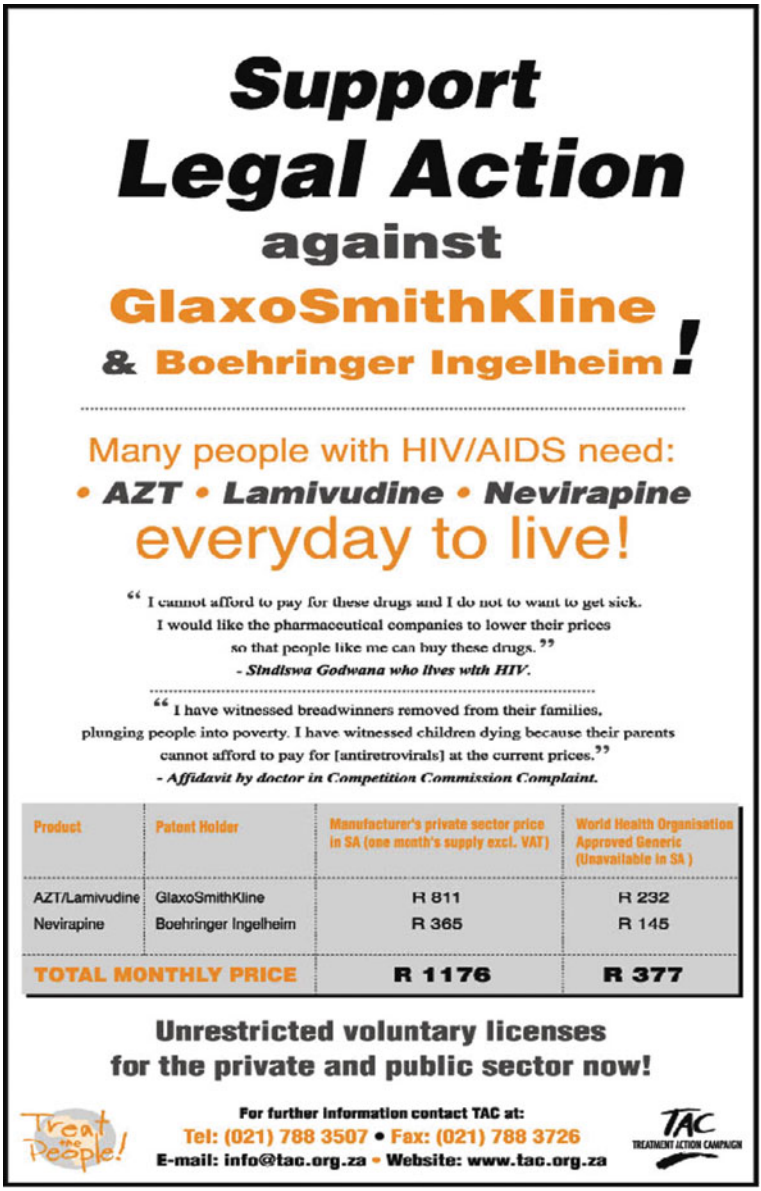
AIDS inhibitors are unaffordable and inaccessible for most people with AIDS. At the same time, pharmaceuticals belong to one of the most profitable industries. In the first half of 2005, Roche's profits reached CHF 4.2 billion, which equal 30% if the company's turnover. ACT UP and other organisations often use the contrast between the impossibly high price of medicines and the companies' profits to sway public opinion and, with it, the companies' behaviour.[4]

Many other pressure groups and NGOs choose a more argumentative path. They seek publicity in the mass media or professional journals; they write directly to companies or take legal action. The high price of medicines is a major target. Pressure groups often emphasise that these prices are not in proportion to production costs. TAC (Treatment Action Campaign) is one leading South African pressure group. In 2003, TAC took action against GlaxoSmithKline (GSK) and Ingelheim to get them to lower prices. TAC took out ads (see figure) and lodged a complaint with the South African competition commission. The complaint was substantiated with personal stories of people with AIDS. TAC argued that the price of these companies' antiretroviral drugs was two to three times higher than that of generic drugs. TAC concluded that these were excessively high prices – which is forbidden in South Africa.

> The excessive pricing of ARVs [by GSK and Boehringer Ingelheim] is directly responsible for premature, predictable and avoidable deaths of people living with HIV/AIDS, including both children and adults.[5]

[4] Act Up, an NGO based in New York, challenges the price policy of Abbot and in between also the income of its chairman.

[5] TAC, The main complaint against GlaxoSmithKline and Boehringer Ingelheim. www.tac.org.za



Medecins Sans Frontieres (MSF, Doctors Without Borders) is another major organisation. Increasing access to AIDS inhibitors is one of MSF's objectives. Although MSF emphasises that governments bear primary responsibility for increasing access, it also points a finger at the pharmaceutical industry. One of its arguments is that medicines should not be regarded

as luxury goods in a free market. In an article in the *British Medical Journal* Nathan Ford of MSF puts it this way,

> The director of the International Pharmaceutical Manufacturers Federation recently said: "For people with no income or little income, price is a barrier. I mean I can't afford certainly a car of my dreams, you know, which might be a Jaguar XJE." But medicines are not the same as sports cars, and patients are not consumers: they cannot choose between AIDS and leukaemia, and few can move from Guatemala to Switzerland. Over 90% of the world's medicines are produced in Western countries by companies that develop drugs according to profit prospects, not health needs. This needs to change. (Ford, 2003)

In an editorial in the *Washington Post*, Donald Berwick, President and CEO of the Institute of Health Care Improvement, suggested that AIDS medication should be *free*; he believes that the directors of pharmaceutical companies have the power to bring this about:

> The devastated nations of the world need AIDS medicines . . . at exactly their marginal costs of manufacture . . . Here is how it could happen: the board chairs and executives of the world's leading drug companies decide to do it, period . . . . No one could stop them; none would dare try. For the small profit they would lose, they would gain the trust and gratitude of the entire world. (Berwick, 2003)

We can distil from these actions and publications various arguments for thinking that a strong obligation to help rests on pharmaceutical industries. All arguments start from the presupposition that there is an extremely great need for good AIDS inhibitors, especially in Africa. On this there is no dispute. But why is this the pharmaceutical industry's responsibility? According to the critics:

(1) When pharmaceutical manufacturers keep the price of AIDS inhibitors high to generate maximum income, these companies share responsibility for the sickness and premature death of many people with AIDS. This argument does not explicitly refer to a duty to help; but it does imply that companies caused serious harm to AIDS patients. The (negative) obligation to avoid doing harm is often considered a norm more stringent than the duty to help. This argument gives rise to several questions. First, it is not evident that maintaining high prices can be considered a case of *doing harm* permitting the pharmaceutical industry to be held responsible for AIDS deaths. In addition, this argument presupposes that the industry has an obligation to supply medicines. After all, only then could the industry rightfully be held responsible for the consequences of a lack of medicines. However, it is still unclear whether companies are subject to this moral obligation. In short, this argument presupposes what it wants to demonstrate.

(2) Medicines are not luxury goods whose development and commercialisation can best be left to the operation of the free market. Patients are not consumers that can opt for one product rather than buying another. AIDS inhibitors and other life-saving medicines are really "priceless goods" – goods whose value cannot and must not be expressed in money. Leaving the sales and distribution of medicines to the market opens the door to great social injustice. On the other hand, imagine that it would be reasonable to consider medicines "priceless goods" that were not to be distributed via the market; that would still leave open the question whether this would lead to moral requirements being laid primarily at the door of pharmaceutical companies that definitely operate on the market. In practice, many countries curb the market's influence on their health care systems; examples are universal health insurance and imposing budgets on health care providers and insurers. In such systems, the burden of expensive medicines rests on many shoulders. When countries with a minimal health care budget also have to deal with many cases of HIV, such steps are out of the question. Any solidarity that comes into play will have to be on an international level. In practice, the many price reductions in developing countries are only possible because (and to the extent that) pharmaceutical companies can charge a higher price in developed countries.
(3) Extreme price reductions and the waiver of patent rights – steps that only the pharmaceutical industry can take – will serve as catalyst in the struggle against AIDS and will help overcome other blockages (e.g. lack of infrastructure and basis health care). This is the essence of Donald Berwick's plea. The argument makes crystal clear that the responsibility for tackling the AIDS crisis does not rest solely with the pharmaceutical industry.

The Pharmacists' Defence

Responses from Roche, GSK, MSD and other companies to the criticism that the high price they charge for their antiretroviral drugs shares responsibility for AIDS crisis are largely as follows. These responses, too, elicit questions and subtleties.

(1) Medicines are expensive, but the price should not be regarded only from the perspective of production costs. While the final production cost can probably be kept down, the cost of development and testing drugs is

immense. The cost of scientific research (laboratory research, animal tests, large-scale experiments with patients) and registration can run to hundreds of millions of euros before a drug actually reaches the market. Moreover, this development is very risky. Roche issued a brochure on its approach to patents:

> As a research-based organisation, the prices of products reflect not only the costs of research and development, but also the risks associated with such research and development. (Roche, 2004)

Patents allow only a circumscribed period to earn back the cost of developing a new medicine. That earn-back is essential for a commercial company. Seen from that perspective, the high price of new medicines is far from unreasonable. A counter-argument is that universities and teaching hospitals do a lot of research with public resources and that this research also ultimately leads to the development of new medicines (Angell 2004). However, it is debatable whether that last is a reason to believe that pharmaceutical companies should set lower prices. It could however lead us to believe that pharmaceutical companies cannot simply focus on maximising profits. By piggybacking on the research of universities which is sponsored by public money they receive indirectly public support and therefore should focus also on public or social responsibility. There are few companies that would dispute that (see the section on Roche at the end of this chapter). A second counter argument brought against invoking development costs is that while these are high, they do not far outpace the sums that companies invest in marketing and advertising.[6] While this argument may be true, it does not lower development costs. The argument seems to be aimed more at stressing the pharmaceutical companies' great financial potential (that can conceivably be used to provide assistance or lower prices) than at underpinning the argument that antiretroviral drugs are unreasonably expensive.

(2) Donations are not a real answer. Although it is obvious that, from the perspective of the duty to help, prosperous companies should donate a portion of their medicines to countries that are unable to pay for them, such action is also not without its problems. Donations are sometimes meaningful, for instance in starting up a pilot project; but they are not a

[6] Marcia Angell claims in the above mentioned article that the budgets for marketing are two and half times as large as those for research and innovation. This is denied by the Pharmaceutical Research and Manufacturers of America (PhRMA). The marketing budget that Angell refers to contains according to them a number of activities which have nothing to do with marketing. See: http://www.phrma.org/publications/policy/15.09.2004.1078.cfm

systematic answer to the AIDS problem. Since patients must be treated for the remainder of their lives, the industry must be committed to continue supplying the drugs – and so must be able to charge at least the manufacturing cost. This last argument draws attention to an important aspect – the need for help to be continuous. However, this concern cannot be sufficient reason to restrict donations. After all, even temporary help can be very worthwhile – if not morally obligatory – when the sickness can be halted for a time in a group of patients. That it is not certain whether the same assistance will be available in 1 year or 2 year's time does not detract from this.

(3) The price of antiretroviral therapy has fallen drastically over recent years. In 2002, Richard Sykes, chairman of the board at GSK, noted that six of GSK's AIDS medicines were available in developing countries at prices 90% lower than in the Western world (Sykes 2002). At the same time, however, he saw that price reductions have had little effect on the use of these medicines in developing countries. That brings us to the next argument.

(4) The price of medicines is ultimately not the core problem. Countries in central and southern Africa simply do not have the infrastructure and health care needed to treat patients adequately. The infrastructural problems and the many other problems implicated in the AIDS epidemic are so large that it is not correct to think that a greater effort by pharmaceutical companies is the primary requirement for turning the tide. The primary responsibility lies with the governments of the countries concerned, even when it is a question of greater access to anti-AIDS medication. Many steps are needed and many problems need to be removed before AIDS patients can receive proper care. The first requirement is a properly working health care system, including infrastructure for testing, monitoring and treatment. The second is that local governments must create the conditions needed for proper care, among which is curbing stigmatisation of, or discrimination against, AIDS patients. The pharmaceutical industry has but a small role to play in many of these problems. At the same time, the industry cannot simply invoke these problems to ignore what it can and must do. Médecins sans Frontières and other NGOs play an important role in setting up pilot projects that demonstrate that the complex routine of treating AIDS is indeed possible in the least developed countries. Donald Berwick's thesis that an extreme price reduction for (or even free) medicines can be an enormous stimulus to overcome all the other problems can be seen as a refinement of the pharmacists' argument that lowering prices does not make medicines more accessible.

It can be concluded that the pharmaceutical industry is not the only one to bear responsibility for providing AIDS patients with greater access to medicines. At the same time, it is reasonable to assert that they should contribute – and to that extent that they have an obligation to help. But the question remains: How far does this duty extend? Is it possible to situate the border between duty and charity with precision? We can illustrate this with the steps that Roche took to increase access to care.

Roche, Social Responsibility and AIDS

Roche, a Swiss company, describes its primary contribution to society as follows:

> Our principal contribution to society is to continue committing substantial resources to long-term research and development aimed at creating diagnosis and treatment options to address the many unmet health needs facing mankind.[7]

The company also states that, in as far as its financial means allow, it is prepared to make significant contributions to the reduction of suffering. Roche has a patent and pricing strategy that helps patients in the poorest countries gain access to its products.

Roche produces three antiretroviral drugs for directly treating AIDS: Invirase (saquinavir), Viracept (nelfinavir), and Fuzeon (enfuvirtide). Fuzeon is a relatively new drug administered intravenously. That makes it (still) difficult to administer this medicine in least developed countries. The WHO recommends the other two medicines as secondary treatment options (when other primary drugs prove insufficient).

Roche has sharply reduced the price of these antiretroviral drugs. Invirase and Viracept are available at "no profit" prices in sub-Saharan countries. According to Roche, these prices are the lowest possible for medicines with a sustainable production method; they are also lower than those of generic versions of the drug (Roche 2005). In addition, Roche supports numerous public health projects around the work. One example is "Phelophepa": a "health-care train" that traverses parts of South Africa 36 weeks a year, going to places where people have little if any access to normal health care. The train does not offer anti-HIV medication, but does provide other types of basic medical, dental, ophthalmic and psychiatric care. Since 2004, Roche has taken out no patents in countries on the UN's "least developed" list. This holds for current and new medicines, for all illnesses; so it also covers

[7] http://www.roche.com/home/sustainability/sus_comm.htm

HIV/AIDS. For HIV/AIDS this course of action has been expanded to all sub-Saharan countries. No action is taken against the production or sale of generic versions of Roche's medicines in these countries. That means that no licence is needed to produce generic versions of Roche's antiretroviral drugs (i.e. Saquinavir) in these countries. These countries may also import generic versions from Brazil, India or elsewhere. *CoreRatings* praised this flexible attitude toward patents in a report on social responsibility in the pharmaceutical industry.[8] Of course, not compelling respect for patents still falls short of making medicines directly available in developing countries. But as the supply of generic antiretroviral drugs grows, prices will fall further.

Given the worldwide AIDS crisis, is Roche's approach to patents morally praiseworthy while remaining morally *optional*, or can it be considered a moral *obligation*? If Roche does have a moral obligation to help African AIDS victims, then much farther-reaching help could also be offered. After all, passively tolerating the manufacture of generic versions of its medicines is still far from doing something to help these countries; before these countries can manufacture medicines they need expertise, technology and investment. In January 2006, Roche took steps to transfer knowledge and expertise. CEO William Burns announced that Roche would help companies in least developed countries to manufacture copies of Saquinavir.

[8] CoreRatings (2003): "In 2001, Roche was forced to cut its prices in Brazil after the Brazilian government threatened to licence a government company to reproduce Roche's HIV/AIDS drug. Roche has responded to that, and other recent intense pressure over access to medicines, by introducing one of the most flexible policies on patenting in the sector. Having already donated its malaria patents to the WHO, the company has also said it will not be seeking new patents on HIV/AIDS drugs in the least developed countries or sub-Saharan Africa. Roche no longer has a drugs donations programme as it believes such programmes are not sustainable. Instead the company has strengthened its procedures on differential pricing by changing the packaging on low-priced drugs and monitoring supply and distribution on the ground in Africa. This maximises the social benefit of the programmes and reduces the risk of parallel importation. The company recently adopted differential pricing for HIV/AIDS drugs which it supplies at manufacturing cost plus transportation costs. Roche has said it will not act against infringements of patents of its HIV/AIDS drugs in sub-Saharan Africa (SSA) and UN defined developing countries. If other companies develop generic versions of Roche's HIV/AIDS drugs, Roche will not take any action if they distribute them through SSA and developing countries. However, those companies will not be able to file patents on Roche's products since it owns the intellectual property rights in developed countries. If such companies export outside of these regions, then Roche states it is obliged to take action to protect these rights." http://www.coreratings.com/site/products/sector_reports/CoreRatings_Pharma_Report.pdf

> We want to use the knowledge we have developed to help strengthen local manufacturing capability and hope to help as many manufacturers as possible in these hardest hit countries by sharing our knowledge, so that they can learn and benefit from our knowledge.[9]

Once again we must ask whether this is an act of charity or a moral obligation.

Concluding Remarks

These examples of Roche's course of action show that there is no limit to the help that can be given to AIDS patients. That makes it difficult to draw a line between moral obligation and charity. It is reasonable to state that the answer to the moral question "how much help should Roche give" depends in part on the degree to which other parties, companies, governments and civilians work to contain the AIDS crisis. The WHO started its "3 by 5" campaign in 2003. Its goal was to provide antiretroviral treatment for 3 million people with advanced HIV by the end of 2005. By the end of 2005 it was obvious that this goal had not been reached. A report by the International Treatment Preparedness Coalition (ITPC) drew attention to the most important blockages: inadequate leadership in countries suffering from the AIDS crisis where too little priority is given to AIDS and health; insufficient international coordination; and an insufficient and uncertain financial basis for international programmes. In many countries, the stigma of HIV infection hinders access to medicines International Treatment Preparedness Coalition (2005). The price of antiretroviral drugs is not the greatest stumbling block. This report shows once again that the criticism that some launch against pharmaceutical companies is simplistic. ("Despite their profits they keep prices for antiretroviral drugs high, which makes them responsible for AIDS patients' premature death".) But this does not answer the moral questions of how far these companies' obligation to help extends and whether they adequately meet this moral obligation.

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Chapter 5
Heineken and Promotion Girls in Cambodia

Frans-Paul van der Putten and Rosalie Feilzer

Abstract In Cambodia so-called promotion girls (PGs) working in bars and restaurants play a large role in marketing beer. PGs' work and the circumstances in which they work are far from ideal. The situation is made more complicated by the fact that some PGs have sexual contact with pub customers after hours to earn more money. Among the most frequently cited dangers to which PGs are exposed is the risk of becoming infected with HIV. Although many parties are involved in the circumstances in which PGs work – chiefly the local pub owners, local distributors and the Cambodian government – foreign media focus mainly on the role of international brewers. Heineken is one of the companies operating on the Cambodian market. This brewer developed a programme for PGs that promote its brands. This case study describes Heineken's position in Cambodia, PGs' position in Cambodia, the way the PGs' relation to foreign brewers drew international attention and, finally, Heineken's policy on the PGs' working conditions.

Introduction

In several Asiatic countries PGs or promotion girls are used to sell alcohol and cigarettes. Cambodia is one of the countries where these women play a large role in marketing beer. Local distributors of domestic and foreign brands use PGs to sell their beer at entertainment spots. PGs working for beer brands customarily work in pubs where they try to get customers to order their beer brand.

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PGs' work and the circumstances in which they work are not ideal. According to CARE Cambodia, part of the worldwide NGO of the same name that fights poverty, it often happens that PGs are subjected to unwelcome sexual advances during their working hours.[1] In addition, many PGs have sexual contact with pub customers after hours to earn more money.[2] Some media report that PGs are exploited (Sauviller 2004) and that through their role as indirect sex workers some PGs contribute to the spread of HIV (Bouma 2003). Although many parties are involved in the circumstances in which PGs work – chiefly the local pub owners, local distributors and the Cambodian government – foreign media focus mainly on the role of international brewers. Heineken is one of the companies operating on the Cambodian market. This brewer developed a programme for PGs that promote its brands. This case study describes Heineken's position in Cambodia, PGs' position in Cambodia, the way the PGs' relation to foreign brewers drew international attention and, finally, Heineken's policy on the PGs' working conditions.[3]

Social Context in Cambodia

Cambodia has thirteen million inhabitants, nearly half of whom are under age fifteen.[4] The country is predominantly agrarian, three-quarters of the population work in agriculture, silviculture or fishery. One consequence of the country's past history of political instability is that Cambodia is one of the poorest countries on the planet. Cambodia has been the scene of wars and occupations since its independence in 1953. The nadir came with the communist Khmer Rouge's reign of terror. Its leader Pol Pot came to power in 1975 after a bitter struggle. The new regime abolished medical facilities, postal services, telecommunication, money, private property and education and restarted the calendar. The urban population was banished to the countryside where it was compelled to establish an agrarian culture. Potential political opponents and ethnic minorities were persecuted. An estimated two million Cambodians, a quarter of the population at that time, died of hunger,

[1] http://www.asianlabour.org/archives/000627.html. 12 Feb. 2004.

[2] One study by the Cambodian government says that 40% of PGs report doing this. Stecklow & Marshall (2000).

[3] This case study reflects the situation at the start of 2005. Heineken helped with the study by granting access to internal company information and offering advice on its incorporation in the text.

[4] General information on Cambodia taken from Kleinen & Mar (2004).

torture or by execution. In 1978, a Vietnamese invasion drove the Khmer Rouge into a few isolated parts of the country where it carried on guerrilla warfare for years. In the early 1990s, the parties allowed the UN to mediate to end the civil war. Mines were cleaned up and the infrastructure for tourists was improved under the supervision of the UN. Hotels, restaurants and pubs sprouted everywhere. That was when the sex industry started its rapid rise.[5]

The rise of new industries and tourism contributed greatly to the enormous exodus from poverty-stricken rural areas to the cities. The tourist industry is the fastest growing economic sector. Many young people hope to find a job there; men generally have a better starting position. Eighty-five percent of women are illiterate and have had little or no schooling. Men are often better educated which gains them access to better jobs in the tourist industry. Given the modest size of the textile industry, the urban job market for unskilled women from rural areas is very small. Some work in bordellos as "direct" sex worker or in the entertainment branch, e.g. as dancer, masseuse, karaoke singer or PG. Some of these women are considered "indirect" sex workers because they earn extra money after hours by going with customers they met while at work. These women do not consider themselves prostitutes because they can decide whether or not to accept a customer's offer (van Luyn 2004; Lubek 2002).

Heineken in Cambodia

Heineken NV is a Dutch company that brews beer in 65 countries and that markets it in over 170.[6] It has been in business since 1864 and has its headquarters in Amsterdam. The founder's descendents control Heineken via two holding companies. 49.995% of the shares in Heineken are traded on the Amsterdam stock exchange. The company produces many brands of which *Heineken* is the most important.[7] The name of the most important product is thus identical with the name of the company. Although Heineken operates around the world, Europe is by far the brewer's most important market. In 2003, the company derived 73% of its sales in Europe. Heineken was one of

[5] URL: http://www.visit-mekong.com/cambodia/background/history.htm. 25 Oct. 2004; URL: http://www.ncbuy.com/reference/country/backgrounds.html. 25 Oct. 2004.

[6] General information on Heineken is taken from the company's annual report for 2003 and the company web site.

[7] In 2004, the brand came in 99th in BusinessWeek's global brand scoreboard: *BusinessWeek*, 2 Aug. 2004.

the largest brewers in the world. Internationally it competed with Anheuser-Bush, InBev en SABMiller. The company said that its primary goal was to strengthen its competitive position and ensure its independence.

In 2003, the Asian Pacific market represented only 4.4% of Heineken's company sales. But this market's population, demographic development, economic growth and low per capita beer consumption means it has enormous potential for sales growth. There is fierce competition in China and Southeast Asia among large international brewers seeking to increase their market shares. Heineken, too, is trying to slip into a leading position in the region. It is not a question of fast profit, but of building an abiding position. That means that Heineken has to invest in marketing its own brand and in building a network of local brewers and distributors. Finding vigorous and reliable local partners is of prime importance in the Asian market. Without good local allies, Western brewers are unable to arrange mass distribution of their products because long-standing personal contacts play a more essential role in Asian business life than they do in the West.

Heineken's primary Asian partner is a Singaporean company, Fraser & Neave Ltd (F&N). Originally, F&N was a British company, now Singaporean Chinese own it. F&N and Heineken have run Asian Pacific Breweries Ltd (APB) in Singapore since 1931. It sees to the production, marketing and distribution of beer in China, various Southeast Asian countries (Singapore, Cambodia, Malaysia, Thailand, Vietnam and Laos) and New Zealand and Papua New Guinea (Korthals 1948; Jacobs & Maas 2001). Heineken owns 42.2% of APB, and F&N owns 37.9%.[8] APB is proportionally consolidated in Heineken's annual figures, which indicates that Heineken and F&N have formally agreed that each would control half of the joint venture.[9] Heineken's relation with F&N is of great strategic importance and is the mainstay under Heineken's position in Asia; APB and, by extension F&N, play a major role in all growth plans. This implies that Heineken's plans in Asia can only be realised with F&N's consent and that Heineken cannot manage joint venture APB as flexibly as it can its fully-owned subsidiaries (Smit 1996). Of course, F&N's interests and Heinekens

[8] http://www.apb.com.sg/profile/profile.html. 4 Nov. 2004.

[9] See also Heineken, *Annual Report 2003* (Amsterdam: Heineken NV, 2004) 77: "Proportionally consolidated participating interests: The companies listed below [among which are APB and CBL] are proportionally consolidated because control of [sic] these companies is exercised jointly and directly by virtue of an agreement with the other shareholders." See also http://www.heinekeninternational.com/content/live/files/downloads/InvestorRelations/H_ENG_JV2002_07_tcm4–4466.pdf. Last viewed 11 Oct. 2009.

do not always coincide. An important example of this is that social expectations have less impact on Asian companies than on a Western company. Heineken is more sensitive to negative media attention for the working conditions at subsidiaries in emerging countries than is F&N. So Heineken feels sooner than its Singaporean partner the need to invest in improving working conditions.

Beer Distribution in Cambodia

Expressed in beer volume, the total Cambodian beer market was good for 15,982,409 gallons in 2002.[10] By way of comparison: that is approximately 0.55% of the 2,879,475,370 gallons that Heineken sold worldwide in 2003.[11] While Cambodia's 13 million inhabitants comprise a modest market, it is one with growth potential. In 2000–2002, APB's sales in Cambodia grew by approximately 35%. Beside the local population, tourists are an important target group for beer vendors. Heineken reported that APB held 47.1% of the Cambodian market in 2003.[12]

APB's Cambodian organisation is called Cambodia Brewery Ltd (CBL). It brews and distributes beer for the local market. APB owns 80% of CBL.[13] APB's brand *Tiger* is this brewery's most important beer brand. Heineken brand beer is sold in Cambodia, but is not brewed locally. Heineken outsourced the import, marketing and distribution of Heineken beer in Cambodia to a Cambodian company Attwood Import Export Co. Ltd. It did so via Interlocal, a subsidiary of Singaporean company Kong Siang (Pte) Ltd. Keeping the distribution chain for Heineken brand beer separate from that for Tiger prevented a conflict of interest for CBL that, like APB, was primarily responsible for supporting and selling Tiger brand beer.[14] Moreover, Attwood is well positioned to protect Heineken beer's "premium" image; it also imports and distributes other exclusive liquor brands (Hennessy Cognac en Moët & Chandon champagne). Heineken had to keep up its ties with Attwood and, via APB, CBL as long as these distributors provided product promotion if it wanted to retain its place as market leader in Cambodia.

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[10] http://www-nl.heinekeninternational.com/about/who/breweries/cambodia_brewery.jsp. 20 May 2005.

[11] For Heineken NV's total beer volume in 2003 see http://www-nl.heinekeninternational.com/images/NVNLjaarverslag_tcm7–10002.pdf. 20 May 2005.

[12] http://www-nl.heinekeninternational.com/about/who/breweries/cambodia_brewery.jsp

[13] APB, *Annual Report 2003* op http://www.apb.com.sg. 4 Nov. 2004.

[14] This did not always run smoothly in the past: Jacobs & Maas (1991).

PGs in Cambodia[15]

Much of the beer sold is sold via bars and restaurants. It is customary in many such businesses for promotion girls to sell beer. They work for the distributor or local brewery and are used to stimulate consumption of a given brand. The pub or restaurant owns the beer that they sell. The owners of the establishments where promotion girls work have a great impact on the girls' working conditions. The pub owner and not the distributor or brewer is directly present when the women do their work.

Whenever he orders, a customer can choose from among the beer brands that the promotion girls who are present at the time pour. The brands compete via the PGs for every bottle and can of beer sold. In many other countries, licensed establishments have exclusive contracts with distributors to purchase only one or a few beer brands. There brands compete by trying to have the greatest possible number of sales points under exclusive contract. In Cambodia this system is not or hardly in operation; whoever does not use PGs does not sell any beer in pubs or restaurants.

All major distributors of alcoholic beverages in Cambodia use PGs. If Heineken is to maintain its market position, it is essential that CBL and Attwood ensure massive presence of promotion girls in the entertainment districts. Large numbers alone are not enough. It is also essential that the women be highly motivated and popular with customers. That gives them the best chance to stimulate beer sales. The women wear uniforms in the colours of the brands they promote and with the brand name clearly visible. CBL uses around 600 PGs. Attwood has around 150 PGs for promoting Heineken beer.[16] It is important for Heineken that Attwood and CBL have their PGs sell as much beer as possible. In this sense, Heineken has a clear interest in the way distributors manage the women. They, in their turn, are dependent on cooperation from the pub and restaurant managers for the women's immediate working conditions.

The promotion girls working for Attwood and CBL are over age 18 and average age 25.[17] Other distributors also use PGs under age 18. In Cambodia, most distributors give PGs a little training when they start work.

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[15] Barring indications to the contrary, data in this section on the general situation of PGs in Cambodia date from 2001 to 2004. The situation of PGs that sell Heineken and APB brands may diverge from this, or may have changed in the meantime.

[16] Care Cambodia (2004). See http://www.fairtradebeer.com/reportfiles/CARE/CAREendlinereport2005.pdf. Last viewed 22 Oct. 2009.

[17] Heineken provided this information.

This usually has to do with pouring beer.[18] Often in exchange for a deposit (Bainbridge & Nara 2002) PGs are given a uniform with the name and in the colours of the brand they promote. Their workday often starts at noon in their employer's office where they change into their uniforms and get instructions on where they will work. Then a bus brings them to a bar or restaurant where they will stay until closing time. Most of the women work seven evenings a week for an average of US$40–US$60 per month. PGs in Cambodia are often paid by commissions or in a wage system with financial bonuses and disincentives. All or part of their pay depends on how much beer they can sell. The payment structure differs from one distributor to the next.[19]

PGs and Prostitution

Having sexual contact after hours is a fast and easily accessible way for PGs to earn an average of US$25 extra per month. That helps the women contribute to the care of family members back home; that was usually the women's initial motive for coming to the city to find work.[20] Research shows that between 30 and 60% of women have regular sexual contact after their work as a PG.[21] These contacts are usually without protection; various sources indicate that rape is frequent (Stecklow & Marshall 2000). Most employers, including the distributors working with Heineken and APB, stipulate that after-hours sexual contact with pub customers is forbidden on pain of dismissal. Moreover, distributors often provide transportation to and from work. However, it is unclear whether PGs are required to use it.

The growth of sex tourism and direct and indirect prostitution in Cambodia lies at the heart of a serious social problem: the rapid rise in HIV infections. The AIDS virus followed upon the heels of the UN and

[18] Data in this section are based on Marshall & Stecklow (2000); Mc Court (2002); van Luyn (2004).

[19] In 2003, CBL used a standard wage annex bonus system for sales over a given limit as well as a disincentive. That was an amount, up to 10%, deducted from wages when sales were under a given minimum. The monthly wage for a CBL PG was then US$50. Heineken provided this information.

[20] URL: http://www.actionaid.org/asia/325_1_31.html. 25 Oct. 2004.

[21] One study by the Cambodian government says that 40% of PGs report doing this: Stecklow & Marshall (2000). A Behavioral Sentinel survey by the National Centre for HIV/AIDS reports 30–60%: Bainbridge & Nara (2002).

the tourists. The first cases were reported in 1991. Cambodia now has one of the highest AIDS rates in all of Southeast Asia.[22] While drug-related infection is significant in China, Vietnam, Thailand and Burma, sexual contact is the main cause in Cambodia (Jansen 2000). Because no family was spared during the Khmer Rouge period, the genocide led to the dissolution of social norms and the disintegration of social and family life. Many men express this in extreme dissipation linked to excessive drinking and unprotected sexual contact. Excessive alcohol consumption results in aggression and sexual audacity.[23] In pubs the PGs are the targets. The expressions range from pawing to request for paid sexual contact, sometimes even rape.[24] The Cambodian culture encourages young unmarried men to engage in sex, since they are expected to enter marriage experienced. Other rules apply to women. A woman's family suffers shame when she has frequent sexual contact with a variety of partners. A well-known Cambodian saying puts it this way: "A man is a diamond and a woman a piece of cotton; when they fall in the mud, the diamond can be washed clean, but the cotton remains dirty forever" (Pheterson 1996; Giebels 2003).

The urban sex industry ensures a rapid transmission of HIV. PGs who have paid, after-hours sexual contact are a particularly vulnerable group because they are not considered direct sex workers and do not want to consider themselves sex workers. That means that they fall outside the government's public information campaigns (Lubek 2002). Customers also perceive sex with a PG as safer than with direct sex workers. All this leads to condom use among PGs being the lowest of all groups in the direct or indirect sex industry. Only 10% of these women have safe contacts; in some cities, 20% of PGs are infected with HIV (Mc Court 2002). An additional problem relating to low condom use is that many PGs looking for work move from city to city, since the demand for PGs depends heavily on the tourist season. That increases the risk of transmitting the virus. Moreover, married men then transmit the virus to their wives. In Cambodia, AIDS and sex workers are taboo. AIDS patients and sex workers are shunned and discriminated against. They keep out of sight, which further augments the risk of transmitting HIV/AIDS (Jansen 2000; Mc Court 2002).

[22] URL: http://www.unaids.com. 1 Nov. 2004.
[23] URL: http://www.state.gov/g/drl/rls/hrrpt/2000/eap/681.htm. 25 Oct. 2004.
[24] URL: http://www.alterbusinessnews.be/nl/index.php. 16 Nov. 2004.

Social Criticism

Ian Lubek, a Canadian psychology professor, played a major role in drawing international attention to the position of PGs in Cambodia. Prof. Lubek is not the only one campaigning to improve the working conditions and health of beer promotion girls. Several national and international NGOs have been working within Cambodia for some years. Still, it is useful to draw attention to this person. In the international media, Lubek is the most often cited critic of the brewers' role in Cambodia. He is keenly single-minded and has forcefully articulated his view on many occasions.

In 1999, when he was passing through on the way to Australia, Ian Lubek got to talking with a young Cambodian who told him about the AIDS problem and the PGs in his country. Back in Canada, he decided to take steps. On 2001, the Canadian helped set up an AIDS prevention project in Siem Reap, the epicentre of tourism in Cambodia (Bouma 2003). Here Lubek joined various national and international organisations to take up the cause of the PGs with help from a modest donation from the Elton John AIDS Fund. The programme focussed on distributing information on how to prevent the HIV virus from spreading.[25]

However the project's scope was too narrow for Ian Lubek: Cambodia lacked proper medical infrastructure; AIDS inhibitors are scarce and expensive. This led to many HIV patients' dying from complications. Lubek believed that the Cambodian government did too little to help PGs. In addition, financial support did not always reach its intended recipients due to corruption and dysfunctional infrastructure. Without the help from (international) employers, charity organisations and NGOs, it was likely that more and more Cambodians would die from AIDS-related diseases. That is why Lubek thought that support from and participation of large international brewers was essential for improving the PGs' health situation (Landsberg 2002). He published an article on Heineken's and other brewers' role in PGs' HIV/AIDS infection, but did not state explicitly why he thought that international brewers had a responsibility to make up for the Cambodian government's inadequate health care (Lubek 2004).[26] However, the article did imply that brewers, as producers of the products that the PGs sell, must use their influence as employer or the employer's business partner. This referred to salary level and assistance with health care. In mid-2002,

[25] URL: http://www.psycholoy.uoguelph.ca/research/lubek/cambodia/aidsep.html. 25 Oct. 2004.

[26] See http://www.fairtradebeer.com/reportfiles/lubekheineken2004.rtf

Lubek contacted several large breweries and kept pursuing them with letters and e-mails. Most did not respond or simply stated that they had not hired any PGs.

Heineken and other international brewers were very important targets for the Canadian professor because they and APB controlled a large share of the Cambodian market and had internationally known names. Moreover, Heineken had set up a HIV/AIDS programme for its own personnel. Heineken first developed this policy in Africa. Its purpose was to make medical help available for employees and family members infected with HIV. Lubek hoped that Heineken would feel called upon to take the first steps and become a model for other brewers to follow.

In 2002, Ian Lubek asked Heineken whether its HIV/AIDS programme also applied to Cambodian PGs.[27] The brewer, feeling it owed Prof. Lubek an answer, said that its HIV/AIDS programme at that time was restricted to Africa and that later it would use the experience gained to introduce it elsewhere. Furthermore, Heineken told Lubek that it was still studying options for a programme for those not on its payroll (e.g. Cambodian PGs) and that in any case every programme must become operative throughout the world.[28]

Lubek thought that things could be done more quickly. Moreover, he believed that in this context there was no difference between an employee and an off-payroll worker. In either case their work directly benefitted the brewer (Lubek 2004). He did not want to make this distinction because the PGs felt that they worked for Heineken since their uniform bore the beer brand's name and since they poured only Heineken beer and competed with PGs representing other brands to capture the largest market share for Heineken.

In 2002, Lubek sent two letters to Heineken with copies to the Cambodian government, NGOs, international dignitaries and the international press (Lubek 2004). In them, Lubek claimed that Heineken's attitude in Cambodia conflicted with its international approach to HIV/AIDS. He thought that Heineken was dragging its feet when it came to helping the PGs in what he considered an epidemic situation that cost lives daily. In the meantime Lubek helped set up two web sites (www.fairtradebeer.com and www.ethicalbeer.com) that monitored brewers' course of action regarding PGs. Lubek's correspondence with and about brewers (often sent to many recipients), his two web sites and his lectures on PGs' working conditions

[27] Heineken NV, in-house documentation.
[28] Heineken NV, in-house documentation.

drew international attention. The media took this up and published articles on the subject in several newspapers and periodicals (Sauviller 2004; Bouma 2003). They were often distinctly negative regarding the circumstances in which PGs worked and considered the major brewers, including Heineken, as accessories to this. Several individuals and investors and the Dutch Trade Union Federation FNV contacted Heineken with questions about the PGs.

Lubek made three demands of Heineken and other international brewers in his letters and articles. First he demanded that salaries be doubled from around US$55–US$110 per month. He believed that this would remove the women's need to accept after-hours sexual contact. Second, he broached the importance of providing efficacious health information to bring about a change of behaviour and so to prevent the spread of HIV/AIDS virus. Finally, Lubek wanted the brewers to distribute AIDS inhibitors free to those PGs who had already become infected.[29]

Lubek's campaign focused heavily on the relation between the PGs work and the spread of HIV/AIDS. Newspaper articles were also quick to lay the link with HIV/AIDS (Stecklow & Marshall 2000). Yet, while HIV infection was a serious problem for those immediately involved and for the health situation in Cambodia, it is important to remember that this was only one of the possible consequences of the PGs working conditions. Research showed that many PGs were sexually harassed during their work.[30] This shows that even apart from HIV/AIDS, the PGs' working conditions posed fundamental problems.

Heineken's Answer and Stance Toward PGs

Although Heineken cut off all direct communication with Lubek after 2002, the company did take steps to adopt a course of action toward PGs. Representatives from Heineken's international medical service paid an initial visit to Cambodia in December 2002. Their purpose was twofold. First, Heineken wanted to investigate the PGs' situation and how local stakeholders would respond to a course of action regarding PGs. Next, they wanted to obtain local partners' (APB/CBL and Attwood) cooperation in improving the PGs working conditions. After the visit, the parties undertook additional steps. They worked to build contacts with NGOs and local government bodies.[31] CARE is an NGO operating in several countries;

[29] http://fairtradebeer.com/reportfiles/lubekheineken2004.rtf. 10 Jan. 2005.
[30] http://www.asianlabour.org/archives/000627.html. 12 Feb. 2004.
[31] Heineken NV, in-house documentation.

one of its specialisations is HIV/AIDS prevention. After being contacted by Heineken, CARE suggested setting up a training programme for PGs in Cambodia on selling beer safely. In April 2003, Heineken representatives visited Cambodia again to contact all parties to evaluate the results of the steps taken so far for PGs and to get them to agree to cooperation with a plan of action that CARE would carry out. In early 2004, CARE set up its Selling Beer Safely programme in Cambodia. The programme contained information on alcohol and its effects, behaviour training on how to deal with difficult customers, health information, information on sexually transmissible diseases (STDs), information on how to prevent STDs including HIV/AIDS, training and information for outlet owners, training for trainers, introduction and supervision of supervisors and creation of better working conditions with attention for transport and changing rooms.[32] This test project, set up at Heineken's request, focussed on developing a course of action regarding PGs that Heineken could use for all promotion girls throughout the world.

The CARE pilot study ended at the close of 2004. Heineken then drafted a policy on PGs worldwide. It continued the approach developed in conjunction with CARE. It contained provisions on hiring, contracts, working conditions, medical care and privacy. In addition, it contained a programme to educate, instruct and train PGs. Heineken stated that the policy would apply to all PGs working for Heineken companies and for business partners working with Heineken brands. Heineken's HIV/AIDS policy will only apply when PGs have no other source of care and when they are on Heineken's payroll, which is not the case in Cambodia.[33]

Heineken's arguments for setting up a worldwide PG policy were that PG work entails serious risks and that Heineken felt it has a responsibility when these risks could lead to HIV infections. Heineken said it had this responsibility as owner of the beer brand that the PGs promoted, even when the PGs sexual contact was not limited to pub customers and even when the company had no control over what PGs did in their free time. The responsibility that Heineken acknowledged in a document entitled "Promotion Girls Policy" tried to keep PGs' work-related risks to a minimum by providing information and training and seeing to safe working conditions.

Ian Lubek's response to this programme had positive notes. The project satisfied one of his demands (information). At the same time, he noted that it did not satisfy his two other requirements, to wit doubling the PGs' income

[32] Heineken provided this information.

[33] Heineken NV, in-house documentation.

and distributing AIDS inhibitors for free (McDonald-Gibson 2003). Apart from that, Lubek acknowledged that Heineken was the first brewer to take steps to set a course of action for PGs in Cambodia. His criticism was very pragmatic. Other brewers did less, but Prof. Lubek and other activists probably thought that criticising them at that point would have had a potentially smaller effect. Lubek and others gave little attention to the Asian brewers that operated on the Cambodian market.

However, Heineken is not planning to raise the PGs pay. The brewer believes that the income is sufficient to cover living expenses, which Heineken defines as providing for oneself and contributing to the maintenance of a family. According to its own word, Heineken, in Cambodia, is one of the best payers in the beer industry. When compared to other occupational groups, the women also earned a very decent wage. That is why Heineken thinks that raising PGs' income would seriously disturb the organisation's pay structure in Cambodia.

The brewer also comments that Heineken's most important business activity is brewing and selling beer and that local governments are the one's primarily responsible for health care. Only when the local governments are unable to meet these responsibilities and when this affects its own employees would Heineken see itself obliged to offer conditional assistance. Heineken's progressive HIV/AIDS programme, set up within the same framework, focuses only on its own employees and their families. In Cambodia, the PGs are not on Heineken's payroll. Rather they work for the distributors. CBL's PGs are subject to a policy that APB set up. Heineken has no direct influence on this. In addition, providing AIDS inhibitors would also require complex treatment and guidance that does not fit well with the rapid turnover in staff and many temporary workers as is the case for PGs in Cambodia.[34] Neither Heineken nor Lubek suggested terminating the use of PGs completely. This would probably lead to a smaller market share, which conflicts with Heineken's objective in Asia.

Conclusion

The working conditions of PGs in Cambodia are far from ideal even when the AIDS issue is disregarded. In a society where women were traditionally required to behave and dress modestly and where men display depraved behaviour in entertainment areas, PGs draw sexually tinted attention from

[34] Heineken provided the authors with this information.

males in bars. Because these women's income is dependent on their ability to get men to purchase a specific brand, some customers feel free to paw and sexually harass PGs. Any kind of friction with customers or pub owners has a negative impact on PGs' turnover, which puts them in a weak position.

As market leader in Cambodia, Heineken is very dependent on PGs' work. As for turnover, the company benefits from a system in which the women are encouraged to sell as much beer as they can. But increased turnover is not the brewer's only concern. In the long term, Heineken wants to continue operating in Cambodia; a great deal is at stake in other countries, as well. The Heineken and Tiger brands are sold in many other countries and the first brand is identical with that of the company. The brand value and reputation of the entire company play a large role in the manner in which the company deals with the situation in Cambodia.

At the same time, Heineken's influence in Cambodia is restricted in several ways. Many competing brewers also use the promotion system. They would like nothing better than to see Heineken recede. The women work either for a local distributor or for a subsidiary of the joint venture. Heineken has to take the competition and local partners into account in all that it does. They do not always share the same interests as Heineken.

In 2003 and 2004, Heineken set up a pilot project in Cambodia to train promotion girls. The training is primarily intended to contribute to preventing HIV infections, but is also aimed at improving general working conditions. NGOs and Heineken's local partners also support the training programme. The company used the results of the pilot project to set up and publicise a worldwide project for promotion girls. The company has chosen to be proactive, while competitors ignore it. There is no data on the effectiveness of Heineken's policy. It is clear that Heineken and its local partners have no plans to do without PGs. This would lead to a loss of market share unless the entire industry did the same. As yet there is no question of competitors joining forces to improve the situation. This would appear difficult to achieve given competitors' passive attitude and Asian brewers' apparent invulnerability to social pressure to improve PGs' working conditions.

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Chapter 6
Heineken and Promotion Girls in Cambodia, Part 2

Frans-Paul van der Putten

Abstract In the spring of 2005, CARE presented a research report at a congress in Phnom Penh. It showed the case of Heineken and the promotion girls (PGs) from a largely new perspective. The approach to PGs that Heineken developed in 2003–2004 was mainly aimed at reducing the PGs' risk of becoming infected with HIV and other sexually transmitted diseases (STDs). However, CARE's new report shows that the girls' working conditions – not the chance that a minority of them will become infected with HIV as a result of after-hours sex with customers – are the greatest threat to the PGs' well-being. The most serious consequences of the PGs' working conditions appear to be that they are daily exposed to violent types of sexual intimidation.

Introduction

In the spring of 2005, CARE presented a research report at a congress in Phnom Penh. It showed the case of Heineken and the promotion girls (PGs) from a largely new perspective. The approach to PGs that Heineken developed in 2003–2004 was mainly aimed at reducing the PGs' risk of becoming infected with HIV and other sexually transmitted diseases (STDs).[1] However, CARE's new report shows that the girls' working

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[1] Heineken International (2004). See also http://www.heinekeninternational.com/selling_beer_safely.aspx and http://fairtradebeer.com/reportfiles/heinekenaidspolicy2002.pdf (both last viewed 26 Oct. 2009).

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conditions – not the chance that a minority of them will become infected with HIV as a result of after-hours sex with customers – are the greatest threat to the PGs' well-being.[2] The most serious consequences of the PGs' working conditions appear to be that they are daily exposed to violent types of sexual intimidation.

CARE's Research[3]

In early 2005, CARE carried out a survey among 640 PGs in Cambodia. The study addresses the situation in the capital and in six other cities. Its purpose was to ascertain the extent to which sexual harassment and abuse played a role in PGs' working conditions. The participating PGs worked for the five largest employers of beer promotion girls. Combined, they employ around half of the approximately 4,000 PGs at work in Cambodia.

CARE's study shows that sexual harassment and abuse occur frequently in beer promotion. Sexual harassment at work entails being confronted with unwelcome sexual advances in a work situation.[4] Abuse is when this is accompanied by manifestations of physical or verbal violence. Of the PGs interviewed, a large majority (80%) has been pawed by customers in the pubs where they worked. More than a quarter of this group said it happened every day. In addition, many women (60%) received occasional threats of violence from a customer when they did not do what he wanted. It did not stop with threats. More than half the women said they had been physically abused by pub or restaurant customers (17% reported that this occurred

[2] Hawkins (15 June 2005) See: http://www.camnet.com.kh/cambodia.daily/selected_features/cd-15-6-05.htm (last viewed 26 Oct. 2009). In addition, even before May 2005 several other articles based on less systematic research than CARE's showed that sexual intimidation was a substantial element of the circumstances in which PGs work in Cambodia. See ActionAid, 'Hand in my Pant: The Life of a Beer Promotion Girl in Phnom Penh (ActionAid 2003) on http://www.actionaid.org/asia/337_5_31.html (1 Aug. 2005). However, the best-known critic, Ian Lubek, still emphasised HIV/AIDS in early 2005. 2005). See: http://www.fairtradebeer.com/reportfiles/Lubek2005.pdf (last viewed 29 Oct. 2009) and http://www.fairtradebeer.com/reportfiles/lubekheineken2004.rtf (last viewed 26 Oct. 2009).

[3] All the data in this section are taken from Bury (2005). See http://www.fairtradebeer.com/reportfiles/CARE/louiseburyCARE2005.pdf (last viewed 24 Oct. 2009).

[4] See also the ILO's description at http://www.ilo.org/public/english/employment/gems/eeo/tu/cha_4.htm (1 Aug. 2005).

daily), and nearly one in three of all those interviewed occasionally required medical treatment as a result of work-time abuse.

According to CARE, beer promotion is a dangerous activity. This is not a matter of being beaten or treated roughly. A considerable portion (38%) of those questioned stated that customers in the pubs or restaurants where they worked had occasionally forced them to engage in sexual acts or had raped them (the study made no distinction between these two). Nearly 4% of all those questioned had undergone this more than 10 times.

The owners of the pubs and restaurants where the PGs work can hardly be called supportive. More than a third (37%) of the respondents had been forced by the owner to be more intimate or friendly with a customer than they wanted to be. Fifteen percent of respondents reported that the location owner tried to force women to engage in sex with customers. A portion (17%) of the PGs who reported needing medical treatment said that they were abused by the owner or his/her staff. In some cases, their own organisation – not the pub or restaurant but the distribution company – was directly involved in the abuse. Eight percent of respondents reported that colleagues (managers, salesmen, drivers, etc.) had forced them to have sex.

CARE notes that in many cases the wage structure probably contributes to the GPs weak position vis-à-vis aggressive customers. Three quarters of the PGs in the study work on commission. Their wage is totally dependent on their sales. This system increases the customer's hold over a PG. The product subject to the promotion, beer, is also a large part of the problem. Not only may we assume that a customer's aggression increases in proportion to his alcohol consumption, it appears that nearly all PGs also drink beer during working hours. A quarter drinks more than five cans or bottles per evening. The women interviewed report that the reason for their beer consumption was that customers forced them to drink or that they did so to sell more beer. According to the study, PGs' alcohol consumption results in behaviour toward the customers that is more intimate and less prudent than otherwise.

The expressiveness of the figures in the study is heightened by the fact that many of the women questioned were but recently employed as PGs. Nearly half of those questioned had been working less than 6 months. The study showed that the employer or length of service as PG made no difference in the intensity or gravity of the sexual harassment and abuse. Although pubs (beer gardens and karaoke bars) are more dangerous than restaurants, sexual harassment occurs everywhere where PGs work.[5]

[5] For the rest, CARE advises against using the terms promotion girls and indirect/direct sex work. They contribute to the public's negative image of PGs and further downgrade an already weak position. Promotion women is preferable. Bury (2005). See

Local Standards

The CARE study's findings provide evidence of a social problem. First, it is important that CARE's researchers focused on the types of sexual harassment that the PGs considered unacceptable. The women who had undergone them considered all the investigated types of sexual harassment undesirable. Second, CARE also studied the most pertinent Cambodian legislation.[6] Unlike rape or attempted rape, unwelcome sexual advances are punishable by 1–3 years imprisonment. When these advances are accompanied by violence or threats, the punishment is doubled. Rape and attempted rape are prohibited on pain of 10–20 years imprisonment. Cambodian law thus clearly prohibits the kind of sexual harassment and sexual violence that many PGs experience at work.[7]

Cambodian labour law also forbids all types of sexual harassment at work. According to this law, "all employers and managers of establishments in which child labourers or apprentices less than 18 years of age or women work, must watch over their good behaviour and maintain their decency before public".[8] So the beer distributor is not alone. The owner or manager of the pub or restaurant where the PGs work are obliged to see to it that the women are not exposed to sexual harassment.

In practice, this legal protection is meaningless for the promotion girls. Laws do exist but few people know about them, and faith in the judiciary system is almost non-existent. According to CARE, "Reporting a serious matter [to the police or their employer] is not even an option in the eyes of most BPs [beer promotion women], and even to report an incident to an outlet manager is not encouraged for fear of reprisal [by the owner of their workplace]".[9]

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http://www.fairtradebeer.com/reportfiles/CARE/louiseburyCARE2005.pdf (last viewed 24 Oct. 2009).

[6] Bury (2005), Annex 2. See http://www.fairtradebeer.com/reportfiles/CARE/louiseburyCARE2005.pdf (last viewed 24 Oct. 2009).

[7] Licadho (2004), 7. See http://www.licadho-cambodia.org/reports/files/48Rape%20briefing%20report%202003%20English.pdf (last viewed 24 Oct. 2009).

[8] http://www.cchr-cambodia.org/Laws/English/LaborLaw.htm (28 July 2005).

[9] Bury (2005), 51–52. See http://www.fairtradebeer.com/reportfiles/CARE/louiseburyCARE2005.pdf (last viewed 24 Oct. 2009).

Impact on the Case

CARE's report does not mention the names of the beer producers, but does say that the abuses documented apply to the entire beer promotion industry in Cambodia. However, two earlier CARE studies were based solely on data about PGs who worked for Heineken partners CBL and Attwood.[10] Although these two studies were primarily aimed at PGs' attitude toward HIV/AIDS, they also collected data on safety at work. According to CARE, these show that the women considered harassment and violence a more serious problem than HIV infection (Quinn 2003).[11] Data from these earlier studies support the more recent CARE report and show that working conditions at Attwood and CBL are no different than elsewhere in the industry.

CARE believes that brewers as well as other parties (including the Cambodian government) have a role to play in improving working conditions. It has addressed recommendations to brewers and their distributors.[12] There will have to be a code of behaviour toward PGs that penalises pubs and restaurants that abuse these women. International companies should ensure that their local partners comply with local and international standards. Brewers and distributors should provide a training programme aimed at combating sexual harassment. These parties would have to investigate others channels for beer promotion.

As follow-up to the information already given on Heineken's organisational relation to the way beer is distributed in Cambodia, we note that Heineken has broad experience with the Cambodian beer market. Heineken opened a representative office in Cambodia in 1993, shortly after the arrival of the UN troops that put an end to the political chaos in the country (Gersdorf 1994). Construction of CBL's brewery was the first major foreign investment to which the Cambodian Investment Board granted approval (1994) (Christern 1997). This brewery – the first to brew international brands in Cambodia – commenced operation in 1996. Upon its establishment, CBL took over distribution operations from

[10] Care Cambodia (2003). See http://www.fairtradebeer.com/reportfiles/CARE/ingridquinnCARE2003.pdf (last viewed 24 Oct. 2009). Klinker (2005). See http://www.fairtradebeer.com/reportfiles/CARE/CAREendlinereport2005.pdf (last viewed 24 Oct. 2009).

[11] See also http://www.fairtradebeer.com/reportfiles/CARE/ingridquinnCARE2003.pdf (last viewed 24 Oct. 2009).

[12] Bury (2005), 13 and 62–64. See http://www.fairtradebeer.com/reportfiles/CARE/louiseburyCARE2005.pdf (last viewed 24 Oct. 2009).

Progress Import and Export Ltd (PIE), a Cambodian company that had formerly distributed Tiger beer (Algemeen Dagblad 1994).[13] Heineken's long presence in Cambodia is pertinent because CARE's report clearly shows that the issues concerning PGs are work-related – sometimes even the distributors' male employees are involved. This is not out of the distributors' sight as was assumed to be the case for the HIV/AIDS issue. Apart from that, the fact that pub and restaurant customers sometimes force PGs to engage in sex shows that the HIV/AIDS issue is not a totally after-hours matter.

CARE's report on sexual harassment and abuse, now available on internet, had not been published directly upon release, although it was distributed among concerned parties, including Heineken. Although CARE financed its own research and concomitant thorough and extensive report it was not clear at the time why the report was not published.

Finally

By the summer of 2005 Heineken's PG policy, made public in 2004, had brought about no visible improvement. The reasons that the company gave in 2004 for drafting a worldwide PG policy concerned the co-responsibility it felt for the risks of HIV infection that the PGs ran.[14] One consequence is that while this policy aimed at reducing risks, it did nothing to crack down on sexual harassment and abuse. CARE drew Heineken's attention to these abuses in the PGs' working conditions in 2005. Thus far, no protestors have set up public campaigns or made specific demands of Heineken. However, there is no reason to expect that the negative attention generated earlier on the HIV/AIDS issue could not flare up once again by the work-related sexual harassment of and violence against PGs.

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[13] PIE bought a 20% stake in CBL, the remaining 80% went to APB.

[14] Heineken International (2004), 2. See also http://www.heinekeninternational.com/selling_beer_safely.aspx and http://fairtradebeer.com/reportfiles/heinekenaidspolicy2002.pdf (both last viewed 26 Oct. 2009).

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Chapter 7
A Disputed Contract: IHC Caland in Burma

Frank G.A. de Bakker and Frank den Hond

Abstract IHC Caland designed, built and operated material, ships and complete systems for offshore oil and gas, dredging and shipping industries. The relatively strong economic growth in Southeast Asia offered opportunities for IHC Caland and other specialised suppliers. In the summer of 1998, an IHC Caland subsidiary contracted for an offshore project in Burma's territorial waters. The order was for several hundreds of millions euros, hence of considerable interest to the company. The contract led to public stir because it involved work in a country controversial for its human rights situation. Many human rights, environmental and union organisations expressed their outrage and tried to move IHC Caland to cancel the contract. A controversy was born. It took IHC Caland long resisted the claims made by the NGOs. It maintained that the morality of commercial agents is limited to abiding with all legal laws and regulations. It therefore argued that it had not committed any moral wrong and was allowed to do business with the Burma government.

In the summer of 1998, an IHC Caland subsidiary contracted for an offshore project in Burma's territorial waters.[1] The order was for several hundreds of millions euros, hence of considerable interest to the company. The contract led to public stir because it involved work in a country controversial

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[1] This chapter uses the name "Burma". The military government has since changed the country's name to Myanmar, but dissidents continue to use Burma; (Myanmar) or Myanmar (Burma). We chose Burma for ease of reading.

W. Dubbink et al. (eds.), *European Business Ethics Casebook*,
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for its human rights situation. Many human rights, environmental and trade union organisations expressed their outrage and tried to move IHC Caland to cancel the contract. A controversy was born. At the time of the contract Burma seemed to have become inextricably associated with the name "IHC Caland". Finally, in the summer of 2003, the Dutch Trade Union Federation (FNV) and the Christian Trade Union Federation (CNV) reached a compromise with IHC Caland regarding its operations in Burma. Nevertheless, the two trade unions and other players in the controversy stressed that they preferred to see the company leave Burma.

Before discussing the company's motives and the responses to them, we will first present a brief description of the situation in Burma and of the company in question. After that we will devote a few sections to the course of the controversy, focussing explicitly on the various arguments presented by the parties to the conflict and to compromise ultimately achieved.[2]

The Situation in Burma

Burma is situated in Southeast Asia. The country borders on India, Bangladesh, China, Thailand and Laos. It is home to more than 52 million people divided over 135 different population groups. The country is rich in natural resources and has a long history. The Union of Burma gained its independence from Great Britain in 1948. The country was governed as a Western-style parliamentary democracy (Zarni 2000). Although after the Second World War Burma was considered one of the non-aligned countries with the best chances for development and growth, by 1987 it had become the UN's "least developed country". In the interval, General Ne Win had put aside the civilian government (1962) after which (1974) the country was transformed into a socialist, one-party state under the Burma Socialist Programme Party (BSPP). Ne Win sealed the country off hermetically from the outside world; the Burmese population was as good as forbidden to travel abroad and visas for foreigners were either refused or restricted to a brief period. Ne Win stayed in power for 26 years, partly as the result of

[2] This chapter uses newspaper articles, press releases, annual reports and other documents to sketch developments relating to IHC Caland's operations in Burma. In addition, we used conversations with Peter Ras, coordinator of Burma Centrum Nederland (BCN) and Jeremy Woodrum, a campaign leader in the US Campaign for Burma. We improved the factual accounts in the text using IHC Caland's and BCN's comments to earlier versions of this chapter. To aid readability, in this chapter we did not refer to each individual newspaper article. A fully annotated version of this chapter can be requested from the authors.

a highly centralised economic policy, military might and extreme repression by military intelligence and other services (Spit 1995).

Social and political unrest grew in the spring of 1988 and culminated in massive strikes that summer. Protestors demanded economic and democratic reforms. The army crushed the rebellion by force (Ferrara 2003). After the summer, Ne Win withdrew and there was a partial change of government. The new government proclaimed martial law and adopted a new name: State Law and Order Restoration Council (SLORC). Summer saw the birth of a liberation movement, the National League for Democracy (NLD). Aung San Suu Kyi, daughter of one of the heroes of the struggle for independence against the British, returned from abroad to become leader of the NLD. In 1989 the military regime changed the country's name to the Union of Myanmar and opened the country to foreign investment in an attempt to deregulate the Burmese economy and attract more foreign currency. But the authoritarian stranglehold on the population did not diminish (Zarni 2000). Amnesty International (AI), Human Rights Watch (HRW) and other organisations regularly drew attention to the military regime's many flagrant and systematic human rights violations that were aimed especially against ethnic minorities.

In 1990, SLORC organised free elections in which several parties participated. The NLD, led by Aung San Suu Kyi, who had been placed under house arrest well before 1989, gained 62% of the votes, good for more than 80% of the parliamentary seats. However, the SLORC refused to acknowledge the NLD's victory. In 1991, Suu Kyi was awarded the Nobel Peace Prize for her years of non-violent struggle. She was released from house arrest in 1995, but it was reimposed from 2000 to 2002. She was arrested once again in 2003 and held in secret detention for more than 3 months before being returned to house arrest. The house arrest continues today (2010), this in clear violation of international and Burmese law.

Calls for a Boycott

Although the events in 1988 and 1989 received relatively little attention in the Western media, groups of activists in Burma, Thailand and the United States exchanged information, maintained a political lobby and worked for democracy. From this grew several online list servers with news on Burma. The best known is BurmaNet, set up in 1994 with support from the Open Society Institute. The first calls for a boycott were heard in the early 1990s:

> By the time BurmaNet was created, there was already a small number of individuals, primarily in the United States, Thailand, and Canada, who were advocating consumer boycotts and were engaged in shareholder, campus and community activism against foreign investors with economic interests in Burma (Zarni 2000: 76).

In September 1995, the Free Burma Coalition (FBC) was established at the University of Wisconsin at Madison in the USA.[3] The organisation was established to combine, streamline and give strength to thus far uncoordinated information and protest actions. FBC used internet and other channels to disseminate its views widely (Danitz & Strobel 1999). Its most important objectives were:

> (1) to end foreign investment in Burma under the current military dictatorship through economic activism and (2) to build a genuinely grassroots international Free Burma movement in support of Burma's freedom struggle (Zarni 2000: 78).

Suu Kyi adopted the call for a boycott. From the mid 1990s, she regularly called upon foreign companies to withdraw from Burma.[4] Her appeal gained worldwide attention. Thanks to the FBC and others a dozen multinational companies decided over a relatively brief period to withdraw from Burma. In the US, nearly 20 communities and the Commonwealth of Massachusetts adopted regulations that deterred or forbid companies from having anything to do with Burma. In May 1997, US President Clinton prohibited new investment in Burma. The campaign's impact probably benefitted from the momentum that accompanied the release of Suu Kyi in 1995, 2 months before the FBC was established (Zarni 2000).

FBC and other organisations saw investment in and trade with Burma as support for the military regime. Because foreign companies could only invest in the company through the military junta, part of the yield would accrue to the junta directly or indirectly through taxes. The junta could use these resources to strengthen its position. On IHC Caland's contract, *Burma Centrum Nederland* (Dutch Burma Centre BCN) noted:

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[3] There are similar specialised protest groups in other countries (http://www.freeburma.org, last viewed on 20th February 2010).

[4] See the French website *Info-Birmanie* (http://www.info-birmanie.org/birmanie/rep.htm, last viewed on 9 December 2004) or Suu Kyi's interview for the European Parliament in which she says "Now is not yet the time for investment. It is more important that there is the right social and political climate which will ensure the right structural changes that are necessary for good economic recovery and sustained development. Until then I think investment is too early". (http://www.tni.org/archives/vervest/burma.htm, last viewed on 9 December 2004).

> IHC Caland paid taxes to the Burmese junta through various channels, including local taxes, income tax for its own staff and tax on operational costs. In doing so the company supported the actions of the Burmese military regime.[5]

Most protest groups chose an approach that focused on the political and humanitarian situation in the country. Protest groups explained companies' economic activities as political acts.

Partly in response to Aung San Suu Kyi's call, many protest groups and organisations – often united in coalitions – put companies around the world under pressure not to invest in Burma or to halt their operations in that country (Shaw 2004; Spar & La Mure 2003; Vergouw & den Hond 2000). Persistent criticism from protest groups led a few dozen companies to decide to withdraw from the country. They include Heineken (June 1996), Interbrew (October 1996), Philips Electronics (November 1996), PepsiCo (January 1997), Hewlett-Packard (November 1996) and Ericsson (September 1998).[6] Other companies had left Burma earlier. Among them were Levi-Strauss (June 1992), PetroCanada (November 1992) and Amoco (March 1994). The companies offered differing explanations for their actions. Some pointed directly or indirectly to protest threats, others spoke of a shift in priorities. Examples are: preventing reputational loss (Levi-Strauss) or pressure from local groups like the Chicago Coalition for a Democratic Burma and the Coalition for Corporate Withdrawal from Burma. Sometimes, companies invoked the protest groups' arguments. Levi-Strauss, for instance, stated in 1992 that

> under current circumstances, it is not possible to do business in Myanmar without directly supporting the military government and its pervasive violations of human rights.[7]

In the Netherlands, too, the 1990s witnessed protests against new investment in Burma. Heineken's decision to withdraw from the construction of a new brewery and to halt exports to Burma was partly due to protests and the threat of a consumer boycott in the Netherlands and the US (Vergouw & Den Hond 2000). Furthermore, in 1997, the Dutch Labour Party (PvdA), the Dutch Socialist Party (SP), the European Parliament Green Party, and the Dutch trade unions FNV and CNV signed an appeal to the business community to

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[5] http://www.xs4all.nl/~bcn/campagne-ihc.html, last viewed on 26 November 2004.

[6] For a survey of companies that have left Burma, see the Canadian Friends of Burma (CFOB) website (http://www.cfob.org/CorpComplicity/CorpComplicity.shtml) and *The Irrawaddy Online* (vol. 12, no. 9) (http://www.irrawaddy.org/aviewer.asp?a=457&z=14, both last viewed on 14 December 2004).

[7] See http://perc.ca/PEN/1994-03/s-freeman.html, last viewed on 2 March 2005.

withdraw from Burma. So, the commotion around IHC Caland's contract did not fall out of the blue. Still, the company seemed surprised at the vehemence of the criticism, as we will see further on. This controversy lasted longer than the protests against Heineken's presence in Burma. One important reason can be that IHC Caland could not be hard hit by a consumer boycott. It supplied the offshore oil and gas industry, rather than the consumer market (Vergouw & den Hond 2000).

IHC Caland

IHC Caland NV was the public holding company of a group of companies that "design and supply tools, ships, complete systems and services to the offshore oil, dredging, shipping and undersea mining industries around the world".[8] IHC stands for *Industriële Handels Combinatie* or Industrial Trade Combine. The company was founded on a cooperation agreement that several Dutch shipyards entered into in 1943. This agreement was concluded in the expectation that together they would be able to accept large orders from Billiton when the Second World War was over. The companies in the combine merged in 1965. The merger was first of all a financial merger, in which the participating companies continued to operate under their own names, but organisational cooperation gradually increased and more companies were added. Finally, the various subsidiaries joined together to form IHC Caland holding company. The company has been listed since 1965 and has been part of the AEX index since 2003.

At the close of 2003, the company was good 4,100 jobs; its six subsidiaries operated in 29 countries. At that time its activities were spread over its offshore oil and gas operations and dredger-shipbuilding divisions. In its 2003 annual report, IHC Caland claimed to be worldwide market leader in most of its niche markets. Tables 7.1, 7.2, and 7.3 show that offshore operations are more systematically profitable than shipbuilding. For that reason, the company announced in August 2003 that it was examining several options for splitting the concern. Shipbuilding operations could be sold, or they could be floated in a separate company. In 2004 IHC Caland split its shipbuilding from its dredging operations. In 2005, after the sale of its shipbuilding operations, IHC Caland continued operating under the name SBM N.V., already in use for its offshore division.

[8] IHC Caland. Press release, 5 August 2004 (www.ihccaland.nl/html/News/05aug04.htm, last viewed on 1 December 2004).

Table 7.1 Nett annual turnover, in millions

	1996	1997	1998	1998	1999	2000	2001	2002	2003
Nett turnover				Euro					USD
Dredging and Shipbuilding	305	367	337	336	679	555	653	566	569
Off-shore	387	261	311	311	550	273	312	364	1.280
Total	692	628	648	647	1.229	828	965	930	1.849

Source: Annual Reports IHC Caland 1993–2003

Table 7.2 Annual profit in millions

	1996	1997	1998	1998	1999	2000	2001	2002	2003
Profit				Euro					USD
Dredging and Shipbuilding	12.4	13.2	30.3	30.3	34.9	32.3	20.7	−50.0	−81.7
Off-shore	30.9	54.7	55.1	55.0	56.2	71.8	97.6	130.0	148.8
Total	43.3	67.9	85.4	82.7	85.7	99.7	113.8	74.8	64.4

The contribution of the Holding are taken into account in the total profit calculations.
The contribution of the holding company to total results is not mentioned separately in Table 7.2 but is included in the total result.
Source: Annual Reports IHC Caland)

Table 7.3 Annual total number of employees, per 31 December

	1996	1997	1998	1999	2000	2001	2002	2003
Dredging and Shipbuilding	n.a.	2.066	2.130	2.589	2.706	2.789	2.775	2.289
Off-shore	n.a.	779	809	890	855	1.237	1.542	1.838
Total	2.004	2.845	2.939	3.479	3.561	4.026	4.338	4.148

The employees of the Holding are included in the totals.
The number of employees working for the holding company is not mentioned separately in Table 7.3 but is included in the total number of employees.
Source: Annual Reports IHC Caland

The Contract

On 13 July 1998, IHC Caland announced that its Swiss subsidiary SBM Production Contractors signed a contract with Premier Petroleum Myanmar Ltd., a British-Burmese joint venture that is partly owned by British Premier

Oil. The contract was for the construction, lease and maintenance of a floating storage and off-loading system (FSO) for development of the Yetagun gas field, 180 km off the coast of southern Burma in the Andaman Sea. FSO systems are moored permanently above or near offshore oil and gas fields to receive and temporarily store oil and gas for transfer to tankers for transport to purchasers. High prices make oil and gas extraction in deeper waters profitable, so the demand for such capital-intensive systems was expected to increase as oil prices rise. The installation was planned to be in operation by the end of 1999. The immense contract was intended to run for 15 years and would reach several hundred million euros. In a first response to this, and a few other orders in Vietnam and China, Dutch financial newspaper *Het Financieele Dagblad* wrote:

> The Asian crisis seems to have had little impact on IHC Caland (new-build dredging ships and oil platforms). (Het Financieele Dagblad 1998a)

Premier Oil acquired the gas field from US company Texaco because this company could no longer operate it after the US government forbade new investment in Burma in May 1997.[9] Officially, Texaco withdrew after an asset review, but it is generally assumed that political pressure in the US and a desire to polish the company's image were important factors (Knott 1997). Other partners in the operation of the field were Malaysian Petronas, Japanese Nippon Oil, Thai PTT-EP and the Burmese government-owned company MOGE (Myanmar Oil and Gas Enterprises).

Commotion

Because it involved economic activities in Burma, the contract elicited a storm of protest in the media. Burma Centrum Nederland (Dutch Burma Centre BCN), Amnesty International, XminY Solidarity Fund, Novib (Oxfam Netherlands), and the trade unions FNV and CNV expressed surprise and outrage at the delivery because it indirectly supported the military junta's oppression of the Burmese people. Foreign currency from the Yetagun project would be an important buttress for Burma's weak economy and so, claimed BCN's spokesman, European money would be perpetuating the Burmese regime.

> The income ends up with the generals, not the population. (NRC Handelsblad 1998a)

[9] This boycott struck several US oil companies; Spar & La Mure (2003) described the conflict between Unocal and the US Free Burma Coalition. See also *Trouw* (1998).

Moreover, protest groups pointed out that other companies were just leaving Burma. In addition, Friends of the Earth Netherlands drew attention to alleged problems with the installation of the adjoining land-based infrastructure. A pipeline, some 60 km long was being laid right through the tropical rain forest. The construction of the pipeline would have an adverse effect on biodiversity; villages would be forced to move and the construction would use forced labour.[10] IHC Caland repeatedly stated that it dealt only with offshore infrastructure and not with whatever may be taking place on land. IHC Caland's CEO noted repeatedly:

> We are far away at sea. (Het Financieele Dagblad 1998b)

BCN – one of the main Dutch players in the protest against the presence of IHC Caland in Burma – is a foundation whose goal is to inform Dutch society on developments in Burma and to instigate and coordinate activities that promote democracy and sustainable development in Burma. In addition, the centre seeks to contribute to a constructive dialogue between the various factions in Burma.[11]

After various tarde unions, development and environmental organisations set up regular discussions on the situation in Burma, BCN was established in the early 1990s to satisfy the need for systematic action in response to the Burmese opposition's call to support all activities that would benefit democracy in Burma. With financial support from Novib and the Open Society Institute, BCN set up and coordinated activities intended to promote democracy and sustainable development in Burma. To achieve these goals, BCN zealously advocated democracy and human rights; it informed the public about the situation in Burma via consumer campaigns; it tried to exert pressure via campaigns against European companies; and it lobbied the European Union and the Dutch government to adopt economic sanctions against Burma.

Other important players were Friends of the Earth Netherlands (Milieudefensie), the trade unions FNV and CNV, XminY Solidarity Fund and the Dutch Socialist Party (SP). Most of these organisations were

[10] Friends of the Earth Netherlands, "IHC Caland doet nog steeds zaken met Birma" (http://www.milieudefensie.nl/earthalarm/alarm77birma.htm, last viewed on 9 December 2004). See also *The Independent* (2000). Similar discussions were held earlier about laying a gas pipeline for another large gas field, the Yadana field; see *The Financial Post* (1996).

[11] Burma Centrum Nederland (http://www.xs4all.nl/~bcn/, last viewed on 26 November 2004).

co-founders of BCN and as such aware of and involved in BCN's activities. But they also sought individual publicity in some campaigns. These organisations are BCN's main support base.

The storm also raged in political circles. A majority of the members of the House of Representatives indicated that the government should set guidelines that hinder companies from doing business with controversial regimes. The European Parliament had scheduled a debate on Burma for the same week that the order was announced. The leader of the Dutch Christian Democratic Party (CDA) stated in Brussels that "Respectable companies no longer invest in Burma". (NRC Handelsblad 1998b). But just at that moment France vetoed a European prohibition against investment in Burma.

Jan-Diederick Bax, then CEO at IHC Caland, said he did not understand the vehement commotion around the contract. He stated in *Het Financieele Dagblad* that gas extraction took place far off the Burmese coast so that the company had nothing to do with internal political problems.

> We're not doing anything illegal. Neither the Dutch government nor the Lower House has forbidden investment in Myanmar. So why shouldn't we do it? (Het Financieele Dagblad 1998b)

At the same time, Bax said that the decision would have been different had it involved inland investment in Burma. He called the contract a normal business agreement, one floating storage site like many that IHC Caland operates.

> We have nine such installations in Brazil, Congo, Vietnam and elsewhere. As of next year there will be one in Myanmar. (Het Financieele Dagblad 1998b)

After that, Bax invoked the fierce competition in the industry as argument. If he did not carry out the contract, Bax would fail to do his duty as CEO, i.e. to earn money for the company's shareholders. The company repeated these arguments regularly.

IHC Caland's deal remained prominent in the news. On 17 July 1998, in an interview in *Het Financieele Dagblad*, Bax reported that Dutch banks did not want to finance this specific contract because they considered the political risk too high. Moreover, they claimed to be afraid that such financing could harm their interests in the US because of its 1997 prohibition against new investment. In the same interview, Bax said that he was overwhelmed by all the commotion around the order.

> We have to see everything in its correct proportions. What good will it do me to start acting proud here in Schiedam. That would have no impact at all. Someone else would just step in and do the project. (Het Financieele Dagblad 1998c)

In a discussion with two PvdA Representatives and a director of FNV, Bax indicated several days later that he was willing to talk about the company's setting up its own code of conduct. He stressed, however, that this code would not address the issue of with which countries IHC Caland may do business; as far as he was concerned the company would follow the Dutch government's guidelines. (Het Financieele Dagblad 1998d)

On 4 August 1998, the trade unions, BCN, XminY Solidarity Fund and Novib met with IHC Caland's management. The discussion proved fruitless. BCN wanted the order cancelled but that was out of the question for IHC Caland.

> They repeated their position, we ours,

according to Bax, who had already spoken with PvdA MPs and was scheduled to meet with Amnesty International.

> No one may have a say about whether we accept or reject an order, but we are willing to discuss a code of conduct on human rights. We do not infringe these. (NRC Handelsblad 1998c)

After these meetings, BCN, speaking for itself and XminY, announced in an op-ed article in the 8 August issue of *Het Financieele Dagblad* that a range of actions would be undertaken. The groups wanted to approach IHC Caland's employees via the unions as well as contacting the board of directors, the council of supervisors and the larger shareholders. In addition, the groups planned to purchase one share in IHC Caland to obtain a right to address the shareholders' meeting. They also made preparations for public protests. Later that month, the Dutch government announced in a letter responding to various questions from MPs that it would investigate possible economic sanctions against Burma. Such sanctions would have to be imposed as part of a broader European campaign.

When IHC Caland announced its mid-year figures on 24 August 1998, BCN held a protest action at the entrance to IHC Caland's headquarters in Schiedam. Three bloodied "victims" of the regime in Burma lay there. Because this protest action had been announced in advance, the meeting drew much media attention. During the meeting, Bax stressed that he was unable and unwilling to withdraw from a contract that had already been signed, even when the Dutch government should announce a boycott.

> If we break this contract, we will get a bad reputation. We do not do such things. (Het Parool 1998)

During the same meeting, Bax said he received no comment on the contract from the company:

> I didn't hear a word of concern from a single employee, shareholder or supervisor. They understand how we work (Het Parool 1998)

At the same time, Bax also stated that the situation would be different if IHC Caland's operations were to require dealing with the public.

> Like Heineken, then matters would be different. But we work business-to-business. And in our network it's just not an issue. (Het Financieele Dagblad 1998e)

A month later, the Dutch government indicated in response to MPs questions that it disapproved of IHC Caland's investment in Burma but that there were no juridical grounds for taking steps against individual companies at that time.

At that point the controversy disappeared from the media, although "the IHC-Burma question" was cited regularly in relation to investment. On 7 October 1998, for instance, the company had a meeting with the Dutch Association of Investors for Sustainable Development (VBDO) on the risks to investors of investing in Burma. Other publications on sustainable investment and discussions on corporate social responsibility generally often referred to IHC Caland's disputed contract in Burma.

Toward a Code of Conduct

In April 1999, Bax announced that IHC Caland was working on a code of conduct but that it would probably not be presented at the next shareholders' meeting. Drafting a code is labour intensive, Bax noted. ABP pension fund, owner of a few percent of the share capital demanded that the company draft such a code. The Dutch ABN-AMRO Fund also let it be known that it was not happy with the contract in Burma. Nevertheless, Bax stressed that none of the major shareholders disinvested in the company after it accepted the order from Burma. Just before the annual meeting, it was announced that IHC Caland would, indeed, not be presenting a code of conduct on human rights. CEO Bax said that he preferred to wait for draft texts from the EU or the Ministry of Economic Affairs. During the shareholders' meeting, ABP appeared willing to give the company more time. Bax resigned as CEO during this annual meeting. Aad de Ruyter took his place.

Chairman of the supervisory board Langman announced on behalf of IHC Caland that the company would present a code of conduct that same year. However, Langman added that the company did not intend to act differently in similar circumstances unless it would risk government sanctions:

> If we should again find ourselves in such a situation, we would again accept the order. We work in many countries that infringe human rights. We do not think that we should act more circumspect when the government does not forbid investment in these countries. (Het Financieele Dagblad 1999)

After the meeting, an ABP director said he was satisfied with the promise:

> We prefer that they take their time for this difficult task than that they make hasty decisions. (De Telegraaf 1999)

However, a policy officer at FNV wrote in June 1999:

> IHC Caland is using its willingness to develop a code to stave off discussion on investing in Burma and on being an accessory to serious human rights violations (van Wezel 1999: 58).

Directly related to ABP's concern, CNV chairman Terpstra referred a few months later to pension funds' social responsibility; he presented an investment code for pension fund managers containing guidelines for how pension funds should handle their social responsibility. This code is based in part on International Labour Organisation (ILO) guidelines. The two trade unions have seats on the boards of many pension funds, including ABP.

A Second Contract and a Code

By the end of 1999, IHC Caland was again in discredit when it became known that the company had accepted a second order from Burma. Although this was a much smaller order – for delivery of a dredging ship – again commotion arose. In response to parliamentary questions to the Minister of Foreign Affairs, the new CEO De Ruyter said that the board of IHC Caland had never spent as much time discussing any other order as it did this one. However, there were no international rules; for that reason IHC Caland again requested a clear governmental guideline. BCN also rejected this order, since the ship would be purchased directly by the military regime which could then improve the country's infrastructure. IHC Caland objected that a dredging ship could not be used to infringe human rights. At the same time, De Ruyter said that the promised code of conduct was nearly finished.

On a political level discussions were held on the desirability of a code of conduct. The employers association VNO-NCW opposed a national scheme because international discussions on responsible business conduct were then ongoing in the EU; they were intended to culminate in agreements. At the same time the labour party (PvdA) worked on a private member's bill that would have companies demonstrate accountability and responsibility in

their annual reports. All these discussions regularly refer to IHC Caland's controversial contract in Burma.

In May 2000, right before IHC Caland's annual meeting, ABN-AMRO, one of the largest Dutch banks, announced that it had closed the office that it had maintained in Burma since 1995 and sold its shares in IHC Caland. Although the bank denied that this was intended to express a moral judgment, it did refer in a letter to BCN to IHC Caland's investment in Burma. In the same period, Gerrit Ybema (of D66, a liberal Dutch political party), then state secretary for economic affairs, said that he wanted to discourage irresponsible social conduct on the part of the business community by withholding export and investment grants.

IHC Caland's code of conduct was officially presented at a shareholders' meeting held on 26 May 2000. Responses were mixed. The ABP pension fund pointed out that the code did not repair the reputational damage associated with investment in Burma. The pension fund wanted to reassess its ownership of IHC Caland shares. A few months later, the FNV trade union demanded in a policy document that pension funds would engage in socially responsible investment. In this regard, the trade union also raised the issue of ABP's investment in IHC Caland. In March 2001 it became known that ABP did, indeed, sell its participation in IHC Caland in 2000 because of the company's investments in Burma; toward the end of 2001 a group of large European pension funds warned companies operating in Burma that they should carefully weigh the risks of such activities. Dutch pension fund PGGM was one of that warning letter's signatories. Together, the signatories represented a large percentage of the capital, which added weight to their warning.

Escalation and "a Different Tone"

De Ruyter resigned as CEO at the shareholders' meeting held 26 May 2000; it is rumoured that this was due to a difference of opinion on the company's strategic direction. Sjef van Dooremalen succeeded him. When Van Dooremalen, in his turn, left in August 2004, *Het Financieele Dagblad* reported that he had played an important role in discussions on IHC Caland's activities in Burma; this was not so much the result of a new direction for the company, but

> because he adopted a different tone from his predecessors, Van Dooremalen was able to blunt the edge of the conflict. (Het Financieele Dagblad 2004a)

However, an escalation had preceded this "different tone".

In June 2000, ministers of OECD member countries agreed on a revision of the *Guidelines for Multinational Enterprises*. These guidelines are a collection of voluntary rules of behaviour for multinational companies. OECD member states drafted a first version in 1976 as part of the *OECD Declaration and Decisions on International Investment and Multinational Enterprises*. The guidelines contain recommendations relating to labour relations, consumer protection and combating bribery, but also on human rights and environmental protection. The Dutch government recommended the OECD guidelines to the business community and planned to use these guidelines as criteria in allocating grants. Responses were mixed. Employer's organisation VNO-NCW is not at all interested in national agreements because in their view only international agreements could guarantee that Dutch companies would be able to compete on a level playing field, while various NGOs preferred to see the guidelines made universally binding on the entire business community. According to van Luijk (2000), however, the new OECD guidelines were a major step forward toward doing international business responsibly. One element in the OECD agreement is the chance to submit a complaint to a national contact point (NCP). There are no sanctions attached to this complaints procedure beyond the publication of whatever contraventions may occur, although unions and other stakeholders hope that an NCP decision will provide grounds for legal action. At the end of 2001, FNV and CNV trade unions announced that they had submitted a complaint to the NCP that summer against IHC Caland on the grounds that the company contributed to the prolongation of the military regime in Burma. The complaints procedure would be rounded off in the summer of 2004.

2002 was a turbulent year in the controversy; pressure on IHC Caland increased. In early 2002, another large company left Burma partly as a result of actions by BCN, Novib, the Clean Clothes Campaign (CCC) and trade union FNV. Triumph, a large Swiss lingerie producer left Burma

> because of the public discussion in Europe. (NRC Handelsblad 2002)

In a new series of actions, BCN called upon 89 Dutch provinces, municipalities and companies not to award contracts for dredging ports to IHC Caland, stressing that IHC Caland is one of the last Dutch companies still involved in economic activities in Burma. In April 2002, Friends of the Earth Netherlands sprayed IHC Caland's headquarters with 6,000 l of (ecological) dredged mud to draw attention to

> the filthy business that this company does. (Rotterdams Dagblad 2002)

Van Dooremalen responded in an interview with the Dutch daily *De Telegraaf* at the end of March 2002. In the interview, he said that the military regime in Burma was no good, but that it was a governmental duty to demand accountability for this, especially on the part of the EU. He repeated the position that IHC Caland had long held. Still, IHC Caland slowly started to change its attitude. When it published its annual figures a few days later, Van Dooremalen announced that the company would accept no new orders in Burma, although it would not break its current contracts. Van Dooremalen said that this decision was reached at the urgent request of then state secretary of Economic Affairs, Gerrit Ybema (D66 party). BCN spoke of an empty gesture because the current contracts would be served out. In a later letter in *Het Financieele Dagblad* BCN's coordinator pointed out that the state secretary had not caused this "modest 'shift in the right direction' but that increasing social pressure had". (Het Financieele Dagblad 2002).

Despite this change of direction, the protests did not stop. For instance, Friends of the Earth Netherlands presented the results of a study on IHC Caland's financial flows; it showed that over the previous years, five Dutch financial institutions had supported IHC Caland with large long-term loans.[12] The presence of one of these institutions, NIB Capital, was striking because NIB is owned by ABP and PGGM pension funds that had earlier spoken critically about IHC Caland.[13] In May 2002, BCN responded to the report by Friends of the Earth by calling on these banks to stop extending loans to IHC Caland; in June 2002 BCN campaigned during IHC Caland's annual meeting to draw attention to Burma's being the world's largest opium producer and to the Burmese government's involvement in drugs trade via whitewashing drugs money through state-owed companies. The message to shareholders was:

> IHC Caland not only helps keep the military regime in power, it also helps the Burmese junta whitewash drugs money (BCN undated)

In September 2002, British oil company Premier Oil announced it would leave Burma and transfer its holdings there to Malaysian Petronas. Premier

[12] The banks in question are ABN-AMRO, ING, Fortis, Rabobank and NIB Capital. See also Friends of the Earth Netherlands, "Bagger Rapport Birma" (http://www.milieudefensie.nl/globalisering/publicaties/Bagger_Rapport_Birma_deel_voor_website.pdf, last viewed on 26 November 2004).

[13] An ABP spokesman responded with surprise, but as a shareholder he was unfamiliar with the loan from NIB Capital. The subject would be treated in ABP's next meeting with NIB Capital. (Algemeen Dagblad 2002)

Oil stated that it was a purely commercial decision, but British and international pressure groups certainly saw the departure as the result of their campaigns. Dutch pressure groups also saw Premier Oil's departure as a good occasion for IHC Caland to withdraw from Burma; after all, its contracting partner had now left. IHC Caland's Van Dooremalen announced that there was little reason for the company to change its stance toward Burma. A contract is a contract and breaking a contract would be expensive and could damage the company's reputation.

On 11 December 2002, BCN and Friends of the Earth Netherlands issued the following press release:

> many civil society organisations and most of the Dutch House of Representatives urgently request five banks to halt their support for offshore company IHC Caland.[14]

The call received support from a broad range of organisations and several companies, varying from BCN and Friends of the Earth Netherlands to Pax Christi, XminY Solidarity Fund and several political parties.[15] In addition, the ASN Bank, which took a different stand from the rest of the Dutch banking community also signed the call. In February 2003, the five banks to whom the call was addressed agreed not to finance any more of IHC Caland's Burmese projects. However, the banks did not comply with the call's request to put pressure on IHC Caland to terminate its contract in Burma. ABN-AMRO wrote that it does not normally provide information on its contacts with customers, but that it would make an exception in this case, given the gravity of the situation. In a detailed explanation, the bank noted that it respected IHC Caland's decision to serve out its contract, but it would not finance any contracts in Burma. Van Dooremalen responded by saying that ICH Caland's Burmese operations were financed by Japanese

[14] BCN and Friends of the Earth Netherlands press release, 11 December 2002. Civil society organisations and parliamentary parties asked the banks to cut off financial support for IHC Caland (http://www.milieudefensie.nl/persber/globalisering/021211.htm, last viewed on 26 November 2004).

[15] BCN, Vereniging Milieudefensie, Novib, de Stichting Interkerkelijke Organisatie voor Ontwikkelingssamenwerking (ICCO), Humanistisch Overleg Mensenrechten (HOM), Both Ends, the International Union for Conservation of Nature and Natural Resources (IUCN), Greenpeace, Justitia et Pax, Multatuli Travel, Body Shop, Pax Christi, Interkerkelijk Vredesberaad (IKV), Transnational Institute (TNI), Stichting Onderzoek Multinationale Ondernemingen (SOMO), XminY Solidarity Fund, Evert Vermeer Stichting, several parliamentary parties (CDA, VVD, PvdA, GroenLinks, D66, SP and ChristenUnie) and ASN Bank all signed the appeal (http://www.milieudefensie.nl/persber/globalisering/021211.htm, last viewed on 26 November 2004).

banks but, given that the company had already decided not to accept any new orders from Burma, he thought the banks' announcement superfluous.

Campaigns continued in early 2003. In January 2003, the Socialist Party (SP) organised an action around an informal meeting of IHC Caland shareholders at Sliedrecht shipyard. Because SP and BCN each held one share of IHC Caland, two protesters also had access to the meeting where they posed critical questions. BCN and Friends of the Earth Netherlands again protested during the presentations of IHC Caland's figures and at its meetings. Once again an appeal was launched to IHC Caland's principal bankers to have them demand that IHC Caland terminate its operations in Burma. Speaking for the company, Van Dooremalen repeated that the company would not accept any new assignments in Burma but that it would serve out its current contracts and in doing so would follow OECD guidelines. A few weeks later, Van Dooremalen announced that this new stance toward Burma had cost the company a six-million-euro contract for the construction of three dredging ships. The order went to a Chinese company.

Toward a Solution?

In the summer of 2003, IHC Caland announced that it wanted to address the human rights situation in Burma by speaking regularly to the Burmese ambassador in London (there is no Burmese embassy in the Netherlands). Calling the ambassador to account is a conscious act, flowing from a desire to comply with OECD guidelines and from talks with Dutch trade unions, BCN and Friends of the Earth Netherlands. In talks with the ambassador held on 11 June 2003, the management of IHC Caland and a representative of the trade union expressed their concern about the human rights violations in Burma, especially forced labour, and requested that their concern be passed on to the Burmese government. In the same press release, IHC Caland announced that it would ask the Malaysian oil company Petronas, which had become the new principal after Premier Oil's departure, to comply with OECD guidelines when working in Burma.

A year later, in July 2004, the trade unions' complaint, lodged in 2001 with the National Contact Point for Corporate Social Responsibility, was formally completed. FNV and CNV trade unions and IHC Caland reached a compromise on the company's economic involvement in Burma. The trade unions would check in a year's time whether the company's operations in Burma complied sufficiently with the OECD guidelines. Although the trade unions still thought that IHC Caland should withdraw from Burma, a policy staffer at FNV said that the union

> had to moderate its demands because the OECD guidelines did not offer sufficient grounds for it to demand that the company leave. (Rotterdams Dagblad 2004)

Referring to the NCP's hearing of the complaint, NGO representatives nevertheless wondered how effective OECD guidelines were, when there was no control over Dutch multinationals' compliance with these guidelines. Moreover, they point out that the OECD guidelines applied only to investments and not to trade relations and that, in addition, the guidelines were not enforceable. For these reasons they argued for making them less voluntary (Het Financieele Dagblad 2004b).[16]

Epilogue: Dialogue or Sanctions?

Meanwhile, the situation in Burma remains controversial and the call for pressure and sanctions continues. In May 2002, Suu Kyi was released from house arrest. On that occasion she stated that the NLD still opposed foreign investments, aid and tourism to Myanmar as long as the military held power; she said she hoped that dialogue with the regime on national reconciliation could now resume. In the spring of 2003, the military regime again tightened its control over Burma; in May 2003 Suu Kyi was again placed under house arrest.

After this deterioration in the situation in Burma, the Bush government decided at the end of August 2003 to impose additional economic sanctions, in part as response to the expanded lobbying by the US Campaign for Burma (USCB) and with agreement of the government in exile. The "Burmese Freedom and Democracy Act" prohibits imports from Burma, freezes the assets of the Burmese government in the US, denies entry to the US to SPDC (the State Peace and Development Council, SLORC's successor) members and offers general support to those working for freedom, democracy and peace in Burma. Congress must reconfirm the act annually. In September 2004, the European Parliament also adopted proposals for heavier sanctions against Burma because the country did not do enough to respect human rights. This measure ensured that European companies could no longer do business with Burmese state-owned companies. One important condition to which companies and political leaders regularly referred seems to have been

[16] This is an op-ed article written by a staff-member at the Centre for Research on Multinational Corporations (SOMO) and a staff member at Irene, an international organisation monitoring the strategies of international companies and employees' rights.

met. Shortly after the European decision in November 2004, the Dutch parliament adopted a motion calling for sanctions and political pressure. That motion called on the government to work for further EU measures such as prohibiting investment, prohibiting the import of teak wood, and to try to have the human rights situation in Burma placed on the agenda of the UN Security Council.

It is hardly possible to predict what turn campaigns against Western companies operating in Burma will take. Arguments presented in this discussion concentrate on weighing economy and market regulation against arguments of political morality (fostering democracy, respecting human rights). Sometimes other voices can be heard; the advantages and disadvantages of boycotts and investment in Burma have been discussed in other publications (e.g. White 2004) and newspaper articles (Financial Times 2004a).[17] Since the summer of 2003, the US Free Burma Coalition (FBC) seems to have chosen for a radically different course. In articles on its website, the organisation notes that it is no longer convinced that Western sanctions and isolating Burma are an effective way to stimulate democracy. FBC now argues for greater cooperation and openness. The background of the publications on the FBC website is not known. Jeremy Woodrum, current USCB campaign leader and former FBC staff member, explained in a telephone conversation on 4 February 2005 that the FBC imploded in 2003 after an internal conflict; all but one of the staff members left FBC and set up the USCB in September 2003 to continue their activities. Since then, FBC has fallen still. Woodrum notes that since that time the Burma movement no longer takes the FBC seriously.

In response to the question what BCN thought of the FBC's changed position, the BCN answered that the legitimacy of their pro-sanction position would dissolve were the Burmese population to turn unanimously against sanctions, but there are no indications that this will happen. BCN has had insufficient contact with FBC to be able to explain its apparent change of course, but it also says that there are still many Burma groups that do support the pro-sanction position,[18] among these are the USCB as is apparent from its leaders' letters to newspapers (Financial Times 2004b). The government in exile also continues to favour sanctions. Protests against companies operating in Burma seem not to have been suspended yet. In addition, at the end of 2004, there was a power struggle

[17] Similar discussions about the announcement of US sanctions took place in Dutch media in the summer of 2003.

[18] BCN oral communication from coordinator P. Ras (12 January 2005).

within the Burmese regime which resulted in a stronger position for the hardliners. The situation in Burma remains controversial and Western companies operating in that country continue to run the risk of being called to account.

All things considered, the Dutch parties grew closer together in 2003. IHC Caland visited the Burmese ambassador in London to discuss the human rights situation in Burma while BCN and Friends of the Earth Netherlands suspended their campaigns in anticipation of IHC Caland's next steps. The trade unions FNV and CNV will check whether the company's operations in Burma comply sufficiently with the OECD guidelines. As far as Dutch protest groups are concerned, whether IHC Caland's compromise has really warded off all commotion on its presence in Burma will depend on whether the company rides out its current course and continues to call the Burmese government and its business partners in the Yetagun project to order for their part in the human rights situation.

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Chapter 8
The ICE Train Accident Near Eschede

Michiel Brumsen

Abstract On 3 June, 1998 a serious accident occurred at Eschede involving Deutsche Bahn's (German Railway) prestigious Inter City Express (ICE) train. ICE 884, "Wilhelm Conrad Röntgen" derailed at high speed (approx 200 km/h) and hit a viaduct that then collapsed on the train. The carriages that followed zigzagged like an accordion against the collapsed viaduct. The accident resulted in 101 dead and 88 injured. It sparked the greatest rescue operation undertaken to date in post-war Germany. This train had been synonymous with safety, reliability and progress. How could the accident have happened? At first glance, this accident was an unfortunate, and perhaps hardly foreseeable, failure of a part that unexpectedly proved to be very crucial. Yet, the case can very well be analysed as a situation that could have been prevented had the technology been better organized.

Introduction

On 3 June, 1998 a serious accident occurred at Eschede involving the Deutsche Bahn's (German Railway) prestigious Inter City Express (ICE) train. This chapter investigates the causes of this accident. The direct physical cause was a steel band coming loose from a wheel, which caused the train to derail, a bridge to collapse, and the train to pile up against the bridge. At first glance, this accident was an unfortunate, and perhaps hardly foreseeable, failure of a part that unexpectedly proved to be very crucial. Yet there are real questions about whether the wheel design was well advised: two different mechanisms, one of which was already known at the time, can

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be identified which led to the wheel developing a fault. More importantly, because the wheel design was unusual, testing it for faults needed to be done using special machinery. The available testing machinery however generated too many false positives, and for this reason an unsuitable standard testing method was used. The conclusion is therefore that for all kind of organisational reasons, the system within which the wheel was used was not properly equipped to identify, prevent or repair any safety problems that could arise.

Investigation into the Cause, Initial Findings

On-site examination showed that a crossing frog originally located some distance before the place of the accident was absent. Crossing frogs are wheel guides mounted beside rails at switches, crossings and the like; their purpose is to keep the wheels on the track. This part had punctured the floor of the first carriage like a spear. Closer inspection showed that the steel tyre had become detached from one of the first carriage's wheels and was entangled in the undercarriage.

These findings led to the following reconstruction. A few kilometres, and 2 minutes, before the accident the passengers in the first carriage heard a bang. At that moment the steel tyre broke and flew off (Fig. 8.1). Afterwards, the train passed a series of frogs; the steel band tore away a crossing frog that became embedded in the train. That caused the wheels to derail. When the train passed a switch just before the viaduct, the derailed wheels moved

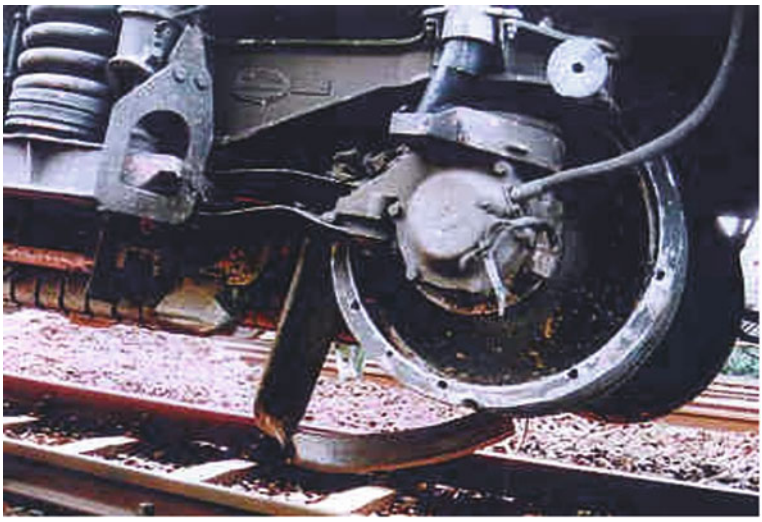

Fig. 8.1 The broken steel styre

the switch. The third carriage shot toward the adjacent track at 200 km/h. The back of this carriage hit the viaduct's pier and the viaduct collapsed on the fourth carriage. The following carriages crashed in a zigzag pattern against the collapsed viaduct. In the meantime, the locomotive had become detached from the rest of the train. This activated the automatic emergency braking system. The locomotive came to a halt two kilometres further down the line. Only then did the engine driver turn around to discover that he had lost his train. He remained seated there in shock for 2 hours until rescuers found him there.

The Wheel's Design

The design of this train's wheels was special, and most likely played a decisive role. Put more precisely: to understand the immediate technical cause of the accident we must know how the wheel is put together. It is also important to know something about alternative designs and about the technical, organisational and economic reasons for choosing this design, although we cannot always be sure of these reasons.

There is still no consensus in the literature on which mechanism actually caused the accident. It is certain that it involved a composite wheel, and not a single-piece, i.e. block-cast, wheel. The design of this composite wheel included a rubber tyre over which came the steel tyre that had contact with the rails (Fig. 8.2). The sudden tear resulting in detachment occurred in the outermost, steel tyre. This set off the fatal chain of events. The same design is used in tram wheels, but at a much lower speed.[1] Other high-speed trains use block-cast wheels. After the accident, *Deutsche Bahn* replaced its composite wheels with the block-cast wheels originally delivered with the trains.

An important principle in train transport is that the wheels' rolling resistance has to be very low; that is what makes this type of transport more energy and cost efficient than road transport. Making wheels and rails very hard and rigid contributes to this low rolling resistance. However, one drawback is that the wheel-rail interface is subjected to high material stress. Several recent train accidents can be understood as symptoms of engineers' continuous wrestling with this (Smith 2003). The basic fact of high material stress resulting from rigid materials and constructions imposes several important requirements: The rails must be laid quite flush and they must

[1] A documentary entitled "Eschede – Seconds to Disaster" – broadcast on *National Geographic Channel* – claimed that the Hannover city tram company encountered *fatigue issues* when it used dual block wheels and that it had warned the German Railway about this in 1996.

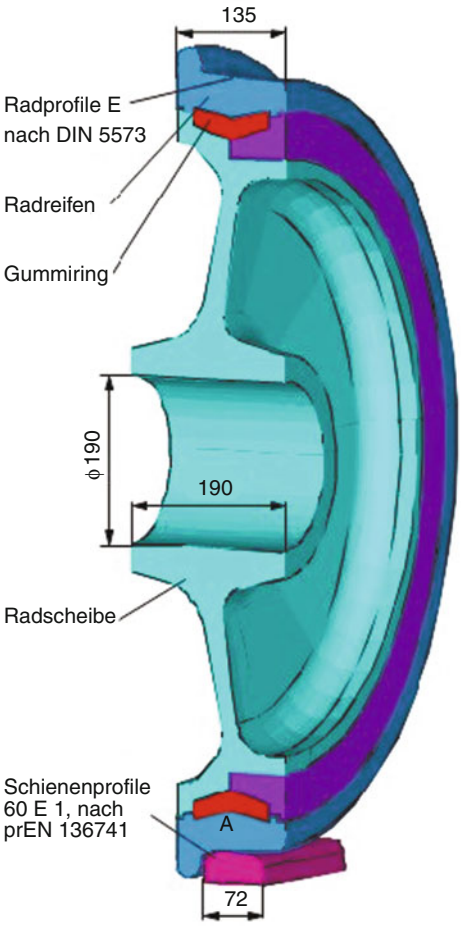

Fig. 8.2 The design of the assembled wheel (Source: Liu, 2002b)

have a regular shape. The wheels must be perfectly round. If one of these is not the case, the wheels slam hard on the rails, usually with (additional) material damage as result. Once a wheel has lost its roundness, this surface will always hit the rail with a blow, which only increases the flattening. The extent of the problem depends on other factors including the wheel's suspension; if the suspension is better it will absorb this blow so the wheel will have less to endure. The higher the speed, the greater the forces at play, and so the worse the problem.

The ICE trains had had problems with comfort, especially in the restaurant carriage. The cabins were jolting and noisy, glasses danced along the tables. Wheels containing a rubber tire were put in place of the block-cast wheels in a largely successful attempt to reduce jolting and noise. Because

rubber is more pliable than steel, this provided a degree of elasticity: the rolling wheel could undergo greater stress without immediate and permanent out-of-roundness distortion. Rubber can spring back much better than steel. This great increase in comfort came at the expense of somewhat higher rolling resistance. The major drawback of this option was that these wheels required more maintenance and better monitoring.

In addition (or actually because of) the higher rolling resistance, there are at least two problems with the wheels, potentially reducing their operational life. Which of these problems was the deciding factor in the accident is, as we noted, still moot. First, the steel tire around the rubber tire constantly distorts. Even though the distortion is minor, it still produces symptoms of fatigue. A paper clip breaks when it has been straightened and bent a few times; a steel tire will become fatigued in the same way. The wheel under consideration had done 1.8 million kilometres and thus revolved millions of times. Second, the wheel and its rubber tire become warm from these repeated distortions. Rubber expands much more than steel, but it is hardly compressible. Here, the rubber band is "trapped" between the wheel and the steel tire. As the rubber heats up, it exerts a high degree of pressure on the steel tire. Computer simulations (using the finite element method) can now calculate the stress distribution in the material (see Fig. 8.3).

The first mechanism (distortion fatigue) was known; the Fraunhofer Institute, that had studied the design, pointed this out when the dual block wheels were put into operation. The second mechanism (expansion of underlying rubber tire) was not known at that time (See Liu 2002a).

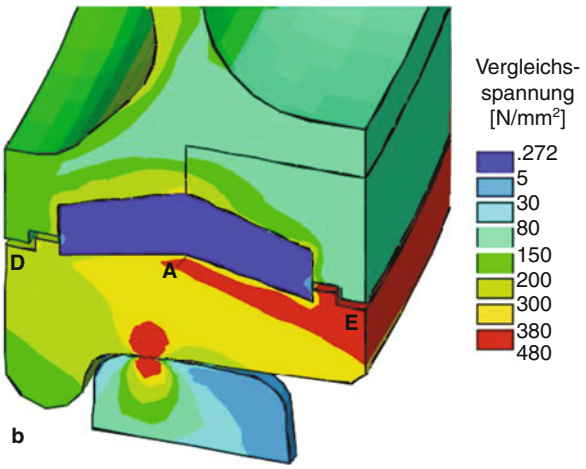

Fig. 8.3 The structure of the wheels used (taken from Liu 2002b)

Regardless, the wheels were inspected regularly. On one side, it was sufficiently well known that they had a lot to endure; on the other, everyone could see that the condition of the wheels was obviously crucial. In addition, the wheels had to meet specific standards. The question thus becomes: were these inspections performed? If so, where they performed carefully and correctly? If, again, the answer is yes, were the standards sufficient? Or would it perhaps have been better never to have used this type of wheel?

Safety Inspections

The wheels were inspected daily in a special workshop. First they were assessed for out-of-roundness distortion. Out-of-roundness distortion results in high mechanical strain. Moreover, during these inspections, the thickness of the outer steel tire was measured and the steel tire was inspected for hair cracks.

The measured value had to meet specific standards. The out-of-roundness distortion was not allowed to exceed 0.6 mm; the steel tyre had to be thick enough to keep the total diameter at at least 854 mm (the diameter of a new wheel was 920 mm). The test for hair cracks could lead to three different results: (1) wheel is OK, (2) wheel needs additional inspection, (3) wheel needs replacing.

That was the theory. Practice was another story.

The workshop where the inspection was done was equipped with ultrasonic equipment to check the wheels for cracks. There, the train rode through a measurement setup at 6 km/h. In principle, this equipment permitted discovery of cracks not visible to the eye because a surface fracture would reflect sound. However, this equipment was unsound for two reasons. First, it could only detect cracks in the tread. It could not detect cracks arising from within, a distinct possibility certainly given the second mechanism explained above. Worse was that the equipment was so sensitive that in addition to raising an alarm when it found cracks, it also did this for innocuous surface irregularities. That resulted in nearly 20% of the tested wheels falling in the “needs replacing” category. That was impossible given the time pressure in the workshop. That is why the wheels were tested the old-fashioned way: by eye (with a lamp) and ear. This last method consisted in hitting the wheel with a hammer and assessing the sound of the wheel. However, it is unlikely that this method, often used on block-cast wheels, was suitable for this type. The rubber ring against which it is pressed muffles the vibrations in the steel tire. One obvious conclusion is that no suitable testing equipment was present.

Furthermore, the standard for out-of-roundness distortion was simply not applied. A week earlier, on 27 May, there was a 0.7 mm distortion; this grew steadily and, the evening before the accident, measured 1.1 mm – nearly double what the standard allowed. One important reason for this was that grinding the wheel was not a high-priority job. There was a scale with six priority levels for train repairs. Repairing the out-of-roundness had priority level 5. A defective coffee machine had a higher priority. Apparently out-of-roundness distortions were not recognised as safety risks, but at most a matter that reduced comfort or increased wear. That is rather surprising for a composite wheel. It is easy to see that metal fatigue in the steel tyre would cause problems a lot sooner when out-of-roundness subjected the wheel to higher mechanical strain.

Finally, there is the thickness of the steel tyre. At the last inspection prior to the accident, the wheel's diameter was 862 mm. That meant that the tyre met the standard (min. 854 mm). But it is by no means certain that this standard – which permitted a 66 mm decrease in diameter – was adequate. After the accident, Darmstadt's Fraunhofer Institute examined the question and this renown German research institute concluded that a minimum diameter of 890 mm would have been wiser. This would have been a much more demanding standard.

After the accident, all ICE trains were thoroughly inspected. Later all wheels were replaced with block-cast wheels. In the process, (at least?) three other wheels were found to have cracks. Any one of these could have caused a similar accident. This seems to make credible the hypothesis that the wheels' safety inspection was insufficient given their design. We examine this hypothesis further on in this case description.

Other Factors that Played a Role

The Train's Design

Beside the design of the wheel, the design of the rest of the train also played an important role. To start with, there is the design of the undercarriage. Designers of the ICE-1 train (the model of the fatal train) opted to give the train conventional sets of wheels. The superstructure – the casing with cabin – was an entirely new design, but the wheel sets were an enhanced version of conventional trains' wheel sets. However, the suspension requirements for a high-speed train are very stringent because the forces to be handled increase with speed. Many high-speed trains, like the French TGV, use air suspension; ICE-1 used steel multiple leaf springs.

This was also probably the reason for the uncomfortable ride on block-cast wheels. You could almost say that the composite wheels with rubber tyres were used because of insufficient investment in designing new air-suspension wheel sets. Understandably, at that point no one wanted to undertake a radical redesign of the undercarriage to increase comfort. The trains were already part of the timetable, and that is a serious barrier for undertaking major modifications.

A second factor that may have influenced the gravity of the consequences is the way the various carriages were coupled in the ICE train. The train folded like an accordion up against the collapsed viaduct, allowing carriages to pile up on top of one another. If the connections had been more rigid, i.e. if there had been fewer hinges – as is the case with France's TGV (Fig. 8.4) this would probably not have happened. However, whether rigid couplings would have made the accident's consequences less serious is a matter of speculation. Of course, the rescue work would have been easier, but a train that comes to an abrupt halt from a speed of 200 km/h will still probably cause many victims, especially in the forward carriages. The train would probably slide together like a telescope.

Other important elements are the alarm and signalling systems installed in the train. ICE-1 and all other high-speed trains are quite high-tech, with all types of built-in, computerised warning systems and sensors. But there was no sensor for a broken wheel. This kind of system, built into a wheel system, warns when there is unusual vibration. In extreme cases it could set off an emergency stop. In 1995, Gottfried Birlk, a *Deutsche Bahn* employee at the workshop in Mühdorf had suggested building this in, but his suggestion was rejected because of its uncertain reliability and the high cost of further technical improvements to the system (Rhein Zeitung 1996). However, such a system was certainly within the realm of technical possibility. It is in use today, in Swiss goods trains and in Eurostar trains.

Passengers in the carriage with the broken wheel knew immediately that something seriously wrong had happened; that is clear from survivors' eye-witness reports. Several minutes passed between the time the tyre broke

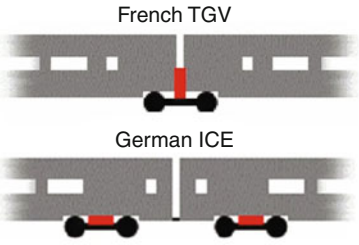

Fig. 8.4 Design of carriage couplings and wheel sets in French and German trains

and the actual accident – minutes that could have been used for an emergency stop. The ICE-1 has no passenger-operated emergency brake. Only the engine driver and the conductor can operate the emergency brake. A passenger did try to find the conductor to report that something was wrong, but the latter wanted to find out what was wrong first before operating the emergency brake. At the time of the accident, he had just arrived in the carriage with the broken tyre.

By and large, we can say that designers ignored the possibility that an emergency could arise in the train and that its consequences could be minimised with timely action. The engine driver did, indeed, have several warning systems, but these all had to do with characteristics of the line up ahead. This explains how it could happen that he only discovered after the locomotive had come to a halt that his train had disconnected long ago.

The Track's Design

In many other countries where high-speed trains are used – France for instance – these run on specially built tracks. This has several advantages: The faster the train's speed, the straighter, flatter and more stable the track has to be. Older tracks often do not satisfy these requirements. Moreover, fewer switches and crossings are needed because tracks are seldom if ever shared with other lines. Tunnels are often placed at road crossings.

The tracks for ICE trains were, and are, mixed. The ICE trains ride over normal tracks shared with other types of trains as well as on special high-speed tracks. The route near Eschede was not a special high-speed track; there were four track lines. The ICE trains rode on the innermost two tracks. However, other trains also used these tracks; that is why it was necessary to be able to move trains from the innermost to the outermost tracks and back. This track design played a large role in the accident near Eschede. The switch whose frog the broken steal tyre tore off and where the wheel derailed lay just 300 meter before the viaduct. The switch that the derailed wheel turned lay only 120 meter before the viaduct. It should be clear that if there had been no switches to the adjacent track, the accident would not have taken on the grave proportions that it did. On 21 December 1993, a TGV train on France's Paris-Lille line derailed at 300 km/h. Only two people received slight injuries. The train did run off the track, but nothing much else happened even though the train jolted on a few kilometres alongside the rails before it came to a halt. A similar accident with the TGV occurred in 2001, again without fatalities and just a few wounded. Comparisons between this and the accident at Eschede regularly point to the more rigid couplings between the carriages that we mentioned above.

Fig. 8.5 Aerial photograph of the accident (Source: Delta Universiteitsblad, Delft, 18 Mar. 1999)

The presence of switches alone was probably not decisive. What was probably more important was that the switch to the outer rail, the one that the derailed wheel turned, was only 120 m from the viaduct. That allowed a carriage to swing directly against a pier. In addition, the possibility that an accident of this type could occur was apparently not taken into account when the viaduct was designed. It was a fairly heavy concrete viaduct with piers relatively close to the track. If the construction had been lighter, its collapse would have had less serious consequences. Now it was a very solid obstruction for a train moving at full speed. One carriage was completely mashed. In addition to that, the rest of the train folded like an accordion as the picture clearly shows. More design changes are imaginable i.e. where the piers are further apart and thus farther from the rail; an earthen wall would have provided an additional protective buffer (Fig. 8.5).

Organisational Aspects

In discussing the accident at Eschede, various authors have pointed out that *Deutsche Bahn* was privatised in 1994, or to be more precise: the West German *Bundesbahn* and the former East German *Reichsbahn* were incorporated in an independent company. The question is, to what extent is this relevant to the accident near Eschede.

To start with, the first ICE-1 trains had already been built in 1990. Design and construction of these trains took place a few years prior to the privatisation. At that time, the *Bundesbahn* was running up heavy losses, which could have been one consideration in deciding not to redesign the wheel sets. In addition, it is clear from the preceding that there was no reliable inspection system for steel tires and that the standards for the wheel's out-of-roundness distortion were not met. It is not unlikely that this was due to financial pressure and the consequent heavy workload in the workshops.

Several serious accidents have occurred in the UK since the railways were privatised. There, too, commentators link the increase in the accident rate to privatisation. Actually, overdue maintenance caused several infrastructure-related accidents at the privatised company Railtrack. After the accident near Hatfield on 17 October 2000 and Lord Cullen's subsequent report on railway safety, Railtrack became so submerged in problems that it was put under administration of the transport ministry a year later and converted into Network Rail, a "not-for-profit" company with state aid. This more or less undid the privatisation of rail infrastructure.

Lodge (2002), however, points out that the organisational changes in the UK were very different from those in Germany. In the UK, the people who designed the privatisation were the same ones who had worked on the privatisation of state-owned energy and telecom companies. In Germany, by contrast, it was the work of a commission composed of transport specialists. One consequence of this was that in 1994 the infrastructure remained the property of *Deutsche Bahn* rather than being assigned to a separate company. Unlike British Rail, *Deutsche Bahn* was not subdivided into smaller companies.

Professor Markus Hecht of *Technische Universität Berlin* argued that *Deutsche Bahn* was actually its own regulator (Brinkbaumer et al. 1999). The design of the ICE-1 and particularly of its composite wheels was certified when the *Bundesbahn* was still a state-owned company, despite the Fraunhofer Institute's misgivings. However, at the time of the accident there was a separate regulator. The *Eisenbahn Bundesamt* (EBA – German Federal Railway Authority) was established in 1994 when *Deutsche Bahn* was privatised. The EBA regulates infrastructure companies and railroad traffic companies via a licensing system. The EBA took over supervision of workshop inspection in 1998.

At any rate, there is still the question whether supervision and certification had changed at all since 1994. The EBA was also criticised for not being sufficiently critical of *Deutsche Bahn*, the successor to the *Bundesbahn*. However, this criticism related mainly to the way the EBA treated *Deutsche Bahn*'s competitors and impeded their use of railway

infrastructure. Moreover, these were all matters that took place in the years after the Eschede accident.

Finally, there is one last organisational aspect. Up to 2 months before the accident, various conductors had entered eight times into the train's computer that the carriage was jittery. It is striking at the very least that no action was taken on these reports especially when the wheel's measurements showed excessive out-of-roundness distortion. Once again we must note that this type of wheel distortion was apparently not treated as a high-priority safety risk. That is surprising, because this type of wheel had not been tested for high-speed trains, and even more because special testing equipment had been purchased to inspect the wheels for cracks (although it was not used because it was too sensitive). A second observation is that it is all quite well to have a high-tech system where conductors can report matters, but that it is not very useful when it leads to an organisational dead end.

Legal Consequences of the Accident

The accident caused 101 deaths. *Deutsche Bahn* paid their families 30,000 German marks (€15,340) for emotional injury, which caused considerable ill feeling. Some of the wounded got more than a million marks (€512,000). In 2001 six family members of victims (with financial support from around 60 others) filed a test case against *Deutsche Bahn* to obtain higher compensation. The survivors' effort proved fruitless. One of the arguments used was the need to maintain a sharp distinction between compensation for emotional suffering and compensation for incurred loss. The court rejected the reasoning of the survivors' attorney that compensation for emotional suffering should be as great as the total value of the destroyed train divided by the number of victims (which was more than ten times the amount paid out).

Beside this civil case, criminal charges were brought in 2002 against two *Deutsche Bahn* employees and one employee of the wheel manufacturer. All three were involved in certifying the composite wheels for use on ICE. They were charged with 101 cases of criminally negligent homicide. After 53 days, the judge concluded in 2003 that no severe burden of guilt for the accident rested on the accused. This was based on several grounds. First, experts had no principle-based objections to composite wheels, so that their introduction did not run counter to prevailing opinions. Second, a crack that could lead to such an accident could develop very rapidly, i.e. within the time it took to travel a few thousand kilometres, so that it cannot be said that inspection procedures carried out in a manner that could reasonably be described as with due care would have prevented the accident. Finally, that

grave errors had been made in calculating wheel strain was deemed unprovable. Taking all this into account the criminal court believed that it should avail itself of the opportunity that German criminal law offers to end proceedings without passing judgment, but still fining the defendants – each for €10,000. Many survivors thought that *Deutsche Bahn*, which they considered guilty of grave negligence, got off scot-free. However, a corporate body cannot be brought to court under German criminal law.

Conclusion

At first glance, this accident was an unfortunate, and perhaps hardly foreseeable, failure of a part that unexpectedly proved to be very crucial. Yet there are real questions about whether the wheel design was well advised. Even more important is that for all kinds of organisational reasons, the system within which the wheel was used was not properly equipped to identify, prevent or repair any safety problems that could arise. If this had been otherwise, use of this wheel design might have been defensible. Furthermore, it is incontestable that the rail design could have been much safer; as France has shown, derailment of a high-speed train need not have such catastrophic consequences. One general comment here is that, while economically attractive, using existing design solutions and infrastructure for such technology can be very risky. The recent derailment in Turkey (2004) of a high-speed train running on older rails and the good reputation of France's TGV for safety both support this conclusion.

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Chapter 9
A Question of Involvement: Unilever and Indian Cottonseed Production

Wim Dubbink

Abstract On 3 May 2003 a coalition of non-governmental organisations (NGOs) accused the multinational Unilever of being involved in child labour in India's cottonseed industry. The company responded by emphatically denying any direct or indirect involvement in child labour. In the public uproar that followed, the coalition of NGOs and Unilever disputed the truth of almost any fact the opposing party produced, including facts concerning the severity and the extent of child labor; even if all parties agreed that child labour is common in the cottonseed industry and that neither Unilever nor its first tier suppliers have employed children themselves. The concrete demands being made of the multinationals and the grounds upon which these where based, almost got lost in the discussion. Upon closer inspection these revolve around four issues: the extent of Unilever's chain responsibility; Unilever's supposed historical blame for child labour in the cottonseed industry; The reasonableness of Unilever having to assume a positive duty to help fight child labour; And the level of precautions the company must take to prevent indirect involvement in child labour.

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Unilever Stands Accused

On 3 May 2003 a coalition of non-governmental organisations (NGOs) accused the multinational Unilever of being involved in child labour (the Dutch newspaper NRC, 2003). The accusation related to the cultivation of hybrid cottonseed in India and the occasion was the publication of a study by D. Venkateswarlu (2003: 1, 18–20), entitled *Child Labour and Trans-National Seed Companies in Hybrid Cottonseed Production in Andhra Pradesh*. According to this study at the turn of the century nearly 25,000 children were employed as child labourers in Andhra Pradesh growing cottonseed on farms that had contracts with a company that – at that time – was controlled by Unilever's Indian subsidiary, Hindustan Lever. The research was carried out on behalf of the India Committee of the Netherlands (ICN).[1] The other members of the coalition were Oxfam Novib,[2] Amnesty International,[3] the labour union FNV–Mondiaal[4] and the Mamidipudi Venkatarangaiya Foundation (MVF).[5]

The public accusation was the culmination of a process of negotiations that had been going on for some time. At the end of February 2002, the coalition opened discussions with Unilever Netherlands regarding the widespread use of child labour in the Indian hybrid cotton industry and Unilever's presumed involvement, using the tentative research findings as a lever. At the meeting the company emphatically denied any direct or indirect involvement in child labour, as it did in every subsequent meeting. Nevertheless, K. Van der Waaij, director of Unilever Nederland Holdings BV, stated that the company was willing to work on measures to combat child labour. Van der Waaij asked MVF's representative to set up a meeting with the chairman and managing director of Unilever's Indian subsidiary, Hindustan Lever Ltd. (HLL). This meeting took some time to arrange. According to MVF, requests for a meeting with HLL in India were rebuffed. According to HLL, MVF was

[1] www.indianet.nl

[2] www.novib.nl

[3] www.amnesty.nl

[4] FNV is an important Dutch labour union; FNV Mondiaal is its international department. Its aim is to promote fair labour conditions and labour rights worldwide, among other things by supporting labour unions (www.fnv.nl).

[5] MVF is an Indian NGO located in the federal state of Andhra Pradesh. By its own account, the organisation takes an "uncompromising stance" against child labour. MVF was established as a research institute on social transformation processes, but since 1991 it has been increasingly transformed into an activist organisation whose aim is to abolish child labour (www.mvfindia.org).

not willing to come to Mumbai.[6] In the meantime, HLL spun off its seed division into Paras Extra Growth Seed (PEGSL) and sold three quarters of the shares to a US company, Emergent Genetics.

On 24 April 2003, ICN had sent a letter to Unilever's chairman, Antony Burgmans, on behalf of the coalition. It contained the completed research report and a request for a meeting:

> We would like to discuss with you the ways Unilever could help find an answer for the children employed in the production of cottonseed for your company. . .. We would, therefore, greatly appreciate it if you could arrange a meeting with us in the near future. Finally, by way of information, the report will be published soon.

A week later ICN sent the research report to the Dutch newspaper *NRC Handelsblad* which published a story under the headline "Unilever beticht van kinderarbeid" (Unilever accused of child labour). This led to a storm of publicity. Unilever fell subject to something all quality brands hope to avoid: an association with child labour. The company let *NRC Handelsblad* know that it was certainly willing to work with NGOs to develop efforts that could contribute to ending the use of child labour in Indian hybrid cottonseed production. However, Unilever also stressed that it was unpleasantly surprised by this false accusation and the fact that the report gained public exposure so rapidly. A few days later, Unilever issued a press release in which it rejected the accusation that it had anything to do with child labour.[7]

The NGOs' campaign against Unilever's alleged involvement in child labour used for cottonseed production did not target Unilever alone. The Unilever protests were part of a worldwide campaign to end the use of child labour in Indian cottonseed production that was aimed at involving Western multinationals. NGOs in Switzerland, the US and Germany also took steps against Syngenta, Monsanto and Bayer. The campaign had merely started with Unilever because Unilever's subsidiary was the largest company.

The concrete demands being made of the multinationals almost got lost in the uproar that followed the unwelcome accusations. The NGOs see child labour in India as a complex problem, linked to many structural causes. They

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[6] The data for this case were collected through various interviews and talks conducted by Iris de Wilde and the author with representatives from many of the parties, in particular representatives from Unilever, Oxfam Novib and ICN. For the sake of readability we have chosen not to keep referring to these interviews. All of the parties have explicitly endorsed the final draft of the paper, in the sense that each agrees with all statements attributed to its own organisation. All of the parties expressed doubts about the description of the facts made by other parties.

[7] Unilever press release, dated 5 May 2003.

want the multinational companies to contribute to solving the problem by countering it in their own supply chain, but more importantly, by contributing to measures that would benefit the industry as a whole, such as measures that could facilitate better education for these children. The ultimate remedy, according to the NGOs, is a higher purchase price for cottonseed. This would allow farmers to hire adults and pay them a living wage, which would leave the children free to go to school. According to the NGOs, the Western multinational companies could be conducive to this process.

Unilever

Unilever, a British-Dutch enterprise, is one of the largest producers of food, household and personal care products in the world.[8] The company was established in 1930 when the Dutch margarine manufacturer Margarine Unie merged with British soap producer Lever Brothers. Unilever has business locations in nearly 100 countries and its products are sold in another 50. In mid-2005, Unilever's activities were incorporated into two divisions – food products and household and personal care products. Its famous food brands include Lipton, Knorr, Hellman's, Slim Fast and Bertolli, while their well-known brand names in household and personal care products include Dove, Vaseline and Pond's.[9] Also in 2005, the company introduced a tri-regional structure to manage its market activities – Europe, North and South America and Asia/Africa, Middle-East and Turkey – while in a matrix-fashion, innovation and category management fell under the control of two new divisions: food products and household and personal care products.[10]

According to its mission statement,

> Unilever is a company that 'meets everyday needs for nutrition, hygiene and personal care with brands that help people feel good, look good, and get more out of life'.[11]

The company also claims a closeness with consumers around the world:

> Our deep roots in local cultures and markets around the world give us our strong relationship with consumers and are the foundation for our future growth. We will bring our wealth of knowledge and international expertise to the service of local consumers – a truly multi-local multinational.[12]

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[8] www.unilever.nl, visited 21 Sept. 2005.
[9] www.unilever.nl, visited 5 Feb. 2005.
[10] www.unilever.nl, visited 21 Sept. 2005.
[11] www.unilever.nl, visited 7 Nov. 2009.
[12] www.unilever.nl, visited 7 Nov. 2009.

The Unilever group has a complicated organisational structure. There are two parent companies – Unilever NV (Dutch) and Unilever PLC (British) – that serve as holding and service-related companies. They are separate legal persons and have separate listings on different stock exchanges. Most of the operating companies are owned by either NV or PLC, with the exception of a few that are jointly owned. Nevertheless, the two parent organisations and all of the group members tend to act as one company. At the level of the parent organisations, this process is facilitated by seating the same persons on the two boards of directors. What is more, the boards are linked to one another by several agreements in which all shareholders of NV and PLC share in the profits of the entire Unilever group. Each operating company bears great responsibility in carrying out its own activities.

Unilever and Corporate Social Responsibility

Unilever is and wants to be known as a company interested in more than shareholder value, or at least a company that wants to earn its profits only within the framework of high standards of conduct.

> Our corporate purpose states that to succeed requires "the highest standards of corporate behaviour towards everyone we work with, the communities we touch, and the environment on which we have an impact"[13]

The company further asserts that

> 'Unilever wants to make a positive contribution to society not only by producing high-quality products, but also more broadly speaking. We want to be involved in the communities where we operate;. . .'[14] And 'as a multi-local multinational, we want to play a role in tackling worldwide environmental and social issues. We do this by working locally and joining with local governments and institutions'.[15]

Corporate integrity, also known as "corporate social responsibility (CSR)", or more generally speaking the moral aspect of doing business is thus important for Unilever.[16] That is expressed in the company's presentation. Its

[13] www.unilever.com, visited 7 Nov. 2009.

[14] www.Unilever.nl, visited 22 Sept. 2005.

[15] www.Unilever.nl, visited 22 Sept. 2005.

[16] In Dutch the term for CSR is "maatschappelijk verantwoord ondernemen", a generic term that relates generally to the moral aspects of doing business. In other countries, such as the US, CSR often only refers to some of a company's moral endeavours, specifically those actions related to solving public or social problems (see e.g., Boatright 1993/2007). We will use the term generically in this chapter.

"purpose and principles (including the Code of Conduct)" and its commitment to sustainability are prominently displayed on the corporation's website.[17] Furthermore, each year Unilever adds a social report and an environmental report to its financial report.[18] Unilever has also developed a code of conduct and, more exceptionally, a business partner code.[19] The code of conduct describes the standards and principles that Unilever wants to maintain and that the general public may expect of it. Its 2004 business partner code describes the standards and principles that Unilever expects its business partners, particularly its first-tier suppliers, to uphold. The document does not seem intended to motivate partners to *imitate* Unilever, though.

> In keeping with Unilever's partnership approach, we work together with our partners, first to establish how compatible their standards are with ours and then, where necessary, to agree on measures and timescales to achieve the desired performance levels.[20]

CSR is procedurally embedded at Unilever. The company considers cooperation on this matter to be very important and joins in dialogue with internationally operating NGOs (Unilever 2003). The fact that WWF, Oxfam Novib and other NGOs participate in this dialogue shows that they take Unilever's socially responsible role seriously.

Unilever's code of conduct is a brief, two-page document that Unilever thinks contains high and clearly described standards of behaviour. The themes addressed include the environment, staffing, consumers, shareholders, innovation and competition. Its first sentence is characteristic.

> We conduct our operations with honesty, integrity and openness, and with respect for the human rights and interests of our employees. We shall similarly respect the legitimate interests of those with whom we have relationships.[21]

The company explicitly forbids using child labour.

> We will not use any form of forced, compulsory or child labour.

The business partner code contains ten, briefly stated principles that Unilever expects its immediate partners to respect. Among the code's stipulations are that Unilever's partners must comply with all current legislation in

[17] www.unilever.nl, visited 7 Nov. 2009.
[18] www.unilever.nl, visited 22 Sept. 2005.
[19] www.unilever.com/ourvalues, visited 22 Sept. 2005.
[20] www.unilever.com, visited 7 Nov. 2009.
[21] www.unilever.com, visited 7 Nov. 2009.

their countries, respect human rights and perform all activities with care for the environment. Regarding employees, the company states that wages and hours must comply with legal regulations. Forced labour is out of the question. A separate item explicitly forbids child labour.[22]

The company views helping to solve global environmental and social problems as one of the important ways it can and should display its focus on moral values. Unilever stresses in various places that it wants to play a role in tackling these problems.[23] Generally speaking, a company can choose between two strategies in giving shape to such involvement. It can develop activities *alongside* its regular activities or it can incorporate them *within* its regular activities, reflecting moral values in its specific moral choices. Unilever does not ignore the first manner, but seems to attach much greater importance to the second.

One of the reasons behind this choice may be the company's apparent belief that activities that can be viewed as being sparked by a moral reason should also be thought of as consistent with commercial reasoning. There are examples to confirm this hypothesis. Several years ago Van der Waaij publicly insisted that commercial reasons were the sole basis for establishing the Marine Stewardship Council (MSC) (Anonymous 2003). The MSC is an independent organisation based in London that issues a quality mark for sustainable fishing. The organisation places heavy requirements on sustainability. Unilever set up the organisation with the WWF because fisheries are dependent on a sustainable supply of fish. Unilever promised that within a foreseeable period it would process only sustainably caught fish.[24]

A possible explanation for the emphasis on a commercial rationale in this type of project is that Unilever – like many other companies (Bird and Waters 1989) – does not like to state explicitly that it is making choices based primarily on moral reasons. Undisputed or dominant ideas on the type of responsibility a company owes its shareholders can play a role here. Awkwardness in dealing with moral discourse is another factor suggested by empirical research (Bowie 1999: 120–139). A third possible factor is a cautious approach to mass communication: the more a company publicly boasts of its moral orientation, the higher the public's expectations will be. And Unilever is apprehensive about this:

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[22] www.unilever.com, visited 7 Nov. 2009.

[23] See www.unilever.nl, visited 21 Sept. 2005, and other sources.

[24] A strategic reorientation that resulted in the sale of virtually the complete frozen foods division put an end to all this.

> As expectations for wider engagement by companies grow, so too are many critics more ready to say when we don't meet their expectations (Unilever 2004: 1).

The Shakti project is another Unilever activity that, like MSC, can be viewed in the context of social involvement or orientation toward moral values and that is also interwoven with the company's own activities. In the project, Unilever's Indian subsidiary, HLL, provides free entrepreneurial training for underprivileged women. These women are organised in self-help groups set up by NGOs and the government. After taking the course, the women can start selling Unilever products through local, small-scale enterprises. This gives them a chance to earn a stable income of around $20/month, nearly double the usual family income (Unilever 2003: 10). A third example is a Dove campaign that attempts to do away with stereotypical notions of beauty. According to the Dove campaign, many modern women approach beauty from a negative self image. Dove wants to show women more definitions of beauty to shorten the gap between their view of themselves and their notion of what is beautiful.[25]

The Hybrid Cottonseed

Cotton is the most important agricultural product in India. Approximately 22,239,500 acres are devoted to its cultivation. This makes India the largest cotton producer, in terms of acreage, in the world. Nearly 40% of the Indian production uses hybrid cottonseed. Hybrid cottonseed is produced by crossing two genetically different varieties of cotton. This is called hybridisation or cross-pollination. The main advantage of working with hybrid cottonseed is that it produces greater yields and higher quality. The hybrid cotton plant is also very adaptable. A final macro-economic advantage of the hybrid variant is that seed production is very labour-intensive and thus provides employment.

Hybrid cottonseed was invented in India in 1970. In the early days state-run organisations saw to its commercial development. Then, economic deregulation and other factors led to spectacular growth in the 1990s and private seed companies jumped on the bandwagon. In time, some of these companies developed their own agricultural seeds. By 2000, 80% of the cottonseed-growing market was in private hands (Venkateswarlu 2003: 14–17) and concentrated in India's south-eastern province, Andhra Pradesh.

[25] www.unilever.nl, visited 22 Sept. 2005.

One of the reasons for this was the availability of cheap labour. Nearly 60% of the hybrid seeds produced in Andhra Pradesh are sold in other parts of India and in other countries. As with other agricultural products, division of labour has entered into the production of hybrid cotton: some companies produce seed of different varieties of cotton (i.e., basic seeds); others cultivate these varieties, cross-pollinate them and produce hybrid cottonseed; and still others use these hybrid seeds to grow cotton. The problem of child labour is concentrated in the second phase: the production of hybrid seeds.

Farmers are not the only or even the most powerful parties in the cotton production chain. The seed company is a very important player. It has a role at the beginning and at the end of the chain. It produces the basic seeds and sells the hybrid cottonseed to cotton farmers. In between, the basic seeds are passed to a seed dealer. Seed dealers, in their turn, sell the seeds to farmers who produce the hybrid seeds. After production, the seed dealers buy back the hybrid seeds from the farmers and sell them back to the seed companies. Seed companies and seed dealers enter into a contract that regulates many matters in detail, such as the type of cottonseed to be produced and the quality and amount. The price at which the producer will buy back the seed from the dealer is also set (buy-back arrangement). The seed dealers also sign contracts with the farmers specifying how to produce the hybrid seeds. The seed dealers sell their seeds to all types of farmers. Some are very large and employ many people, in which case the farmer and labourers are usually not of the same caste. Other farms are much smaller and these usually employ their own families to produce the cottonseed.

This complex organisation of the supply chain is partly the effect of Indian legislation. The seed companies cannot grow the seeds themselves because Indian law does not permit companies to own large parcels of land. In addition, outsourcing is much more advantageous because some labour laws do not apply to small production units. The set up with the seed dealers is a new idea. Before 1990, seed companies often negotiated directly with cottonseed growers. The increasing demand for hybrid cottonseed has led seed companies to work on a larger scale, which made it difficult for them to negotiate directly with farmers.

Child Labour

According to estimates by the International Labour Organisation (ILO), nearly 250 million children between the ages of 5 and 17 were employed as child labourers at the start of the twenty-first century. The ILO is careful to point out that there is a difference between *child labour* and *child work*:

> Not all work done by children should be classified as child labour that is to be targeted for elimination. Children's or adolescents' participation in work that does not affect their health and personal development or interfere with their schooling is generally regarded as being something positive. This includes activities such as helping their parents around the home, assisting in a family business or earning pocket money outside school hours and during school holidays. These kinds of activities contribute to children's development and to the welfare of their families; they provide them with skills and experience and help to prepare them to be productive members of society during their adult life.[26]

Child work is common around the globe and morally unproblematic. Many children, in very different national circumstances, carry out work that is entirely consistent with their education and full physical and mental development.

By contrast, child labour is by its nature morally wrong and a violation of children's rights. There is a large consensus worldwide that child labour is at variance with the right of each child to a normal development that includes education, playtime, care and adequate mental and physical health. Hence, any adult involved in child labour is committing acts that are morally wrong. The same goes for anybody profiting from child labour. The fact that nearly every country in the world has signed and ratified major treaties banning child labour evinces the universal rejection of child labour. Such treaties include the UN *Convention on the Rights of the Child* (1989) and the ILO *Convention Concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour Convention* (1999; No 182), acclaimed by a rare unanimous vote.[27]

But then, how can child work be distinguished from child labour? Drawing on international agreements (UN Conventions 138 and 182), the ILO (2002: x) identifies three categories of child labour, with the latter two being considered among the "worst forms":

(1) Labour performed by a child who is *under a minimum age* specified in national legislation for that kind of work;
(2) Labour that jeopardizes the physical, mental or moral well-being of a child, known as hazardous work;
(3) The unconditional worst forms of child labour, which are internationally defined as slavery, trafficking, debt bondage and other forms of forced labour, forced recruitment for use in armed conflict, prostitution and pornography, and illicit activities.

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[26] http://www.ilo.org/ipec/facts/lang–en/index.html, visited 7 Nov. 2007.
[27] www.ilo.org, visited 14 Aug. 2005.

According to the ILO (2002: x), some 180 million children age 5–17 (or 73% of all child labourers) are now believed to be engaged in the worst forms of child labour. This amounts to one child in every eight in the world. Of the some 171 million children engaged in hazardous work, nearly two thirds are under 15 and therefore require immediate withdrawal from this work and rehabilitation from its effects.

Child labour continues to be a widespread problem and the imperfect implementation of national legislation against child labour contributes to this. More importantly, child labour is not an isolated problem. It is closely related to gender or caste discrimination, poor or powerless governments, lack of freedom, failing political representation, poorly functioning educational systems, poverty, and other socio-political ills. India is one example of a country facing such problems. Many international governmental organisations (ILO, UNICEF) and international NGOs (Plan International, Oxfam Novib and MVF) are working to change this. Some of these organisations focus on specific projects in the countries in question, including campaigns to increase awareness, programmes to establish schools and encourage children to attend them, and anti-poverty programmes. Other organisations focus on raising the awareness of individual citizens and the broader public in countries where there is no child labour. This can put pressure on internationally operating companies that benefit from child labour or are in a position to contribute forcefully to ameliorating the problem. Examples of such campaigns are those against child labour at the time of the 1998 soccer world championship and the campaign in the 1990s against Nike and other manufacturers of sportswear and sports accessories.

There are also organisations that have programmes aimed exclusively at companies. One example is the ILO's International Programme on the Elimination of Child Labour (IPEC), which targets companies directly. The IPEC operates on the premise that companies have a crucial role to play in combating child labour and it emphasises first and foremost stringent compliance with national legislation on the subject.[28] The most effective way companies can contribute is by "setting high standards on workers" rights and on the use of child labour in their own operations and to seek to extend those standards generally among the business community, including subcontractors'. IPEC believes that there are many reasons for companies to turn away from child labour.

> Employers realize that, apart from obvious humanitarian and social concerns, combating child labour makes good business sense. Children who are left uneducated or are damaged physically or emotionally by early and hazardous

[28] www.ilo.org, visited 14 Aug. 2005.

work have little chance of becoming productive adult workers. They realize increasingly, too, that public exposure to the use of child labour can cause immeasurable damage to the company image.

Child Labour and Hybrid Cottonseed

It is normal for children in India to *work*. As in other emerging countries, children are expected to help their families by performing tasks. But child labour is also not uncommon in India. There are between 50 and 60 million child labourers in India, 15 million of whom live in slave-like circumstances. According to Venkateswarlu's report, nearly 450,000 children age 6–14 throughout India worked in the cottonseed industry in 2002.

There are several reasons that the organisations involved decided to draw Indian and international attention to the situation in cottonseed production after 2000. Well-known Western companies play a leading role in cottonseed production. They are often more easy to call to account for their role than purely Indian companies. Western companies usually have a business code in place, thereby explicitly indicating that they will comply with given ethical standards. In addition, Western consumers are more critical when it comes to such moral questions and that makes Western companies more vulnerable on this point. Furthermore, in the 1990s, the MVF had explicitly requested that Western NGOs make the battle against child labour in cottonseed production a priority of their activities because it gained little ground in the industry. It claimed that the main reason for this was the seed dealers' aggressive recruitment of children. So, it wanted support from Western multinationals in its conflict with the dealers.

There are also several important industry-specific arguments for choosing to focus on the cottonseed industry. Cultivation of hybrid cottonseed is highly labour-intensive. Cross-pollination must be carried out manually over a 4-month period each year, a task usually assigned to girls. Sowing and harvesting are also often left to them (Venkateswarlu 2003: 8). The farmers prefer children – especially girls – because they are easier to control and cheaper to hire. It is also easier to convince children to work 11 or 12 h a day. In addition, children earn around 30% less than what adult women earn per day and 55% less than adult men. Children earn approximately 10–25 rupees (INR) per day (1 INR was approx. 0.014 EUR or 0.021 USD on 27 Nov. 2009). Some people claim that girls are better able to perform the delicate manual tasks required for cross-fertilisation because of the build of their hands.

A second industry-specific argument is that child labour is increasing in this industry, as a result of the growth in hybrid cottonseed production.

And finally a third reason is that the work children do in cottonseed production can in many cases be classified among "the worst types of child labour". Many children working in cottonseed production are victims of debt slavery or "bonded labour". Indian law prohibits debt slavery but implementation of the law is imperfect.[29] In practice, children are still forced to work to pay off an advance or debt that their parents owe (at excessively high interest rates). Recruiters take the initiative in approaching parents.[30] Given the pittance that the children earn, it inevitably takes their families a long time to pay back the debt. The children are often handed over to a farmer for an entire season or even several years. Matters are exacerbated by the fact that the work itself seriously harms the children's health. One of the major causes of this is the children's exposure to pesticides considered harmful to humans, such as Endosulfan, Monocrotophos, Cypermethrin and Mythomyl. These products cause nausea, headaches, disorientation, breathing problems and other health problems (Venkateswarlu 2003: 33). Furthermore, because of their work in the cottonseed fields, many children get little or no schooling. At least 29% of the children have had no schooling at all. More than half of the children leave the educational system after just a few years to work in the cottonseed fields (Venkateswarlu 2003: 10). Multinationals and cottonseed production Western multinational seed companies play a large role in Indian cottonseed production. They usually opt for a construction that involves an Indian subsidiary. Some of the subsidiaries operating under such arrangement are Mahyco (US Monsanto), Syngenta India (Swiss Syngenta), Proagro (German Bayer), Advanta India Limited (Dutch Advanta/Limagrain) and Paras Extra Growth Seed (PEGSL) (Monsanto). Until 2002, Unilever's Indian subsidiary, Hindustan Lever Limited (HLL), owned PEGSL. After that it passed first to US Emergent Genetics, then to Monsanto, which bought Emergent Genetics in 2005.[31] Taken together, Western multinationals control 20% of the market; PEGSL alone controls 10%. Venkateswarlu's report projected an increasing role for Western multinationals in coming years; one reason for this is the introduction and use of genetic manipulation techniques.

Unilever's involvement in cottonseed production is a legacy of Unilever's long history in India. Before the Indian economy was deregulated in the

[29] www.indianet.nl, visited 23 Aug. 2005.
[30] www.indianet.nl, visited 23 Aug. 2005.
[31] www.emergentgenetics.com, visited 23 Sept. 2005.

early 1990s, foreign investors were obliged to invest part of their earnings in Indian export products (Berkhout 2003). HLL resulted from the 1956 merger of three of Unilever's Indian subsidiaries. Since then, HLL has strengthened its position on the Indian market and is currently the largest fast-moving consumer goods company (FMCG) in India. Parent company Unilever owns 51.6% of HLL.

Until recently, cottonseed production was also part of HLL. During a strategic reorientation in 2002, HLL spun off its seed division as the subsidiary PEGSL and then sold most of the shares. HLL retained a 26% financial interest in PEGSL, in the form of overdue payments that the purchaser – Emergent Genetics – could not meet at that time. It was agreed that these remaining shares would be gradually passed on to PEGSL over several years. That operation has since been finalised. In the period right after the sale, when Unilever still owned shares in PEGSL, the relationship with PEGSL/Emergent Genetics was purely financial, according to Unilever. Unilever had no management control over PEGSL during that period.

The Indian Report: Disputes as to Its Factual Claims

An important factor in the Dutch conflict between Unilever and the NGO coalition was the report by Davuluri Venkateswarlu. Analytically, the report can be divided into two parts: the empirical (i.e., factual) research into the scope and gravity of child labour in cottonseed production, including a descriptive account of the industry, and an interpretative account of the moral and political involvement of Unilever and other Western multinationals. We will look at the empirical part first.

Venkateswarlu based his study on primary and secondary sources. Much of the secondary research is made up of studies that he had conducted earlier. The primary research is a field study carried out between 1999 and 2001 at 22 farms. According to the report, 12 of them produced for HLL. None of the 22 farms is identified and the report has little to say about the research methodology used. That leads to occasional questions, for instance in terms of determining the gravity and scope of the use of child labour in cottonseed production. The report says that there has been a spectacular increase in child labour in recent years. Altogether in 2000, the report says, this affected some 450,000 children in all of India and approximately 250,000 in Andhra Pradesh. That means that, according to the report, at the turn of the century, nine out of ten workers in cottonseed production were children (Venkateswarlu 2003: 11).

Table 9.1 Table copied from Venkateswarlu's report. According to the report this table shows the increase in child labour for the period 1990–2000 (Venkateswarlu 2003: 17)

Year	Total production area of hybrid cotton in acres	Total number of children involved in child labour
1990–1991	6,160	61,600
1995–1996	21,880	218,800
1998–1999	28,000	280,000
1999–2000	30,000	300,000
2000–2001	24,783	247,830

These estimates are based on a sample survey that determined the average number of working children per hectare (1 ha = 2.47 acres), plus an estimation as to the total number of hectares in use for cottonseed production (see Table 9.1). These figures were also used to make an estimation of the number of child labourers indirectly related to multinationals based in the West, like Unilever (see Table 9.2). It is, of course, worth asking whether these figures can be used without a proper methodological account, especially if they are going to be used as a basis for making accusations.

Regarding the gravity of the child labour, the report says that given the nature of the work and the degree to which children are involved, we cannot mask the various tasks performed by children in cottonseed production as mere children's work as opposed to child labour. It is definitely appropriate

Table 9.2 Table copied from Venkateswarlu's report. According to the report this table shows Unilever's involvement with child labour (Venkateswarlu 2003: 18)

Company	Owner's nationality	Production land used, in acres*	Number of children involved
Hindustan Lever (HLL)**	Dutch/UK	2,500	25,000
Syngenta	Swiss	650	6,500
Advanta	Dutch/UK	300	3,000
Mayhyco-Monsanto	American	1,700	17,000
Proagro	German	200	2,000

Number of children (6–14 years old) employed in hybrid cottonseed production in the Indian federal state of Andhra Pradesh on farms that supply Western based companies (2000–2001)

* acre = 4.046,86 m^2; ** as of 2003: Paras Extra Growth Seed

to speak of child labour being used for cottonseed production, often in the very grave form of debt slavery. The report illustrates the gravity of the situation with cases like that of a girl named Narsamma (see Box 9.1). Her tragic fate is presented as a case study. But here again, there are problems with its methodology. The story has been written in such a way that it is completely unverifiable. According to the report, real names could not be used for fear of repercussions. While that may be true, it still makes it hard to use such cases to link HLL to child labour practices.

Box 9.1 Narsamma Case (Source: Venkateswarlu 2003)

Narsamma, a 12 year old scheduled caste girl, has been working in the cottonseed fields of an employer in Alavakonda village in Sanjamala mandal (Kurnool district) for last 3 years. Her employer is a local farmer who produces "Brahma" variety of hybrid cottonseeds in two acres for a reputed multinational seed company (Hindustan Lever Limited). She came from a remote village in Prakasam district. Her native village is about 100 km away from her work place. Though her parents own three acres of dry land the income they get from their land is insufficient. They also work as agricultural labourers.

Narsamma had to discontinue her studies after third class to pay back a loan of Rs. 2,000 taken by her father from a middlemen who arranges labour for cottonseed farmers. She joined in cottonseed fields in 1998. For first crop season (July 1998–Dec 1998) she was paid Rs. 450 per month and now she gets Rs 800. Every year during work season she comes to Alavakonda village along with other children from her native village to work in cottonseed fields. She stays with the employer about 5–6 months (July–December). Employer provides her accommodation and food during her stay with him. She stays in the employer's cattle shed, where all other migrant children are put up. The cattle shed is a small room originally constructed for keeping cattle. It does not have proper ventilation and the floor is dirty without proper cover. Part of this room is covered with cattle fodder. As employer does not have other place to accommodate migrant children he keeps them in this room. During the season when children are accommodated in this room he shifts the accommodation of his cattle to an open place in front of this room.

Her daily routine starts with waking up early in the morning at 5 a.m. and getting ready by 6 a.m. to go to the fields. From 6.30 a.m. in the morning till 7 p.m. in the evening she is in the fields doing various

sorts of work. She is engaged in cross pollination till 12 a.m. Around 8–8.30 a.m. 15–20 min break is given for taking food. From 12 a.m. to 2 p.m. she is engaged in other works like weeding, picking up cotton kappas, carrying water for pesticide application etc. (pollination and emasculation works are done in specific timings. Pollination work is done in the morning hours preferably before 12 a.m. and emasculation after 3 p.m. During this gap children are entrusted with other works) From 2 to 3 p.m. 1 h break is given for taking lunch, rest and playing with other children. From 3 to 7 p.m. she is engaged in emasculation work. She comes back home at 7.30 p.m. She is free from 7.30 to 8.30 p.m. Takes food at 8.30 p.m. and spends about an hour or so in the employer's house watching TV. During harvesting season, while watching TV she also does work like separating cotton "kappas".

Recalling the health problems she had faced during the last working season Narasamma stated that "I was ill for two times. First time I had heavy fever with cold, headache and vomiting because I worked during rain and got wet. That day three of my colleagues were absent and we had to do their work also. To finish the cross-pollination for that day we were requested to work even during raining time and also late hours. Because of that I got fever the next day. It started with cold and headache and finally resulted in heavy fever. I did not go to the doctor. I thought it was not that serious to consult the doctor. My employer brought some medicines for me and I took it. I took 2 days rest and after that I was OK and went back to work. The second time I got severe headache and felt giddiness which was not normal while working in the field immediately after spraying pesticides. I complained to my employer. He suggested her to go home (his residence) and take rest for that day. I went home and took rest for that day. In the evening my employer asked me if I wanted any medicine but I said no. I resumed my work from the next day".

Unilever Netherlands disagreed vigorously with the facts as presented in the report. It did not dispute all of them, however. Unilever agreed that the worst type of child labour can be found in India and in cottonseed production in Andhra Pradesh.

> We all know that such things occur there.

For the rest, however, Unilever considered Venkateswarlu's report unsound and thus inadmissible, or at least insufficient, as evidence of its involvement in child labour. With regard to the methodology used, Unilever concurred

with the reaction of the Indian Association of Seed Industry (ASI). The ASI is an Indian trade association representing seed companies. Its membership includes prominent multinationals and national Indian companies. According to ASI, we must treat Venkateswarlu's report as an informal document, which lacked adequate instruments for collecting data and based its findings on a tour of 22 seed farmers (0.2% of the population) (ASI 2004).

As for the actual facts presented, Unilever maintained that the researcher seriously exaggerated the number of children involved.

> The numbers are based on an unrepresentative sample. We calculated that if Venkateswarlu's figures were correct, the cottonseed industry employed only children.

Unilever also cast doubt on Venkateswarlu's conclusions about the gravity of the child labour within the industry. It noted that children in emerging countries often perform work (as opposed to labour) for their families.

> In India, as in other developing countries' agricultural sectors, children frequently work on farms that are run by their families.[32] But the part they play is one of a participant in a family unit, a contributor to the family enterprise outside school time.[33]

In addition to that, Unilever emphasized strongly that the report did not specifically demonstrate a connection between child labour and plantations linked to HLL. According to Unilever, there is hardly any concrete proof of such a link to be found in the report. It noted, in that regard, that HLL had always been one of the most respected companies in India and that it always set its purchase prices above regular market prices. In addition, Unilever stressed that HLL had long included a provision in contracts with seed dealers that suppliers were not allowed to use child labour. Moreover, Unilever pointed out that the contracts between seed dealers and farmers also contained a provision obliging farmers to comply with Indian law.[34]

HLL always verified whether farmers and seed dealers respected these agreements with regular visitations, oral inquiries and requests for confirmation of their adherence to these requirements. However, in one letter Unilever toned down its claims about regular verification.

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[32] Letter by Heleen Keep, Unilever, Corporate Relations Department, London, to Dresdner RCM Global Investors (UK) Ltd., dated 3 Dec. 2001.

[33] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

[34] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

> Field visits by HLL staff were not designed to either police or closely supervise the work of the farmers, but were spot checks to test compliance with our requirements.[35]

Nevertheless, the company was sufficiently convinced of its own position, as the following shows:

> If the coalition really had a case against us and really wanted to reach its goals, they should have lodged a complaint against us long ago with the Dutch Ministry of Economic Affairs' National Contact Point (NCP). [The OECD has commanded national governments to set up NCPs as a means of exacting its guidelines for multinational companies. NGOs and others can report infractions of OECD directives to the NCP. The OECD takes a strong stance against child labour.] But the coalition never reported us. Why not? Because it is unable to do so. It has no proof, because there is no proof. Unilever fully complies with the OECD directives.

The Indian Report: Disputes as to Its Moral Arguments

Venkateswarlu's report was more than a statement of facts. It also contained political and ethical argumentation that the researcher used as a basis for concluding that Unilever bore a heavy responsibility in the struggle against child labour and that it fell short of this responsibility in the matter of Indian cottonseed production. Before going into this, it is important to stress that Venkateswarlu admits that the Western multinationals and their first-tier subsidiaries have no children on their own payrolls. The problem arises with the independent farms where the actual cultivation for the Western multinationals takes place (Venkateswarlu 2003: 33).

Hence, the seed companies were not directly involved in child labour. It is also only fair, though, to point out that we should not overemphasise the moral significance of this absence of direct involvement. Moral condemnation can also accompany indirect involvement in injustice. A fencer, receiving stolen goods acts immorally; the same goes for someone who knowingly helps a person blackmail someone else. This was exactly what the report was getting at. According to Venkateswarlu, Unilever was a direct beneficiary. Consequently, Venkateswarlu concludes that Western multinationals bear a great responsibility – certainly in the sense that they should be able, and ought, to do something about it:

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[35] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

> The exploitation of child labour in cottonseed farms is linked to larger market forces. Several large-scale national and international seed companies … have involved themselves in subtle ways in perpetuating the problem of child labour. The economic relationships behind the abuse are multi-tiered and complex, which masks legal and social responsibility. (Venkateswarlu 2003: 33)

Venkateswarlu used three arguments to substantiate his position. He stated that seed companies are a powerful party. They can set conditions for farmers in contracts (Venkateswarlu 2003: 33), but they do not do so. They remain passive. Next, Venkateswarlu posited that seed companies pay a low price for cottonseed. According to Venkateswarlu, this price is so low that the farmers have no other option than to hire children. They cannot pay adult wages with the price they get. This is all the more distressing, according to Venkateswarlu, because the seed companies make big profits on the sale of the cottonseed to farmers (Venkateswarlu 2003: 26–29). Thirdly, Venkateswarlu maintains that the various multinationals, in particular, cannot deny their responsibility because they have committed themselves to acting in accordance with the highest standards of social responsibility. He refers to Unilever's code of conduct as one example. By ignoring the problem, the multinationals' behaviour even falls short of their own standards.

> The activities of these MNCs in the area of cottonseed business in India are certainly not in tune with what they claim about their commitment to socially responsible corporate behaviour. (Venkateswarlu 2003: 24)

Unilever objected to the moral arguments put forward in the report, as well. According to the company, the role of Western multinationals in cottonseed production was being overemphasised. It pointed out that Indian companies controlled 75% of the market. In addition, Unilever disputed the notion that the company could be held fully responsible for everything that took place throughout the supply chain. In various responses, Unilever plainly showed that HLL itself had never hired children and that HLL made certain that this was also the case for its first-tier business partners, in this case the seed dealers.[36] At the same time, the company acknowledged that the situation was less obvious in the rest of the supply chain.

> The situation is less clear in the actual cultivation of cottonseed, but we do not believe that girls are subjected to forced labour to cultivate the cottonseed that we buy.[37]

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[36] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

[37] Letter by Antony Burgmans, chairman of Unilever, to M. Filbri, Oxfam Novib, dated 18 Dec. 2001.

Unilever also pointed out that it is important to remember that the company itself had no contact with these farmers. It stresses repeatedly that "Unilever has no dealings whatsoever with any of the farmers".[38] According to the company, this has important practical and ethical implications. The practical implication is that

> HLL or the seed organizer (i.e. the seed dealer) has no direct or indirect role in the farmer's practice of either taking help from his family members, or employing labour. . .. The farmer is not an employee of either HLL or the seed organizer.[39]

The moral implication is that these are independent parties that are each responsible for their own actions.[40]

> (The farmer's) individual practice of using his family members or outside labour cannot be governed by us.[41] In situations in which the linkages are not direct, but diffuse, company involvement is commensurate and respects the many responsibilities of different contributory parties and agencies.[42]

One final argument used to defuse Venkateswarlu's moral claims was that HLL has withdrawn from cottonseed production.

> In 2002 we sold the business to a US company. However, it did not have enough money at the time to take over the whole company. That is why we held 25% of the shares for a while; but we no longer bore any management responsibility.

This response did not convince the coalition. The parties crossed swords in public and privately several times in the post-May 2003 period. At first sight, the discussion seemed to focus on *facts* that the parties disputed. Unilever reiterated repeatedly that its suppliers did not use child labour, while the coalition insisted equally often that it did (albeit further down the supply chain). Whereas Unilever insisted that it paid out higher purchase prices, the coalition had strong doubts about this assertion. The coalition also insisted that these were often cases of some of the worst types of child labour, while Unilever said that we should not ignore the share of cases that were really merely children's work and not child labour.

On the one hand, it is completely understandable that the discussion would concentrate on specific facts. The coalition framed its accusation against Unilever mainly in terms of a factual instance with severe ethical

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[38] Shubhabrata Bhattacharya (25 Jun. 2001).

[39] Shubhabrata Bhattacharya (25 Jun. 2001).

[40] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

[41] Shubhabrata Bhattacharya (25 Jun. 2001).

[42] Letter by Heleen Keep, Unilever, Corporate Relations Department, London, to Dresdner RCM Global Investors (UK) Ltd., dated 3 Dec. 2001.

and public relations ramifications; so Unilever reacted by disputing the facts, especially because of their severe implications.

> An accusation of child labour can stick for years. Unfortunately this is also the case even when it is undeserved

Unilever repeatedly said. On the other hand, the fixation on the truth value of specific facts is somewhat dissatisfying, morally speaking. The commotion about "facts" distracted attention from four political and ethical issues about which the parties – implicitly – also disagreed. One could say that the Dutch discussion between Unilever and the coalition would remain deadlocked as long as these underlying issues were not settled. That is why we will single out these underlying political and moral issues for attention here.

Moral Dispute 1: Chain Responsibility and Infringement of Rights

The coalition claimed that Unilever should have played an active role in combating child labour throughout the supply chain, even when its only link to child labour was through farmers to whom the company was only indirectly connected. The discussion followed two different lines of argumentation, which were not clearly distinguished. One of these grounded the need for Unilever to play an active role in combating child labour in the morally significant fact that the company had acted morally wrong. It had contributed to the causes of child labour and thus was – in part and indirectly – to *blame* for child labour. Unilever had to step in because it had somehow violated children's rights. The second line of argumentation maintained that it was Unilever's duty to step in and help combat child labour, even though the company itself was not to blame for causing child labour, either in part or indirectly.

Morally speaking these arguments are fundamentally different. In the first case, we are dealing with morally wrong conduct by Unilever that has given rise to a violation of children's rights; in the second, we are dealing with an obligatory duty to help that does not originate in any prior blameworthy conduct. Morality judges these situations differently: it is the difference between being an accomplice in drowning a person and accidentally driving past a pond in which a person is drowning or perhaps even watching a real-life television show in which the camera crew drives past the pond. We will start by discussing the first line of argumentation.

The global discussion on international companies' responsibilities leans heavily on the public discourse about human rights. The UN (2003)

expresses its "norms relating to the moral responsibility of transnational companies" completely in terms of not infringing upon and protecting and promoting human rights.[43] The OECD's Guidelines for Multinational Enterprises (2000)[44] also refer to respect for human rights. The coalition's first argument dovetailed with this dominant line of thinking regarding respect for human rights. The coalition argued that Unilever infringed upon the human rights of the children because of its indirect involvement with the practice of using them as farm labour.

The notion of supply chain responsibility was essential for the coalition in giving this argument credibility. Supply chain responsibility means that an economic agent bears moral responsibility for the entire production chain in which it operates and from which it benefits. If there is injustice at any point along the chain, at least some of the blame falls on all of the links. Supply chain responsibility implies that a company or person can never allow human rights to be violated anywhere along the chain, no matter how indirectly one is involved. If there is involvement, however indirect, then one's behaviour is reprehensible and one can be called to account morally. That certainly applies when one derives some level of economic or other advantage from the abuse, as in a low purchase price. Another compounding factor is when any of the company's actions (again, such as paying a low purchase price) indirectly contributes to prolonging the unjust practice. The coalition's assertion was that because of its supply chain responsibility, Unilever had been involved in and could be called to account morally for child labour.

For the supply chain responsibility argument to work, the coalition had to give an account of what was special about Unilever's position, compared to, say, a regular consumer buying clothes made of the hybrid cotton in Germany or the Netherlands. How could the coalition justify targeting Unilever and not such consumers, as well, when these consumers are presumably also aware of child labour practices in India and Unilever's track record was not quite so bad compared with that of regular consumers? Not many consumers ask regular retailers to prove that their merchandise has been made without using child labour; while only a small percentage buy their clothes in special shops that sell products with a no-child-labour guarantee only. To give muscle to the argument that Unilever bore special responsibility because of its supply chain responsibility, the complainants

[43] United Nations Economic and Social Council, Commission on human rights, Sub-Commission on the Promotion and Protection of Human Rights (2003) Fifty-fifth Session. Agenda item 4, *Norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights*.

[44] www.OECD.org

pointed to four factors. First, Unilever is special because of its power as an economic agent. It has a significant sphere of influence. Second, Unilever is, at the very least, an unwilling accomplice because it passively collaborates in prolonging the practice by offering a low market price for the hybrid seeds. Third, Unilever benefits from the practice for the same reason. Fourth, Unilever is negligent about checking up on its possible involvement (see Moral Dispute 4).

Even though the notion of supply chain responsibility – and its desirability, limits and implications – had not really been made an explicit theme of the discussion, Unilever clearly objected to the idea. The company did not accept the concept of supply chain responsibility. Unilever only accepted full responsibility for its own behaviour and that of its first-tier suppliers; it rejected being responsible for the actions of more distant links down the supply chain. In its *2004 Social Report* Unilever states:

> Through our new Business Partner Code, we are working with our first-tier suppliers on human rights, labour standards, working conditions and care for the environment (Unilever 2004: 2).

Unilever argued that no economic actor – whose primary aim is to generate a profit and who has to operate under the pressure of a competitive environment – could possibly assume a heavier responsibility than that. The company would collapse if it had to interpret the "sphere of influence" concept so broadly that it applied to the entire chain of production. In addition, the company had to guard against promising things it could not provide.

> As expectations for wider engagement by companies grow, so too are critics more ready to say when we don't meet their expectations.

Despite the company's reservations, Unilever's position should not be taken to mean that it did not want to assume any responsibility at all for the rest of the supply chain. The company repeatedly said that it expected all suppliers to comply with its code of conduct. It also inspected farms and stated that it would immediately terminate contracts with growers where abuses were found.[45] The company insisted throughout, however, on maintaining a distinction between keeping an eye on matters and assuming full responsibility.[46]

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[45] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

[46] Letter by M.K. Sharma, vice president of Hindustan Lever, to Mary Cuneen, Anti Slavery International, dated 9 July 2003.

Moral Dispute 2: Chain Responsibility and Duty to Help

Oxfam Novib, in particular, used another moral argument to defend the assertion that Unilever was obliged to do its utmost to combat the use of child labour in cottonseed production, even if it did not directly employ children itself. This second argument focused on the principle that moral agents have a duty to help those in need. Morally speaking, there is a striking difference between this argument and the previous one, because the duty to help's appeal to action is grounded much less in blame. In so far as the issue of blame is involved at all, it is not the kind of blame related to prior actions on the part of the agent:

> It is unfortunate that Unilever consistently refuses to take seriously the most important point, which is that Unilever is in a good position to make a difference. It was never our intention to hold Unilever liable for child labour, either legally or morally. What we kept telling Unilever all that time is that it had to adopt the issue of child labour in cottonseed cultivation. They had to make it their problem. This was one reason why we did not want to given Unilever names of individual children. We did not want to reduce the problem to individual cases for which Unilever might possibly be held legally liable. We think that Unilever should assume responsibility for the problem as such, apart from the question of whether Unilever buys directly or indirectly from farmers involved in the practice. Our reason for thinking that Unilever should assume this responsibility is not directly linked to the question of whether Unilever's own suppliers hire children. The point is that Unilever has a relation to this practice, that everyone knows that children are systematically employed in this practice and that Unilever is in a position to make a difference. . .. Unilever says that it is always open for a meeting and that is true and good. However, in the case study we asked Unilever to do something extra this time.

The fact that Oxfam Novib reverted to the duty-to-help argument is quite interesting, but also troubling because the duty to help is, in fact, a very complex principle. Sometimes this duty is very compelling and demands that we take at least some kind of action, even if we still have discretion as to the "what and how". Thus interpreted, it is a duty to rescue and being indifferent to it is, in fact, blameworthy. The standard example is a situation in which a person happens to walk past a pond in which someone is drowning. The passer-by must help. Even though she is not at all responsible for causing the drowning, it is still blameworthy to ignore the situation. Still, she has some discretion in deciding what to do: she can jump into the water, but e.g. when she if not an experienced swimmer, she can also decide to call the police.

There is also much less stringent interpretation of the principle that we are obliged to help others which apply in many other, less urgent cases. As such, the duty to help means that we may not always ignore the needs of

others, must take these into account in our decisions and must sometimes act based on this principle. Under this interpretation, we have discretion not only with regard to what and how, but also when. Typical situations where this interpretation of the principle applies are cases in which we are asked to donate money for a charitable cause or when a friend is in need. According to Oxfam Novib the child labour case is one in which the duty to help ought to be interpreted as a duty to rescue. Unilever must step in just like we all would be obliged to act if we came across a pond in which a person was drowning.

The coalition's appeal to an obligatory duty to help is striking in light of commonly accepted views in modern business ethics. Even the idea that companies have a duty to help at all is controversial. Specialists in business ethics like Donaldson (1989) and Elfstrom (1991) posit that the duty to help that is customary among individuals does not apply to companies, or only to a limited extent. The same point of view is confirmed by a recent UN report on the duties of business enterprises, the so-called (United Nations 2003: 19):

> . . . [C]ompanies cannot be held responsible for the human rights impacts of every entity over which they may have some influence, because this would include cases in which they were not a causal agent, direct or indirect, of the harm in question. Nor is it desirable to have companies act whenever they have influence, particularly over governments. Asking companies to support human rights voluntarily where they have influence is one thing; but attributing responsibility to them on that basis alone is quite another.

So, Unilever could easily have parried Oxfam Novib's appeal to the duty to help by simply rejecting it. It is noteworthy that Unilever chose not to do so:

> As a company we know that we are not here only to make a profit. Perhaps we do not advertise it as much as other companies do, but for us it is obvious that we must contribute to society. We do this in many ways, some – like the Shakti self-help project – we make public, while we prefer to keep others out of sight.

But Unilever insisted on one thing regarding the duty to help: it was fully optional, at least in the commercial context. Unilever wanted to remain in full control over the what and how of any morally necessary effort:

> We want to decide where we aim our efforts. We will decide what we will do when. We believe that we must concentrate on issues related to fish, water and agriculture. We feel linked to these themes. Moreover, they fall within the field of our expertise, putting us in a better position to evaluate projects related to them and to evaluate whether our resources are put to best use.

In other words, Unilever compared the situation in India with the situation in which a person is asked to donate money to a charitable cause. The company also stressed that there were limits to its duty to help:

> We are a company that must operate on the market. We cannot do everything. The most important responsibility for helping people in need lies with the government.

Because of these crucial disagreements about the nature of the duty to help, Unilever in the end rejected Oxfam Novib's argument that it *had* to help fight child labour. But it also made clear that its decision was not grounded in a principled rejection of the duty to help:

> Child labour is upsetting and must be brought to an end as rapidly as possible. However, we bear no direct or indirect blame for the practice. At the same time we choose not to focus our extra social efforts on this issue. There are other, urgent problems, among which sustainability, with which we have closer ties. Of course you may disagree with this choice, but that is no reason to stress only the negative all the time like the coalition does. It tries to make it appear as if we do nothing at all. Actually, we are not doing so badly.

Moral Dispute 3: Historical Blame

One argument that Unilever started using after 2003 to defuse the coalition's claims was that it had since left the cottonseed production industry. According to Unilever, that put an end to its responsibility in the issue. The coalition disputed this. A third moral argument to defend the position that Unilever bore responsibility focuses on this. According to the coalition, withdrawal from the industry did not put an end to the company's responsibility:

> Unilever bears a historical blame because the company contributed – indirectly – to the use of child labour. The blame certainly covers the post-2001 period, when the company could have known what was going on but willingly and knowingly chose to deny all involvement. By helping in the struggle against child labour, Unilever can rectify errors it committed in the past. It is immoral to deny this blame.

Unilever also rejected this argumentation. HLL's withdrawal from cottonseed production in 2002 was a decidedly relevant fact. It put an end to the file entitled Unilever and Cottonseed Cultivation.

> A profit-based company has to set a limit to the moral responsibility that it can assume.

Moral Dispute 4: Prevention

Another ethical question on which the coalition and Unilever differed involved a procedural issue. What precautions should a company take to prevent indirect involvement in child labour (even if it does not recognise

supply chain responsibility)? This question grew out of Unilever's admission that the situation on the farms was unclear but that it nevertheless believed that: (a) there was no child labour being used on its farms, and (b) it was morally acceptable to do business with these farmers.

> The situation is less clear in the actual cultivation of cottonseed, but we do not believe that girls are subjected to forced labour to cultivate the cottonseed that we buy.[47]

The ethical question implied in discussions on the matter was: when is it reasonable to believe such a thing, especially if one is going to do business based on that belief?

According to Unilever, it was justified in believing there was no child labour being used on the farms. The company did not blindly accept what it was told but relied on a three-part prevention policy. Unilever required seed dealers to have farmers sign a contract promising to respect all current legislation; it carried out regular inspections throughout the supply chain; and it requested all parties to cite proof of any specific cases found to the contrary.

> We will investigate every case thoroughly to discover whether it is true and which plantations hired these children. We will certainly take measures.

According to the coalition, this was insufficient for validating a reasonable belief that there was no child labour used in the supply chain. The most important argument was that child labour was too closely linked with the entire industry:

> It is very difficult to buy cottonseed in such a way that you buy only from farmers that have nothing to do with child labour. Even if you can do that, accomplishing it requires a lot more effort than just occasional inspections and having all suppliers sign a paper in which they claim to refrain from using child labour.

Furthermore, the coalition also thought it was not acceptable to hold other parties responsible for detecting possible abuses, certainly when the accounts of these abuses would only be taken seriously when the children's full names were listed:

> Given the gravity of the situation, it is unacceptable to leave the task of denouncing abuses to others. What is more, you misjudge the situation in which the children – and their parents – live. Revealing the names of the children makes them very vulnerable to local social pressure and may lead to court cases that take many years and absorb a gigantic amount of energy. . .. In a case like this one where

[47] Letter by Antony Burgmans, chairman of Unilever, to M. Filbri, Oxfam Novib, dated 18 Dec. 2001.

> basic human rights are at risk, it is not up to (others) to prove that Unilever has overstepped itself. It is for Unilever to show more convincingly that it is pristine.

In 2006, the Swiss company Syngenta took the type of preventive measures that the coalition had in mind. Syngenta is still active in the cottonseed production market and has recognised supply chain responsibility with regard to child labour for some time. One of the measures that it took to ensure that its supply chain did not use any child labour was to instruct seed dealers to work primarily with small farmers with few employees. The reasoning behind this was that it is mainly the large farmers who systematically employ children sold into debt slavery. Small farmers usually employ their own family members. They, too, will often use children, but the chance is greater that these children will be treated better and be allowed to go to school. In this way child labour is transformed into children's work. Another measure Syngenta took was to sign an agreement with a US NGO called Fair Labour Organisation (FLO) to provide external monitoring of its production chain.

The Aftermath of the Discussion in the Netherlands

The accusations were not the only source of Unilever's displeasure with the case. What disturbed the company also very much was the way the coalition went about its work. In retrospect, many of those involved agreed that Unilever and the coalition communicated poorly between February 2002 and April 2003. Both sides have confirmed that they were willing to discuss the issue during that period but that neither took the lead. Unilever had contacted its Indian subsidiary, HLL, and learned that the latter was willing to set up talks with MVF; the coalition maintained contact with MVF and understood that attempts to contact HLL were rebuffed. The coalition and Unilever no longer discussed the issue themselves, except for one time when Director Van der Waaij asked a representative of the coalition about it. Unilever thought the coalition was negligent; on one Dutch talk show, Chairman Burgmans spoke of "thunderous silence". In the interviews Van der Waaij insisted that

> If the negotiations in India were stalled, they should have told us so. We are always open for a meeting.

The brevity of the period between Unilever being sent the report and the coalition's publicity campaign long remained an open wound for Unilever:

> That the report was sent so quickly to the newspaper NRC is absolutely disgraceful. The coalition should have given Unilever more time. It knew that letters to the chairman first pass through staff meetings. As a result, the issue was in the newspaper before we really had time to take a good look at it.

Since Unilever thought the accusation was unjust and the way it was expressed unacceptable, the company took a hard stance toward the matter.

> The whole affair was a matter of reputation. Unilever has a good name and the coalition wanted to take full advantage of this. The coalition knew very well that anyone linking Unilever or a similar company with child labour was guaranteed to draw media attention. It used this method to try to compel the company to accept a responsibility.

In addition, Unilever contends that not all of the groups in the coalition had pure motives:

> Some groups live from scandals like child labour. Were it not for these scandals, they would lose their inspiration, the ability to accuse others and, not least of all, their source of income. Other respectable parties like Oxfam Novib and Amnesty International were foolish enough to allow themselves to be harnessed to these others. You can't help but wonder whether a coalition that works in such a way is itself operating ethically.

According to Oxfam Novib, the coalition agrees with Unilever that there were lost opportunities in the period from February 2002 to April 2003. The coalition was also willing to admit that the period between sending Unilever the report and notifying *NRC* was very short, "although – even in the business community – some very abrupt deadlines are used". Oxfam Novib noted here that since then they have drafted their own code of conduct entitled *Principles for Cooperation with Companies*.[48] The principle of hearing and being heard is given an important place in the code. Nevertheless, the coalition still has a different perception of the case. According to the coalition, Unilever was negligent, certainly in the period from February 2002 to April 2003:

> One might expect a more alert response from a company facing such serious accusations. Unilever remained too passive and walked away from its responsibility to help eliminate child labour in Indian hybrid cottonseed cultivation. At a given moment, the coalition thought it had to take action. That can include some less friendly tactics. We just wanted to achieve our goal. That is why the national India working group sent chairman Burgmans a letter with the completed research report on behalf of the coalition.

[48] www.novib.nl/mvo, visited 12 Oct. 2005.

Epilogue

What about the Indian children at the heart of all this? All things considered, the Indian and worldwide campaigns against the use of child labour in cottonseed production are starting to bear fruit. In 2001, the government in the state of Andhra Pradesh passed a resolution ending child labour in all its forms. Other legislation is in the works. The state has also started a campaign to inform parents and children. More than 5,000 cases of administrative measures have been brought against employers. In India, NGOs have also undertaken proactive action against the use of child labour in cottonseed production. This includes information campaigns, establishing schools and setting up centres that prepare children for school.

Especially pertinent for this case is that, partly due to the severe criticism in and outside India, there seems to be a revolution in the thinking of many seed companies, including Western multinationals. After responding with initial reticence, nearly all large multinationals, including Bayer and Monsanto, admit that they cannot guarantee that their production chains are free of child labour and that intensive monitoring is needed to stamp out the practice. ASI (Indian Association of Seed Industry) – to which Monsanto, Syngenta, Advanta, Proagro and Emergent Genetics all belong – decided in 2003 to work with MFV to end child labour. To this end, in 2003 all ASI members accepted the notion of supply chain responsibility and took initial steps in 2004 against child labour. These include systematic monitoring. Practical arrangements between Syngenta, Monsanto, Bayer, MVF and local groups were negotiated in 2005. A system of penalties is in preparation that would impose punitive cuts in benefits on farmers shown to employ children. Farmers caught repeatedly will find they have no purchasers for their cottonseed. Despite this approach, ASI insists that Venkateswarlu's first report was sub-standard.

All this taken together has led to a significant reduction in the number of children labouring in Andhra Pradesh (Venkateswarlu 2004: 16). Some speak of a 30–40% drop. The only problem with these figures is that the province has suffered from a drought in recent years. There are thus external reasons for the fall in cottonseed production. Another factor is that some seed companies have slowly shifted their operations to other provinces where there are fewer qualms about using child labour.

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Chapter 10
Rise and Fall of Silicon Valley in Flanders: Lernout & Hauspie Speech Products

Marc Buelens and Eva Cools

Abstract The early years of Lernout & Hauspie (L&H) were turbulent. The company crawled from one financial crisis to the other. At the beginning they repeatedly had to go to friends, acquaintances, distant acquaintances, local businessmen (butchers and bakers) and farmers. A prime minister, a provincial governor and various mayors, even the heir to the throne all spoke in public and often showed their unconditional support with financial resources. In 1995, L&H became listed on the US Nasdaq technology exchange. Starting in 1996, the company started along the takeover path. Among the companies it acquired were its two most important US rivals, Dictaphone Corporation (7 March 2000) and Dragon Systems (27 March 2000). The company displayed spectacular growth and drew new investors. In 1997 Microsoft invested $45 million to acquire nearly 8% of the shares. Later it became clear that the board at L&H grossly underestimated one factor: the last two takeovers meant that nearly half their turnover was generated in the USA. L&H's management was clearly no match for the US press and analysts that smelled blood. The financial operations were far from transparent and most experts became convinced that L&H was a clear case of fraud. Bankruptcy became unavoidable.

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The Founders

Jo Lernout, then 39, and Pol Hauspie, then 36, founded the public limited company Lernout on 10 December 1987. Two years later the company changed its name to Lernout & Hauspie Speech Products (in Flanders mostly known as L&H). Friends and acquaintances helped set up the company; it had €300,000 in capital, but not all of that was in a bank account. There was "creative" contribution in kind consisting of know-how. This kind of contribution is rare when setting up a company; civil-law notaries do not accept it without reason; at the very least it requires a report from an external accountant. The first shareholders were promised that they would be paid back within 18 months. So from the company's very start, Jo Lernout and Pol Hauspie had to be on the lookout for new investors. This became a constant theme running through the story (De Witte et al. 2002). They repeatedly found themselves with their backs to the wall financially. They repeatedly had to go to friends, acquaintances, distant acquaintances, local businessmen (butchers and bakers) and farmers. L&H was once called a "14 year search for money" (Van Apeldoorn 2001).

The founders' had an ambitious goal for L&H from the very start. They wanted to make it the world leader in speech and language technology. L&H's mission was to supply all imaginable speech and language technology applications. Moreover, L&H intended to supply these core technologies for all imaginable types of processors and for multiple languages. To carry out this mission, Jo Lernout and Pol Hauspie signed licensing contracts with three Belgian laboratories that held world-class status in speech and language technology at that time. Later, L&H would sign more licensing and joint venture contracts and would hire international experts. The many takeovers that started in 1996 would turn the company into the world leader in speech technology in the second half of the 1990s.

By appealing to farmers, political leaders, bankers, bicycle racers, local businesses and housewives, Lernout and Hauspie served an educational role, first in the immediate vicinity, later in the province of West Flanders and finally, throughout the Flemish region. Flemings had to learn to invest in venture capital. Doubters were proven wrong at all technology trade fairs. Many, common people and professional investors alike, invested unconditionally and took substantial financial risks to invest even more. Investing in L&H became a sign of patriotism for people in the province and the region. Moreover, the project was nearly certain to provide a nice yield. And who would think of doubting... a royal prince, a prime minister, a provincial governor and various mayors, even the heir to the throne all spoke in public and often showed their unconditional support with financial resources.

Jo Lernout is a visionary, a salesman. The man has a compelling vision. With a BA in science he had enough technical and scientific training to understand the technical background of speech and language technologies. As experienced salesman at Wang, as driven personality, as honest local boy, he was able to convince everyone that the future of speech technology had already started. Whether in the smallest church hall, the best-filled convention centre or most highly educated auditoriums, it was always the same: Jo Lernout was the top of the bill. Disarming, never arrogant, clear as crystal, he set his listeners dreaming by taking them on a trip along the endless applications for speech technology. Surgeons, drivers, even housewives: how have they all managed to survive without speech technology? We will all soon be talking to our refrigerators and our cars. We will be able to speak on the phone with the Chinese because super-powerful software will translate our words into Mandarin and back again. Jo Lernout gave awesome demonstrations of speech and translation technology that worked, of voiceXpress packages and virtual management assistants. The future had really begun. Moore's law, which states that the capacity of a computer chip doubles every 18 months, is indeed a law of nature and the consequences can scarcely be grasped. It is as plain as the nose on your face that computers will soon be smarter than people. Then we will *have* to talk to them because language is humanity's natural medium for communication.

Pol Hauspie's interest was clearly on the financial side. He had an office for software accounting (HPP: Hauspie Pol Poperinge) in Poperinge, the city that made him an honorary citizen in 1999. That office was a formidable competitor for some of Wang's products. That is how Jo Lernout came to meet him. They gradually became real friends and dreamt of a new company. The unconditional bonds of trust certainly do not date from the first day. Before they set out together in 1987, they took a few days off together in the Ardennes woodlands at Pol Hauspie's suggestion. They became better friends as their contacts and shared activities increased. "We're brothers", Pol Hauspie would often repeat. Where Jo Lernout was known as a shrewd salesman, everyone knew that Pol Hauspie was the prototypically rock-solid, meticulous, 100%-reliable, nose-to-the-grindstone worker, the model of the idealistic, authentically Catholic native of West Flanders. Pol is intensely religious and very active in his church choir.

Rooted in the Vicinity

Lernout and Hauspie had their roots in the broad neighbourhood around Ypres. As soon as they raised enough cash, they did all they could to put their home province on the world map. L&H would sponsor the most

wide-ranging projects from a local basketball club to a language technology park called Flanders Language Valley. But above all, they were driven by a higher calling. They wanted to increase employment in that out-of-the-way part of Flanders. On 21 January 2001, honorary citizen Pol Hauspie addressed the Poperinge municipal council. He called upon them to support him in his efforts to provide employment in the area. Later, long after the debacle, Jo Lernout commented:

> We were a company that almost anachronistically wanted to provide employment in our home area. (Claeys 2005)

The two entrepreneurs' ties with the area are legendary. This is a company set up by West Flanders natives, with West Flanders capital and a West Flanders mentality: work hard and smart, take well calculated risks. Looking back at the collapse of his company, ever hard-working Jo Lernout said:

> I come from a family where all were intensely religious, Catholic and self-employed. I inherited a strong work ethic from my parents. In good times and bad, the message was 'keep on working'. (Claeys 2005)

Jo and Pol, as everyone called them, because of course everyone in the area knew them, remained modest, meticulous workers who had invested in the future technology. They held up a mirror for their area. Everyone could see that what Jo and Pol did was good. The people in the area were grateful. Jo and Pol were awarded the most prestigious honours that West Flanders had to give: following in the footsteps of eminent writers Hugo Verriest and Stijn Streuvels, political leaders Achilles van Acker and Dries Vlerick and eminent business leaders Anton Beeckaert and Jan Lannoo, they became "Knights of West Flanders" in 2000 in service of the local secret societies like *De Swighenden Eede* and *t Manneke uit de Mane*.

The First Step Is Always the Hardest, and Certainly for L&H

L&H's early years, right after 1987, were turbulent. The company crawled from one financial crisis to the other. Jo Lernout recalls that at one time they could not pay their staff and a bailiff threatened to impound the company's assets. The persistent stream of crises elicited from Jo Lernout the oft-cited statement:

> the grass is always greener on the edge of the abyss. (De Witte et al. 2002)

Jo Lernout and Pol Hauspie had a dream but no money. They continually had to look for investors, because R&D was expensive. L&H became one long round of pass-the-hat in which they often had to use their personal assets as guarantee. To attract investors, Jo Lernout and Pol Hauspie also had to do more than tell a nice story. Potential investors also wanted to see some tangible achievements. The pressure to prove that the technology works meant that L&H initially developed products that were really no more than gadgets, like a talking Christmas tree decoration.

In 1992 Jo Lernout and Pol Hauspie took the wheel and tried a different approach to carry out their mission. Instead of working on practical applications for end users, L&H turned to the development of basic technology. L&H wanted to develop a standard, preferably a world standard. But the direction they were heading never changed completely. The manoeuvring only got more daring. Money remained a problem. At the same time, more institutions invested in speech technology, including the Flemish government and an investment company that it controlled. As with so many technology companies, most of these investors put their hopes in the future. Analysts considered speech and language technology the next technological wave in what could be a market worth millions of dollars (Maremont et al. 2000). L&H became the focus of the biannual Flanders Technology International trade fair. As of 1997, plans for Flanders Language Valley started to ripen. Jo Lernout and Pol Hauspie dreamt of attracting other companies that also work on speech and language technology. In that way, they hoped to give back something to the area and create two thousand jobs in and around Flanders Language Valley. The 60-acre industrial site opened at the end of 1999. A cluster of companies built on the talents of polyglot Flemings would definitively put Ypres on the world map. Jo Lernout and Pol Hauspie were convinced that language technology was *the* up and coming thing and that Flanders was the ideal place for developing this new industry because Belgium was a multilingual country with extensive language teaching.

In 1995, L&H became listed on the US Nasdaq technology exchange. L&H's flotation was a natural step in the company's evolution and seemed to be a success from the start. The introduction on the NY exchange not only stilled the voracious hunger for financial resources, it made L&H international and respectable all at once. However, the listing on the Stock Exchange and the accompanying enormous expectations of investors at home and abroad, put the management under very great pressure to report better figures each quarter. Above all, it put the company under the surveillance of the Securities and Exchange Commission (SEC), the US exchange authority.

At that time, L&H still had not turned a profit and its sales were hardly more than a few million euros. Sales would rise exponentially in the subsequent years. The share price swung spectacularly from $11 at the time of flotation (1 December 1995) to $16 at the end of the first day then to $45 and $92, to between $75 and $80, back to $25, up to $72, only to crash first to $28 then to $13 and finally to nearly zero.

Gold Fever

The 1990s were known for an economic mentality that – in retrospect – can no longer be considered reasonable, but that investment banks, consultants, business schools and, especially, the financial economic press all accepted at the time. It became clear later that all the conditions for a bubble were present, but at the time few seemed to be concerned about this. On the contrary, those who listened to prophets of doom in 1995 missed out on tremendous stock market yield because they apparently still did not understand that a "new" economy had arisen.

Internet and ICT caused a shift in economic and financial thinking. Nasdaq and Easdaq (the European counterpart of the US technology exchange) are two new exchanges set up solely for technology shares because these shares had their own dynamism. For them, growth was much more important than dividends. Operational profit was considered a misleading indicator. The link between share price and profit figures was considered broken. It was crucially important to be the first to develop new products, the fruits of new technology. Only at a later stage did sales become important. And only after that did profit become pertinent. Once the product had a near monopoly, the profits would be gigantic. These expected profits were capitalised on the market in anticipation.

Investors did not speculate on profit or dividend but on the increase in share value. The more and the faster the products were developed and brought to market, the greater the share value would become. Capital gains of 200 and 300% in just a few months were no longer just a dream. It could happen. It had happened. It would happen again. Gold fever was rampant. The first to lay claim to a vein could sell the claim the next day at considerable profit, long before the first ounce of gold was extracted.

Companies bought other companies and paid in shares in the new merger. Everyone won, because the mere announcement of the merger sent share prices up. The seller got an extra amount on top of the sales price, the buyer did not have to fork out any cash. New investors entered the market

goaded on by the perception of permanent price gains. But good news was needed every quarter: new products that passed tests, new investors clamouring to get in, another company bought, and the sales of new products that far exceeded grandest hopes. When the supply of good news faltered, share prices could take a nosedive turning the company into a takeover target.

"Sometimes a Little Less Scrupulous. . ."

In January, 1997, readers of the weekly business magazine *Trends* voted Jo Lernout and Pol Hauspie 1996 managers of the year, a prestigious and striking distinction. Their comment was:

> From an ethical perspective, we never overstepped the line. If we had done that, we would have ceased to exist, because then the trap would have sprung shut. Anyone examining our balance in September 1995 before the Nasdaq launch would have seen that we carried a cumulative net loss of $72 million on our books. Our operating capital was in the red. Yet our greatest asset didn't show up in the balance: the loyalty of customers, suppliers and staff. You can't assign numbers to such things. Yet they are crucial. If you make a mistake there, you've had it. (Buelens 2002; Kay 2003)

Later, Lernout will adapt his outlook to the perception of the rest of the world:

> It can be asked whether all aspects of the way we treated our shareholders was by right and factually ethical. (Trends 1997)

The founders seemed on occasion to be not scrupulous enough in their choice of staff and associates. In 1993, L&H contacted Maurits De Prins, a very controversial businessman and former head of Super Club, a video chain store. In 1996, they set out with Ray Kurzweil, best known from his books *The Age of Intelligent Machines* (1990) and *The Age of Spiritual Machines* (1999). But in 1993 Kurzweil Applied Intelligence was discredited when accountants discovered evidence of fraud in the books. A lot of the turnover turned out to be imaginary. In 1996 before L&H set out with Ray Kurzweil, *BusinessWeek* wrote the following in response to the proceedings against several former senior staff members at Kurzweil Applied Intelligence:

> Ethical experts say the decision to keep phony revenues in the records may arise from a misguided sense of loyalty. 'Executives in this type of situation often have an emotional investment in the company. . .. They have all this wonderful stuff to

> offer the world. So they rationalize. They say, We'll do this temporarily, and that will give us time to make it all come out right. But instead, they dig themselves in deeper'. (Claeys 2005)

Then they recruited Gaston Bastiaens in 1996. He was known in the technology community mainly for his failures (Apple's Newton, Philips' CD-I) and for contested transactions at software company Quarterdeck.

Later, Lebanese-Armenian businessman Harout Khatchadourian proved to be involved in financing L&H. He put in $36 million. His name struck a sour note in Flanders. He may have been involved in a possible case of tax fraud related to the Beaulieu textile empire via a secret system of fake commissions set up by his father Aram Khatchadourian. Even now this case has not been brought to court. Nevertheless, the association of the name Khatchadourian with L&H surprised everyone in Flanders.

A Growth Company Needs a Lot of Money

L&H constantly needed a large flow of money. Starting in 1996, the company started along the takeover path. Among the companies it acquired were: Mendez Translations (10 September 1996), a Spanish, German and Italian translation agency (5 November 1996), Berkeley Speech Technologies (27 November 1996), Kurzweil Applied Intelligence (16 April 1997), Gesellschaft für Multilanguage Systeme (28 May 1997), and above all its two most important US rivals, Dictaphone Corporation (7 March 2000) and Dragon Systems (27 March 2000). Few people seemed concerned that Dictaphone Corporation had debt to the tune of €450 million. Later it became clear that the board at L&H grossly underestimated one factor: the last two takeovers meant that nearly half their turnover was generated in the USA. That meant that detailed accounts had to be submitted to the SEC, the US stock exchange watchdog. L&H's management was clearly no match for the US press and analysts that smelled blood. The last shred of goodwill was lost when L&H insulted stock exchange analysts ("if you're too stupid to understand. . .") and made statements that came back like a boomerang, "there is nothing wrong in being smart" (Maremont 1996; De Witte et al. 2002).

Cooked Books or High-Tech Finance?

As L&H grew it became obvious that the butcher and baker were no longer sufficient to satisfy the company's nearly insatiable need for fresh capital.

Pol Hauspie was co-designer of a series of complex financing plans. The founders used a complicated holding structure to keep a firm grasp on all this (De Witte et al. 2002). Jo Lernout and Pol Hauspie set up L&H Holding, a company under Belgian law. Its purpose was to organise supervision of L&H and to keep it rooted in Flanders. L&H Holding was involved in investments in the networks around L&H. According to Jo Lernout, this was Pol Hauspie's strong point:

> He is very creative. Legally it's all right, and it helps you survive. (Merchant et al. 2003)

In addition they set up numerous financial structures outside of L&H, the best known being language development companies (LDCs). The LDCs held licences to develop L&H's basic technology for use with a specific language group. For instance, LDCs were set up to develop speech recognition systems for Arabic and Hindi. Were L&H to do this work themselves, it would increase costs and push down the bottom line on the income and expenditure account. When a language development company did the job and paid royalties to L&H, L&H booked a nice turnover instead of a loss. For their books to be in order, the LDCs had to be financially independent of L&H and L&H could not do the developing. Gradually people began to suspect that neither was the case.

Credit default swaps, i.e., selling part of the risk on a loan, and other techniques were used to keep various credit risks off the balance sheet. Artesia Bank, L&H's principal banker, provided a €28 million bridging facility in 1998 and 1999. It was later suspected that this money was used to book phony sales. Loans were also turned into sales via a detour to South Korea; contracts were antedated which raised turnover and the bonuses linked to them. These and other practices were later bandied about in the media. No one was ever sure whether they simply lied about these and other constructions or whether they thought these were normal constructions for a growth company in the new economy. For the purely juridical side of the case – were the financing mechanisms used legal or fraudulent? – we must of course wait for the court's decision (Maremont et al., 2000).

On 27 July 2000, L&H Holding sold no fewer than 625,000 shares to Gaston Bastiaens, who held operational management of the company from 1996 to 2000. He paid €40 per share, while the market price was €30. Bastiaens borrowed $25 million from Artesia Bank Nederland to buy the shares. The revenue from the sale accrued to Jo Lernout, Pol Hauspie and Nico Willaert, a less visible personage behind the scenes at L&H, someone with good contacts (e.g., the royal family). The sum was directly placed in short-term investments (Anonymous 2003). A series of transfer operations, possible double use of guarantees and shady reinvestments give the impression that L&H wanted to use the same money twice. It was

later uncertain which bank owned the sum, because several pledges proved worthless after the bankruptcy. This situation put several banks in serious difficulty. The minimum that can be said is that the transfer operations were far from transparent; later the media would severely criticize it and it in a court case. Nevertheless, the company displayed spectacular growth and drew new investors. In 1997 Microsoft invested $45 million to acquire nearly 8% of the shares. Bill Gates came to offer his personal support when Flanders Language Valley opened. Everyone seemed to be there: Belgium's prime minister, Flanders' minister president, leading industrialists and even Prince Philip, the heir to the throne. In 1999, Intel invested $30 million. Anyone who had any doubts about Jo Lernout and Pol Hauspie was clearly someone with no feeling for facts.

A Fine Piece of Research Journalism

While L&H's figures for 2000 were not examined too closely in Flanders, they raised some hard questions in the US. The books showed that 52% of L&H's first quarter sales in 2000 came from South Korea. In a year's time, sales increased by a factor of 607. Two *Wall Street Journal* reporters went to Korea to document the spectacular growth. They came across remarkable data. One company said it had not bought anything from L&H but *sold* to it. Three other companies had to that point never bought anything. Three others had bought, but for much less than claimed. Still another said that it bought no products, but that a joint venture with L&H had bought them. L&H tried to show that it was all a misunderstanding; it commissioned auditing company Klynveld Peat Marwick Goerdeler (KPMG) to perform a special audit. Later, once Gaston Bastiaens was dismissed because he lost confidence after the revelations, the new management asked PricewaterhouseCoopers to examine the books again.

John Duerden, formerly of Dictaphone, took Bastiaens' place in 2000. He, in turn, left amid a full-blown crisis in January 2001 to make room for Philippe Bodson, the epitome of Belgian management. When Bodson learned of the fraud discovery, he said he

> was very impressed by the level of sophistication of the fraud and the amount of imagination that went into it. (Echikson and Moon 2000)

Flanders quickly divided into a camp that retained and a camp that lost faith in L&H. The local area remained loyal; local political figures continued to voice their support. Those who remained loyal started to believe in a conspiracy theory. They thought the US government did not want a Belgian company to own critical technology. In this theory, speech recognition,

given the numerous military applications, had to be brought under full US control. L&H had to be eliminated. Under such circumstances, they thought, it was easy to find a Korean stick to beat down a pup in West Flanders. Jo Lernout did not support this theory, "I don't think there was any conspiracy. No one forced us to the takeover of Dictaphone – a US company with a large turnover and high debt ratio – just to make it easier to bring us down (Carreyrou 2001). However, in later interviews, Lernout dramatically changed his tone, attributing the downfall of his company to a CIA-conspiracy.

Lawyers in the Lead

After the economic turbulence came the legal turmoil. On 21 September 2000, the US Securities and Exchange Commission (SEC) launched an official investigation into L&H's financial reporting. On 9 November 2000, L&H distributed two press releases. In the first they admitted that "some errors and irregularities were found" in the accounts for 1998, 1999 and the first two quarters of 2000. The second announced the resignations of Lernout, Hauspie and Willaert. The court in Ypres instituted a preliminary investigation on 12 November 2000. At L&H's request, two accounting firms examined its figures: first KPMG then PricewaterhouseCoopers. KPMG seemed to be both judge and party. The office served as external accountant and at least one key staff member had received an important position in the network around L&H. KPMG ascertained that the management systematically passed on misleading information. The report that PricewaterhouseCoopers released on 6 April 2001 said that 70% of the income attributed to L&H's Korean department was imaginary. On 26 April 2001 the Belgian Justice department ordered the founders' arrest – in genuine US style complete with handcuffs – on suspicion of forgery, falsification of annual financial reports and price manipulation. They were kept in preliminary detention for 9 weeks. The company's operations continued under a temporary court-ratified composition; it worked on setting up a credible recovery plan.

October 2001: The Curtain Falls

Commercial court judge Michel Handschoewerker had to conclude that the recovery plan was de facto a liquidation plan.

> Under those circumstances, the court cannot offer the company protection against its creditors. (Lernout 2005)

Bankruptcy became unavoidable.

The bankruptcy hit many small investors like an uppercut. Political leaders maintained a discrete silence. Banks that appeared to have granted loans without any real collateral now licked their wounds. Suits were prepared in Asia, the US and Belgium. Employees were let go. The local community was traumatised. Flanders Language Valley became a ghost town.

The questions around Flanders' most visible and spectacular bankruptcy continue to spark controversy. L&H has left many Flemings with permanent scars. Is the L&H debacle a classic example of run-away entrepreneurship? Or is it simply large-scale fraud? The courts still have to decide on the legal aspects. But can we point to a place where, ethically seen, things began to go wrong? No one has ever asserted or seriously defended the idea that Jo and Pol were thieves from the start. They undoubtedly had 100% faith in their dream. Is there a correlation with the hiring of new people? Without doubt. But a correlation is not a causal link. Why did a company so closely associated with the local social and economic fabric come to such a brutal end?

May 2007: The Trial

The fraud trial started at the Ghent appellate court on 21 May 2007. Hundreds of angry investors attended the first day. The financial press was mainly interested in the fact that financial services group Dexia and accounting firm KPMG were among those charged. Twenty-one persons were charged with accounting fraud and manipulating share prices. It was claimed that some 50,000 people lost money. The courthouse was deemed too small and the trial took place in a convention centre.

Prosecution spokesman Dominique Debrauwere told journalists,

> The revenue was dramatically overstated between 1997 and 2000 and this led to investors and potential investors being misinformed about the true state of the company's finances. (Scheidtweiler 2002)

In January 2008 Pol Hauspie pleaded guilty, much to the dismay of Jo Lernout who still claimed his innocence: the technology was real, and the sales were genuine. The company was the victim of a CIA-conspiracy. Lernout remains the strongest believer. He told the court:

> Google could have been in Flanders. (Lernout 2005)

The trial's complexity (340,000 pages), the number of accused, and endless procedural matters proved a hindrance. The verdict is expected for the fall of 2010.

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Chapter 11
Construction Fraud

Johan Graafland and Luc van Liedekerke

Abstract Due to the actions of a whistleblower The Netherlands was confronted with a massive case of construction fraud involving almost the entire construction sector. Price fixing, prior consulting, duplicate accounts, fictitious invoices and active corruption of civil servants were rampant practices. This case description concentrates on price fixing and prior consulting which were long standing industry practices that only became illegal in 1998. We trace the history of price fixing in the construction sector and the institutional factors that pushed the sector into price fixing. We consider several institutional proposals to solve the issue as presented by a parliamentary investigation committee as well as the building sector itself.

Introduction

On 6 December 2001, the Dutch House of Representatives set up a temporary committee to investigate construction fraud.[1] Construction fraud can be defined as "all illegal and untrustworthy operations by construction companies and sub-contractors; which aim to undermine market forces

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[1] In 1953 (De Vries Commission), 1971 (Standing Committee on Economic Competition) and 1982 (Consultative Body on Regulating the Tendering System) the government also set up commissions to weigh proposals for solving problems in the construction industry. The new parliamentary committee delivered its report in 2003 (Tweede Kamer 2003).

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in the construction industry and reduce exposure, increase profitability or ensure continuity" (Priemus 2002). The widespread fraud with which the Netherlands suddenly seemed to be infected provoked exasperated cries. Jan Marijnissen chairman of the Dutch socialist party gave breath to widespread feelings of disbelief among the Dutch by saying:

> has the Netherlands really turned into a land of fraud?

May be not, but still it is possible that within relatively corruption free countries particular industries become permeated with fraud and corruption. For instance: around the same time Norway, Sweden, Denmark and Finland struggled with large scale price-fixing scandals in the asphalt industry; a core element of the construction industry. None of these countries are known for being particularly prone to corruption yet all of them were confronted with significant fraud cases (Cobouw 2002).

Is it due to the particularities of the construction industry's structure that it is susceptible to fraud? Or is it due to the people working in the industry? Are they unusually susceptible to the temptations of fraud? Those involved insisted for a long time that there was no question of fraud and certainly no question of immoral conduct. They say that even should some practices have been unacceptable, we must view these in their proper context. To offer one example, Joop Janssen, former CEO at Heijmans construction company, said that construction fraud came down to a question of culture (Van Empel 2002).

> The construction industry is technology-driven. A bridge may not collapse. So the bridge has to have sturdy columns and for these you need technical skill. That is why the construction industry attracts a particular type of person. People who work in the construction industry are used to fixing things themselves. They choose freedom over red tape and paperwork. (Tweede Kamer 2003)

During the preparatory investigation, Joop Janssen told Marijke Vos, chair of the parliamentary investigative committee that

> You people [the politicians] just don't understand it. You have no idea how the industry's culture works. These are customs that have become ingrained over decades. Justifying one's actions is not part of the industry's cultural component. . . . Construction workers are real he-men. (Tweede Kamer 2003)

According to the construction industry itself we have to look for the explanation of the typical characteristics of the industry outside the industry itself. In the end the government provoked the wide spread use of price agreements and other typical practices. In the same interview as quoted above, Joop Janssen drew attention to the fact that many of the fraudulent practices arose because clients – usually the government – did not reimburse the cost

of tendering–thus provoking the fraud. Others explain this by drawing attention to the unique Dutch construction industry's institutional context. On one side you have an army of bureaucrats that manage more than half of the money in the industry, on the other a strong corporatist culture in which cartels and consultative interest groups are deeply rooted. In this context, secret agreements or deals, passing a job on to a colleague, a pre-arranged price and made-to-suit tender specifications will naturally take place. These and other statements show that fraud in the construction industry is not self-contained. Several contextual factors appear to have contributed to the situation. The objective of this case description is to provide this contextual information and prepare the ground for a judgment on the ethical quality of the construction business and building contractors' conduct. But first, we must know what construction fraud is.

What Is Construction Fraud?

Construction fraud is typically understood to encompass three activities. First is the so called "informal consultation" or "prior consultation" preceding each official tender. During this consultation – legally forbidden since 1998 – contractors come together to decide who will do a given job. The contractor with the lowest price is given a chance to acquire the job. But the others do not leave empty handed. This contractor adds two so-called "corrective elements" to the pricing procedure: reimbursement for calculation expenses and a price mark-up euphemistically labelled "price improvement" by the sector. The reimbursement for calculation costs is a fee that the chosen construction company pays to competitors to cover the cost of tendering. Price mark ups are increases to the lowest price to reduce the lowest submitter's exposure. Koop Tjuchem's – later revealed – duplicate accounts showed that the price mark-up resulting from prior consultation came to approximately 8.8%.[2] On an annual industry volume of 15 billion euros, that equals nearly 1.5 billion in excess profits. This refutes the building contractors' argument that prior consultation is only intended to reimburse calculation costs, because calculation fees – when they were standard procedure – came to only 2% of the contract price (Hé 2003). Building contractors

[2] There is still an element of competition because the principal choose the tender with the lowest price. Anticipating the price change when securing a contract, companies that want to acquire a job bid under cost in the prior consultation. This mechanism makes it doubtful whether the price change resulting from the prior consultation was ever really 8.8%.

and their individual members were not the only ones to benefit from these price increases. Some of the money flowed to trade associations like the Amsterdam Contractors Association (AAV). It used the money it received to pay for gratuities for its members, e.g., an annual trip on the Rhine or a vacation flight with a leased DC9 (*NRC* 23 Oct. 2004).

Issuing and collecting fictitious invoices is a second aspect of the construction fraud. Claiming costs not incurred adversely affects principals and increases profit margins inappropriately. An article in the Dutch daily *NRC Handelsblad* attests that Strukton issued 13.1 million euro in fictitious invoices on a tunnel project. This money was siphoned out to other projects, to make up for the losses there (*NRC* 2 Dec. 2002). Keeping duplicate accounts allowed this practice to go unnoticed.

A third aspect of the construction fraud involved the building companies' attempts to obtain information on budget ceilings. "Grubbing official" and other terms were used as euphemism for the corrupt civil servants in provinces and municipalities and at the Directorate-General for Public Works and Water Management that provided this information (*NRC* 17 Sept. 2002). Among their rewards were visits to bordellos or written-off leasing vehicles (called passing on a car). Colluding construction companies could use information on budget ceilings to raise their prices to that level. Contractors called this doing business Italian style. You read the bids during the prior consultation to determine the lowest price. The lowest bidder would get the job but the price of his bid is raised to the budget ceiling as revealed by corrupt officials. The difference between the budget ceiling and the price of the lowest bidder is split into equal shares. When for instance ten companies took part in the prior consultation, each got 10%. This reduced exposure and increased profits.

Besides these three activities, we can also classify other acts as fraudulent, among them construction companies' tax fraud and employees' use of company materials while moonlighting. Like other labour intensive industries (hospitality, consumer goods repair), construction is known for moonlighting (Graafland 1990). The parliamentary committee set up to investigate the fraud chose not to include these types of activities in its definition of construction fraud.[3]

[3] Construction is also known for high absenteeism (EIB 2001a). In 1998, 32 of every 100 employees received a disability payment (EIB 2001b). The workload is heavy and has even grown in recent years (EIB 2001c). Nevertheless, recent benchmark research shows that construction companies are no worse at socially responsible business practices than metallurgy or financial service industries (Graafland and Eiffinger 2004).

Although the construction fraud's three aspects – prior consultation, fictitious invoices and bribing civil servants – are linked, the rest of this article will focus on the first facet.

Who Are the Parties Involved?

Construction fraud had an impact on several stakeholders. The most important are the building contractors and the various government authorities. We can classify these by level. Building contractor are involved

- on a meso level: construction industry trade organisations, e.g., Building Netherlands (formerly AVBB [the Coalition of Dutch Construction Industry Organisations])
- on the company level: entire individual contracting companies
- on a personal level:
  - individual managers responsible for drafting quotations and securing orders for their companies
  - members of the building contractors' board of directors
  - the building contractors' employees that undergo the indirect consequences (e.g., greater profits, more sales, more jobs) of their employer's participation in building fraud
  - directors of the construction industry's trade organisations.

Government bodies affected include:

- the European government, mainly as legislator
- the Dutch national government, as legislator (Competitive Trading Act) and monitor (Economic Investigation Service – Netherlands Competition Authority [NCA]) and as purchaser of major infrastructure projects
- local and/or regional governments as regulators (issuing permits, approving zoning and municipal land-use schemes) and as purchasers of the building contractors' products
- individual public officials acting on behalf of local, provincial or national governments and entrusted with awarding jobs to building contractors.

Other stakeholders involved in or affected by the construction fraud or its consequences are the building contractors' other customers, their shareholders,[4] their accountants[5] and society as a whole (including tax payers).

The Background

The construction fraud had a long history. It is difficult to ascertain exactly when it started. For decades the Dutch government had officially recognised the practice of prior consulting and had supported it. Several possible causes influenced the rise of construction fraud. In this section, we treat causes relating to the nature and production of the construction industry's product. After that we will examine the institutional aspects of the construction market and the history of prior consultation, with attention to the government's role.

A basic characteristic of the construction industry is that nothing can be produced ahead of time. A commission always precedes production. This makes it difficult for building companies to deliver production gradually during cyclical fluctuation. Because building contractors produce capital goods for other companies and because business investment is much more sensitive to trading cycles than are consumer goods, construction companies are extra sensitive to discontinuities. Another factor that restricts opportunities for a balanced scheduling of building activities is the dependence of government contracts on political decision-making, which after consuming much time and causing great delays often expects haste in implementation. Such reasons lead building contractors facing empty order books to work at a loss to avoid the expense that results from a great variation in turnover, e.g., the cost of laying off staff in slow periods and hiring new staff when business picks up.

[4] One consequence of the construction fraud's becoming known was that construction company stock prices fell by up to 15%. When it became obvious on 14 February 2004 that there were price agreements in other segments of the earth, road and water works industry (following upon news of other shadow accounts), stock prices of companies involved fell sharply once more (*NRC* 16 Feb. 2004). The literature on the subject also shows that a lack of corporate responsibility is detrimental to a company's share price. See: Soppe (2000), Rao et al. (1996), Davidson et al. (1994), Graafland and Smid (2004).

[5] Testimony before the investigatory committee shows that accountants did not draft the fictitious invoices. "There had long been no real auditing", according to Deloitte & Touche's Veenstra (*NRC*, 17 Sept. 2002).

A second characteristic is that construction is site-dependent. A production process and organisational framework have to be created for each job. This increases the need to work with familiar partners. The building contractors, the various subcontractors and related companies (architects, etc.) know one another and cross paths regularly. All contractors cultivate relationship management. They nurture and maintain contacts, meet at service clubs, etc. This expands opportunities to make deals.

A third characteristic is that construction projects tend to be unique, to require large investments and to have a long technical and economic lifespan. This is particularly true of major infrastructure projects like tunnels, etc. Each project is different, which means a unique price must be set. Drafting bids for such projects is expensive; and according to the industry, calculation expenses need to be reimbursed. Furthermore, something can always be overlooked when compiling a budget. This helps explain the great difference in bids during tendering. Principals often lack the expertise needed to assess price bids. The need to check whether the calculation was truly correct can also justify the pre-prior consultation.

Moreover, the lack of mass production means the risk of unexpected setbacks during construction is relatively large. However, the market structure (see below) requires building contractors to agree to a price before they can produce and calculate the actual cost of the product. Add to that that the customer's requirements cannot always be rendered with adequate detail (in specifications and drawings), which means they must be completed or modified during construction. Uncertain factors like weather, soil conditions at the building site, etc. reinforce the construction industry's unforeseeable character. One consequence is that the final cost is sometimes very different from the agreed price. Some projects are very profitable, while others run a loss. That makes it very important for a building contractor to reduce exposure to risks. The so-called "price improvements" were one way of doing so. The average profit margin in the building industry is far from high, around 2–3% of turnover.

Institutional Characteristics of the Construction Market

In addition to these characteristics related specifically to the nature of the product, the construction market also differs from other markets in the structure of competitive relations within the industry (Van Waarden 2003).

First, the construction market is known for its public tenders. This stimulates price-based competition. The details of the planned building are largely fixed in the principal's tender specifications and drawings. This separates

design from implementation. Moreover, in the Dutch situation the principal typically did not require a detailed description of how contractors plan to carry out the task. The whole tender revolved around the price. All other criteria – e.g., quality – carry less weight. The lowest price was the most important criterion against which the principal compared submissions.

As soon as they have been awarded a job, contractors tried to cut costs by substituting cheaper material for expensive types. In this way cuts in prices lead to cuts in quality. Another strategy used to compensate inadequately low prices is to calculate a higher profit margin on work in excess. When additional work is needed during the construction, the contractor is in a much stronger negotiating position because he is dealing with the principal in a one-on-one meeting and because the principal cannot call in another contractor (except at very high cost). Moreover, the contractor can profit from his superior knowledge. The contractor knows the site's modalities and circumstances better than the principal does. That is why a project's final cost is often much higher than the tender price. Each disparity or omission on the estimate is an occasion to claim work in excess. The result is that relations in a project quickly sour. This, too, adds to the construction industry's poor image.

Second, the construction industry has a low concentration ratio. In the Netherlands, there are more than a hundred thousand construction companies, each with a rather narrow specialty. High market segmentation is the result. Entry requirements are relatively low. Construction workers and machines can be hired-in easily for a single project. Temporary employment is not unusual; there are many self-employed workers in the industry. In comparison to other industries, investments are relatively low. "If you've a shovel and a customer, you can start up a construction company in the Netherlands" (Van Empel 2002). One result is that competition can sometimes be especially heated. This set-up produces a buyers' market.[6]

Another factor reinforcing competition is that the national government is a powerful player when it comes to commissioning infrastructure work. It has been argued that the dominant position of the government as principal in the industry has contributed to the construction fraud (Priemus 2002). The government commissions 90% of all ground, road and waterworks. This leads to an imperfect construction market in which the government holds a powerful position vis-à-vis a large group of contractors. That makes it easy for the government to play one off against the other. There is a danger that

[6] That contractors often work with many sub-contractors does little to make construction procedure comprehensible for the principal.

the construction companies compete to undercut one another. As monopsonist, the government is seldom, if ever, willing to pay a calculation fee.[7] Contractors have to see for themselves how to earn back the cost of often very extensive calculations. Another widespread problem is the way government agencies go about like hawkers asking for quotations from construction companies and then use this information (and the expertise it represents) to demand lower prices from competitors.

> The government window-shops at various construction companies then combines the cheapest and most innovative aspects from various tenders into a contract awarded to the lowest bidder. (Van Empel 2002)

This means that building contractors have to bear heavy calculation costs without their effort being rewarded with a contract. This removes all stimuli for innovation in the industry. Moreover, according to many in the industry, the government in this way provoked fraud.

Historical Background

The Dutch government had permitted prior consultation since 1953 to prevent construction companies from collapsing under heavy competition. The road-building contractors combine *Wegenbouw Aannemers Combinatie* (WAC) was established in that year. Under the guidance of an independent chairman, it offered a forum for prior consultation that met government-approved rules. Dozens of small building cartels have followed its example since then. Earthworks, dredgers, every job category had its own cartel to set prices and distribute contracts. In 1963, all the separate construction cartels joined one umbrella organisation the association of cooperative price-regulating organisations (*Samenwerkende Prijsregelende Organisaties* (SPO)), with the government's approval. Twenty-eight cartels representing more than 4,000 construction companies joined this umbrella organisation which was officially allowed to organise a prior consultation process in close cooperation with the government.

[7] A perfect market has a multiplicity of suppliers and takers, none of which can exert substantial influence on the market price because of their small share of it. In a monopoly, one supplier provides goods/services to a multiplicity of customers and can exert significant (upward) influence on market prices. In a monopsony, one taker buys goods/services from a multiplicity of suppliers and can exert significant (downward) influence on market prices by playing one supplier off against the other.

The vulnerability of this formal prior consultation became evident from the ease with which it could lead to other, illegal, types of prior consultation. Contractors often met one another away from the independent chairman for consultations before the formal meetings. At this pre-prior consultation, contractors agreed to higher amounts than the official calculation fee. This was illegal. Yet it was widespread. The independent chairmen reported it regularly.

> Once, I arrived at the meeting at an hotel but I found the front door locked. So I went around the back and found the meeting room full. (NRC, 24 Mar. 2002)

and

> At a meeting at Gouden Karper hotel I saw that the parking lot was already completely full. Apparently the pre-prior had just finished, because on the way from my car I saw several contented contractors. (Idem 2002)

As of 1987, tendering methods followed rules in a set of uniform pricing regulations with the government's approval. Companies wanting to submit a bid had to register with the SPO. The SPO organised the prior consultation that designated one contractor to negotiate with the principal and that set the calculation fee.

Five years later, large-scale pre-prior consultation was still widespread among road builders. But on 5 February 1992, the European Commission prohibited construction cartels and imposed a fine of 24 million euro on the Dutch contractors' cartel. The Commission judged that prior consultation disrupted free competition because cartel member companies had an advantage over non-member companies. The Dutch government and the construction industry were outraged, but in 1996 the European Court of Justice upheld the prohibition of construction cartels. The uniform pricing regulations proved to contravene Art. 85 of the EEC Treaty. Dutch contractors had to submit to free competition. Accordingly, in 1998, the Dutch Competitive Trading Act forbade prior consultation.

Because of this long historical background and the engrained culture it produced, companies found it difficult to do away with prior consultation on their own. In November 2001, a Dutch television programme showed that many construction companies ignored the prohibition against cartels and still made price-fixing agreements. Dutch newspaper *NRC Handelsblad* ran a headline on 15 August 2002 that said, "Price-fixing prohibition fails. Contractors wanted to get out of illegal system" (NRC 2002). Reporting on the period between 1998 and 2001, this article described how major exchange-quoted Dutch contractors (e.g., HBG, Heijmans en Volker Wessels Stevin) tried several times to obey the law and exit the illegal price-fixing

system. Because attempts to follow the law resulted in "a drastic fall in orders", according to HBG CEO J. Veraart, contractors decided to return to pricing agreements and prior consultation on bidding. In Veraart's words,

> Too many parties took part in bidding. You couldn't withdraw from the system on your own. We were all trapped in the system. (NRC 24 March. 2002)

Another contractor, Scheurs, also recounts that he could not escape the system.

> I was obliged to work within this system because all the others did so. I had to issue invoices with incorrect descriptions. Were I not to take part in the tendering fee system,[8] my fellow submitters could very easily have underbid me thanks to the tendering fees that they received. (NRC, 24 Mar. 2002)

Van Well and Nelissen, directors at Dura Vermeer, defended the long continuance of illegal practices by referring to individual contractors' difficult position.

> Individual contractors could not set up market-wide arrangements. . . To be sure, our first responsibility is to the 3,600 families that earn a living at this company. (NRC 13 May 2004)

They, too, point to the construction industry's culture.

> Betraying colleagues was an enormous cultural turnaround in the industry. (IDEM 2004)

Van Well and Nelissen mention attempts to break out of the system in 1992 and 1996. In the end, it did not work. Because the Dutch government had defended the prior consultation system in Brussels for so many years, it was not thought of as a punishable act but rather as part of risk management and care for the company's continuity.

And some government officials too continued to play the game. Deloitte & Touche gave a sad picture of the municipalities' ability to resist fraud. "According to Deloitte & Touche, local governments had service networks of government officials that leaked information to contractors; they were known for maladministration, incomplete specifications and sloppy tendering procedures. Moreover, Deloitte & Touche also noted that few municipalities had a policy on ethics. Successive studies into malpractices in the Directorate-General for Public Works and Water Management produced the same picture" (*NRC* 17 Sept. 2002).

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[8] A surplus charge was the extra margin added to the tender during illegal prior consultation.

The Industry's Response and the Aftermath

On 9 November 2001, the construction fraud received prominent coverage on Dutch television. In one broadcast, Ad Bos, former director at Koop Tjuchem, told an interviewer about Koop Tjuchem 's duplicate accounts. These duplicate accounts showed widespread involvement of contractors in illegal prior consultations. The duplicate accounts covered the period 1988–1999 and contained forbidden agreements related to 3,445 bids for a total tender value of 3 billion euro. One example: in a job for the Ministry of Defence's Infrastructure Agency, Koop Tjuchem distributed almost 1 million euro over thirteen other contractors. That amount was included in the 7 million euro contract price. Sometimes this type of payment came after just one phone call. Another example: in a job for the province of Limburg, Koop Tjuchem agreed over the phone with the KWS/Bloem-Hoensbroek combine that Koop would get 1% of the 2-million-euro contract price. Koop got this money without taking part in the official tender (*NRC* 16 Jan. 2003).

Building contractors were initially hesitant to respond to this publicity. CEOs of large companies denied knowing anything about such practices because they were not personally involved in attracting commissions. Managers who did admit to being involved in illegal prior consultation often sympathised with it. As contractor Henk Burggraaf said:

> I didn't sit there for financial gain. I wanted to protect my market. . . Maybe it is against the law, but I didn't see it as a crime.

Even when paying fines, contractors remained aloof from any notion of guilt. As J. Koelman (who represented Strukton, on the board of directors at the KSS/Strukton/HBG combine) said:

> That would look like pleading guilty. And I refuse to admit to even one fault. (NRC 10 Sept. 2002)

He knew that construction companies sent fictitious invoices, but he saw fictitious invoices as something different from falsified invoices.

> Nothing dishonourable happened.

(*NRC* 10 Sept. 2002). Wim van Onno, CEO at BAM NBM, a large Dutch construction company, also rejected accusations.

> The whole construction industry rotten? That's not correct.

BAM co-director de Vries even said

> But we love competition! What really irritates me is the implication that we are just fat lazy builders tossing jobs back and forth. (*NRC* 2002)

Martien Heijmans, division head at Heijmans Infrastructure, noted that

> If continuity and employment are your first concern, you cannot be the only one to withdraw from something that pervades the entire industry. (Hé 2003)

Another case of duplicate accounts surfaced in February 2004. It showed that construction fraud was not restricted to large government projects. Between 1,995 and 2,001 dozens of companies had made price-fixing agreements for the construction of office buildings, schools and hospitals. It appeared that senior managers at participating companies were well aware of what was going on since they were the ones to make the agreements (Financiele Dagblad 2004). Predictably, political officials responded with indignation. The government sent the construction industry an ultimatum that same month. Construction companies were given until 1 May 2004 to submit their duplicate accounts and report other violations to the Netherlands Competition Authority (NCA). Anyone caught after that deadline would be excluded from tendering procedures.

The government's ultimatum had its impact. BAM, one of the leading companies in the industry, said in Dutch newspaper *NRC*,

> We decided to reverse course to avoid having to operate defensively; we are working with all our cards out on the table. (NRC 2004a)

Other large Dutch construction companies – Heijmans, Ballast Nedam, Volker Stevin, Dura Vermeer and Strukton – also decided to give the Netherlands Competition Authority (NCA) the information it requested (NRC 2004a). In March and April, a growing number of companies submitted their duplicate accounts to the NCA. By 1 May, the number rose to 400 builders. They represented 70% of construction turnover (Vulperhorst 2005: 66). Large clients, among which Philips, Shell, ING and ABN AMRO, followed the government lead and threatened to exclude mala fide builders (NRC 2004b).

While the threats increased in tone and number, the attitude in the construction industry finally changed. Whereas initially the construction industry refused to admit guilt and took on the attitude "let them prove that we did something wrong", people slowly started to pass the buck. Directors at Dura Vermeer builders apologised publicly (*NRC* Handelsblad 13 May, 2004), but added that in their view, the construction fraud did not harm the Dutch economy. They thought that the cartel agreements had not increased prices. In addition, individual companies took various measures to reduce the chance of construction fraud. One result was that Heijmans introduced a code of conduct. Before the construction fraud, CEO Joop Janssen opposed

such a code of conduct (Janssen 2001). Companies also incorporated mechanisms that would warn senior managers of any unacceptable activities in the company. Examples for Heijmans include having an external controller to supervise bidding procedures and obliging Heijmans managers to sign a document stating that they did not participate in illegal prior consultation (Graafland 2004). Most companies claim to have cooperated with the NCA's investigation (*Cobouw* 17 Feb. 2004). Nearly 350 of the 400 roadwork companies that the NCA prosecuted for their role in the construction fraud chose for the accelerated penalty procedures that the cartel authority created to deal with the construction fraud. According to the NCA, massive interest in a rapid settlement showed that the construction companies wanted to put their house in order (*NRC* 2004c). Another factor in this high response is that authorities gave companies a 15% discount on fines when they signed up for the accelerated procedure (see below).

Institutional Measures

The parliamentary committee investigating the construction fraud made several suggestions for reforming institutions in the construction industry in its report.[9] As it was a whistle blower who had brought the case before the media, one of the first suggested measures was strong whistle blowing protection next to clearer tendering laws. Further suggestions included not paying calculation fees for standard jobs and basing awards on lowest price. A designing fee could be offered for difficult or innovative work. Builders also considered it reasonable to base selection for standard projects on the lowest price. These suggestions elicit various comments. What is a standard project? A standard project implies that the commissioning party provides a complete set of specifications and that the construction company need do no more than implement these. But how many hospitals or fire stations are identical? Moreover, how efficient is this way of working? After all, a standard project leaves no room for innovation during construction.

Another suggestion in the committee's report is that the government should do more to enforce the law. One way of doing so would be to give a greater role to public spending watchdogs like the *Algemene Rekenkamer* (the Dutch General Accounting Office). Government authorities should

[9] You can download the Dutch report from www.bouwfraude.nl (access is restricted to customers of Bedrijvenweb Nederland B.V.).

institute codes of conduct that explicitly state what it expects of its employees. More guarantees could also be built into the tendering procedure, e.g., by extending contacts with companies to more than a few individuals and by instituting job rotation. Moreover, government authorities should appoint a trusted third party and set up whistle-blower regulations.

A third proposal in the committee's report was that implementation risks should rest on those who can do most to control them. That is not always the contractor, on whom it now rests. One way to do this is public private partnership. According to Jan Holleman (chairman of AVBB, the Coalition of Dutch Construction Industry Organisations), large, complex projects can best be carried out with all parties cooperating from the drawing board right through to implementation and management, with a proper distribution of risks and duties. When road laying encounters delays because permits hold up work, the government, not the contractor, should bear the cost (Ter Veer 2002). Cees van Staal, publisher of *Building Business*, expected a lot of the innovative commissioning practice with shared risks or mixed financing (Ter Veer 2002). The UK has had positive experience with this. The objective should not be the lowest possible price for the customer, but quality through cooperation. This option for public private partnership can sometimes have better results than a public tender in which only the lowest price is chosen. Research in the UK showed that proper interaction and shorter building time lowered investments by 13% when contracts encourage teamwork (*Cobouw* vol. 148, n 34).

For that, contractor and customer must trust one another. Not everything can be nailed down tight ahead of time. This way of working will require a new open culture. To promote this open culture, Jan Holleman argued for clear codes of conduct and for new training courses in the building trade that focus on social and communicative skills and that produce broadly oriented managers that, unlike today's nerds, are able to work within partnerships.

Two other institutional measures that aim at healthy competition and restoring trust between contractors and customers include setting up a Coordinating Council (*Regieraad*) and a Foundation to assess the Integrity of the Construction Industry (*Stichting Beoordeling Integriteit Bouwbedrijf*).[10] The Coordinating Council's task is to launch change in the construction industry so that it can again claim to be healthy, transparent and innovative. The Coordinating Council has suggested specific renovations to shape

[10] The Ministries of Economic Affairs (EZ), Housing, Spatial Planning and the Environment (VROM) and Transport, Public Works and Water Management (V&W) established the Coordinating Council for the Construction Industry on 6 February 2004 (www.regieraadbouw.nl).

this change in various parts of the building industry like earth, road and water works, utilities and homebuilding. The coordinating council's purpose intends to stimulate all parties to assume responsibility for their tasks.

In October 2003, Building Netherlands set up a Foundation to Assess the Integrity of the Construction Industry (abbreviated SBIB in Dutch). The SBIB's goal is "to encourage the drafting, managing and monitoring of disciplinary codes intending to ensure the construction industry's integrity in bidding for contracts and in competing in the Netherlands".[11] The SBIB supports construction companies' integrity policies, makes them visible for third parties and monitors compliance with this integrity. Its activities concentrate on the introduction of and compliance with business codes. The SBIB lists companies with a business code in a public register and provides information on the criteria set for mention in the register. Furthermore, SBIB monitors compliance with provisions in the business codes and imposes penalties when needed. To this end SBIB has established a supervisory committee consisting of independent external experts in business ethics and competition. This committee handles complaints about violation of codes by companies listed in SBIB's register and offers binding advice to SBIB on penalties.

Penalties

The NCA designed a special penalty system for building fraud. It had three different discounts on the fines that the NCA imposed on construction companies:

- The clemency arrangement gave a discount on the fine for companies that voluntarily reported cartel arrangements to the NCA (NRC 2004c). This largest discount reached around 50%.
- Companies that signed up for rapid settlement got another 15% discount (NRC 2004d).
- Companies received an additional 10% discount when they reached a financial arrangement with the customers they duped (NRC 2004c).

Normally, the penalty could reach 10% of the tainted turnover. Those handling the construction fraud assumed the penalties would reach 10% of a

[11] www.sbib.nl

year's turnover. That paved the way for a rapid settlement of construction cases and cut penalties down by 75%.

NCA imposed the first fine, for €100 million, on 22 companies in December 2003. In a second round, following at the end of 2004, it imposed another €100 million on 344 construction companies. In 2005, it fined 155 companies €40 million; in 2006, fines on 596 companies brought in €70 million. Although the amounts may seem large, the European Commission expressed doubts in a letter to the NCA on the preventive efficacy of fines that it considered relatively low given the turnover concerned (NRC 2006). At the same time as, and parallel to, the construction fraud in the Netherlands, the European Commission investigated the creation of cartels in the asphalt industry elsewhere in Europe. The commission fined 14 companies €267 million on a €500-million turnover over 8 years. NCA, by contrast, imposed a €233-million fine on the road and waterworks industry, which come to 0.7% of 2001 turnover (€34 billion). The NCA's argument for this relatively mild approach is that the intention could not be to decimate the industry. Were it to follow the Commission's lead, it would have imposed a monster fine of a few dozen billion euros which would have wiped out large parts of the entire industry.

In addition to the NCA's fines, construction companies also faced civil claims from customers that thought they had paid too much (*Cobouw* 18 Feb. 2004) and claims from the tax service as well as investigation of criminal action. In these affairs, too, we see that the government sought to punish not destroy. The public prosecutor for instance apparently "forgot" to specify in the summons that the focus was on the *intentional* aspect of participation in illegal consultation prior to bidding. That meant that the contractors were charged with breach of the Competitive Trading Act rather than with criminal behaviour. A breach far less serious in Dutch law and with a shorter period of limitation. The public prosecutor's procedural "error" had a major impact, because a conviction for prior consultation could have led to exclusion from government contracts nationally and throughout Europe (NRC 2004e).

Conclusion

The Netherlands is a country that scores consistently very high in the TI corruption perceptions index. It is therefore no surprise that the massive nature of the construction fraud, involving almost the entire sector came as a serious blow to the country. We have tried to analyse how such a massive derailment could come about. Essentially old practices continued while the

world moved on and because bad habits are so hard to eradicate the entire sector found itself in due time at the wrong side of the legal divide. It is interesting to see how the self-understanding by the sector moved on as the scandal exploded. While there was clear moral blindness and even denial of any wrongdoing at the beginning, by the end of the crisis most participants recognised their mistakes and new standards were put in place. Moral learning took place as the industry leaders moved from denial of fault to acceptance that something had gone wrong and finally pro-active construction of a new institutional structure where better moral standards can grow. It is a sobering lesson for every country on top of the CPI index.

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Index

A
Accountable, 17, 27
Autonomy, 27

B
Bribery, 91
Business
  community, 4, 6, 7–9, 11, 39, 81, 90–91, 123, 142
  ethics, 3–10, 19–32, 138, 174
  partner, 61, 64, 97, 118, 132, 136

C
CEO, 6, 45, 50, 85–86, 88–90, 160, 169–171
Child labour, 113–115, 118–119, 121–135, 137–143
Civil
  servant, 15, 162–163
  society, 93
Code
  of conduct, 87–90, 118, 132, 136, 142, 171–172
  of ethics, 3–10
  moral, 6
Competition Authority, 163, 171
Compliance, 27, 95, 123, 131, 174
Conflict, 57, 65, 72, 84, 90, 96, 122, 124, 126
Consumer, 45–46, 80–82, 85, 91, 116, 118, 124, 126, 135, 162, 164
Contract, 58, 64, 77–97, 114, 121, 130, 132, 136, 140, 146, 153, 161, 164, 167, 170, 173–175
Control, 9, 11, 13–14, 16, 24, 26, 38, 41, 55–56, 64, 95, 116, 124–126, 138, 155, 173
Corporate governance, 6
Corporate responsibility, 9, 39, 164
Corporate social responsibility (CSR), 7–9, 88, 94, 117–120
Corporation, 16, 19, 23, 95, 135, 145, 152
Culture
  corporate, 161
  organisational, 24

D
Discrimination, 48, 123
Dubbink, W., 11–17, 19–32, 113–143

E
Environment, 4, 9, 16–17, 117–119, 136, 173
Ethics, 3–10, 12, 14, 17, 19–32, 138, 148, 169, 174

F
Fraud, 11, 145, 151–152, 154, 156, 159–176

I
Institution, 3–10, 16, 19–32, 92, 117, 149, 172
Integrity, 6, 117–118, 173–174
Internet, 74, 80, 150

J
Job, 28, 55, 82, 105, 149, 153, 161–163, 165–167, 170, 172–173
Justice, 20, 22–23, 46, 131, 135, 155, 168
Justification, 19, 30

L
Least developed countries, 48–50, 78
Loyal, 15, 154

M
Management
  change, 7, 9
  ethical, 26
  reputation, 7

Market
construction, 164–167
imperfect, 166
price, 130, 136, 153, 167
regulation, 96
Marketing, 47, 53, 56–57
Maclagan, P., 26
MNC, 132
Moral
duty, 137–139
obligation, 14, 17, 39, 45, 50–51
question, 51, 124
reason, 119
requirement, 46
Morality, 8, 12, 16–17, 23–27, 31, 96, 134

O
Organisation, 7, 14–15, 17, 21–27, 31, 38, 40, 42–44, 47, 57, 61, 71, 78–81, 85–86, 89, 91, 93, 95–96, 114–115, 117, 119–121, 123–124, 141, 163, 167, 173
studies, 7, 24

P
Poverty, 40, 54–55, 123
Power, 21, 28, 37, 45, 54, 78, 92, 95–96, 136
Pressure, 15–17, 25, 31–32, 38, 42–43, 50, 66, 81, 84–85, 91–93, 95–96, 103–104, 109, 123, 136, 140, 149
Price fixing, 30, 160, 168, 171
Privatisation, 109
Profit, 6–8, 28, 31, 41, 43, 45, 47, 49, 51, 56, 83, 109, 117, 132, 136, 138–139, 150, 161–163, 165–166
Promotion girls (PGs), 53–55, 58–66, 69–74
Property intellectual, 41–42, 50
Public tender, 165, 173
private public partnership, 173

R
Rawls, J., 21
Reputation, 4, 6–8, 66, 87, 93, 111, 142
Respectable companies, 8, 86
Rights
human, 30, 78–79, 81, 85, 87–89, 91, 94–97, 118–119, 134–136, 138, 141
patent, 39, 46
prosperity, 47
women, 55
Risk management, 7, 169
Risk safety, 105, 110
Rules, 7, 12, 22, 25–27, 29, 40, 60, 89, 91, 167–168

S
Sex
safety, 40, 60
tourism, 59
worker, 54–55, 60
Sexual harassment, 70–74
Shareholders, 56, 80, 86–88, 90, 92, 94, 117–119, 146, 151, 164
Social
capital, 27
injustice, 46
norms, 60
responsibility, 7–8, 47, 49–51, 88–89, 94, 117–120, 132
Stakeholders, 43, 63, 91, 163–164

T
Tax Fraud, 152, 162
Trade
ethical, 9
fair, 146, 149
Trade union, 63, 78, 81, 84–85, 87, 89–91, 94, 97
Trust restoring, 173

U
United Nations (UN), 39, 50, 55, 59, 73, 96, 122, 134–135, 138

V
Values, 21, 25, 46, 66, 104, 110, 117, 119–120, 134, 150, 170
Van Luijk, H., 3–17, 91
Virtue, 14–16, 56

W
Wage, 24, 32, 59, 65, 71, 116, 119, 132
Whistle blowing, 172
Women
abuse, 73
promotion girls, 53–55, 58–66, 69–74
self-help, 120
World Trade Organisation (WTO), 41–43