Journal of Business Ethics (2007) 73:319–331
DOI 10.1007/s10551-006-9209-z

Corporate Directors and Social Responsibility: Ethics versus Shareholder Value

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ABSTRACT. This paper reports on the results of an experiment conducted with experienced corporate directors. The study findings indicate that directors employ prospective rationality cognition, and they sometimes make decisions that emphasize legal defensibility at the expense of personal ethics and social responsibility. Directors recognize the ethical and social implications of their decisions, but they believe that current corporate law requires them to pursue legal courses of action that maximize shareholder value. The results suggest that additional ethics education will have little influence on the decisions of many business leaders because their decisions are driven by corporate law, rather than personal ethics.

KEY WORDS: board of director, ethics, social responsibility

Introduction

Corporate ethics and social responsibility are hotly debated topics in the academic literature and popular media. Business ethics mandates are included in the Sarbanes Oxley Act of 2002 (Sarbanes and Oxley, 2002) and the listing regulations of the major stock exchanges (SEC, 2003); premier business schools throughout the U.S. have recently developed centers for corporate ethics and corporate social responsibility; and authors are making repeated calls for improved and expanded ethics education (e.g., Copeland, 2005; Waddock, 2005). Much of the recent literature in accounting and business suggests that the "tone at the top" is failing to protect stakeholders due to low ethical standards and personal integrity (Copeland, 2005) and poor ethics education (Waddock, 2005). As a result, researchers argue that improved ethics training is the key to improving corporate ethics and corporate social responsibility. While greed and corruption have driven several recent corporate collapses, this research proposes that numerous underlying problems associated with apparent ethical deafness and lack of social responsibility are driven by perceptions of corporate law, rather than personal ethics.

This paper examines ethics and social responsibility at the true top of the corporate ladder: corporate directors. Directors are ultimately responsible for the strategic decisions of the corporate organization; they must act in the interest of stakeholders; they are charged with upholding the integrity of financial reporting; and directors face increasing responsibility to increase corporate ethical standards and social awareness. Limited research, however, has directly examined decision-making by directors facing social responsibility decisions and ethical dilemmas. Directors drive the social responsibility of corporations, but we know very little about the determinants of directors' decisions. To address these issues, this study employs an experiment where highly experienced corporate directors make decisions that draw upon personal ethics and directly affect corporate social responsibility. The decisions require consideration of both legal duties and ethical duties.

The results of the experiment indicate that: (1) directors that have duties to shareholders consistently give up corporate social responsibility for increased shareholder value, even when their personal morals and ethical standards suggest alternative courses of action; (2) directors making

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decisions from the perspective of a business owner, rather than a director, do not consistently trade ethical standards or social responsibility for wealth maximization; (3) directors recognize the ethical implications of decisions that affect social welfare; and (4) directors favor shareholder value over personal ethical beliefs and social good because they believe that current corporate law requires them to pursue legal courses of action that maximize shareholder value. Taken together, the findings indicate that our corporate leaders make decisions that emphasize legal defensibility, rather than ethics or social responsibility. The results also suggest that additional ethics education may have little influence on the decisions of most business leaders because their decisions are driven by existing law, rather than personal ethics.

The decision-makers at the top of the corporate organization are aware of social responsibility, and they have well-developed standards of personal ethics. Directors perceive, however, that their legal duties favor shareholders above all other stakeholders and society. Directors make decisions that are legally defensible and entirely rational given the legal environment in which they operate. If we desire to increase the social responsibility of corporations and allow business leaders to apply their ethical standards to business decisions, changes in corporate law rather than changes in ethics education will be necessary. It appears completely appropriate to blame several recent business failures on personal greed and unethical behavior, but the broader picture of business ethics requires that we acknowledge stakeholders other than shareholders in the business model. The business leaders at the helm of the organization are not always hollow, but they are hindered from expressing high levels of ethics and social responsibility by the nature of their duties to the corporate entity. The findings of this study call into question whether ethics training will significantly influence the decisions of business leaders when they perceive that placing personal ethics and social responsibility above profit maximization creates significant legal liability.

The remainder of the paper describes the relevant literature and hypotheses, followed by a description of the methods and results. The final section includes conclusions and discusses potential extensions.

Background and hypotheses

Ethics and social responsibility

In his discussion of the state of ethics in the accounting profession and in business, former Deloitte & Touche CEO James Copeland states that ''the only common denominator [in financial and business failures] seems to be unethical behavior and a lack of character and integrity'' (Copeland, 2005). He also suggests some potential causes for our ethical crisis, such as the decline of religion, the drug culture, the deterioration of education system, and negative impacts of the entertainment industry (Copeland, 2005).

Waddock appears to agree with Copeland's arguments that personal ethical standards are the cause of the ethics crisis, and she states that ethical problems have stemmed from the fact that our business leaders are hollow and lack appropriate moral and ethical standards (Waddock, 2005). Further, Waddock believes that business leaders are unethical because graduate business education fails to teach ''connections between business, society, nature, and the world'' and emphasizes profit maximization (Waddock, 2005).

It is true that we have recently witnessed the actions of several business leaders that lack moral character, and business education should dramatically increase the emphasis on the effects of business on society and nature. Further, evidence from psychology research indicates that moral reasoning skills develop throughout adulthood, and education can influence moral reasoning (Kohlberg et al., 1983). However, the current research proposes that increased individual integrity is not enough to solve our ethics crisis because many of the underlying causes of the crisis involve the corporate legal structure. We cannot limit the discussion of business ethics to personal integrity and education.

Conspicuously absent from the current discussions of the ethics crisis is any mention of the nature of corporate organization or the current business environment. Corporate charters, stock exchange listing requirements, and federal regulation all require that managers and directors pursue the goal of maximizing shareholder wealth, often at the expense of other stakeholders. Is it appropriate to blame the ethical crisis in business on some moral or religious decline, or do we also need to examine the corporate environment in which businesspeople must operate? Are faculty members teaching students to favor shareholders because of faults in the business education system, or are they teaching students how to comply with existing corporate law? Perhaps the changes needed are more fundamental than additional ethics education. Marshall (2005) sums up the state of corporate ethics and social responsibility in the corporate business model when he states that "the fact remains that in the U.S., financial performance has been king."

Most examples of ethics violations in the popular press and the academic literature focus on gross violations of law for personal gain. Ethics involves more than compliance with regulation and law, however. Corporate social responsibility (CSR) research offers a more comprehensive and meaningful definition of corporate ethics. Bansal and Kandola (2004) indicate that responsible firms "should operate within legal parameters and not knowingly harm stakeholders." In a summary of foundational CSR literature from Bowen (1953) and Preston and Post (1975), Ostas (2004) defines CSR as both compliance and cooperation with the creation, implementation, and reform of business law. That is, for firms and individuals to be ethical and socially responsible they must comply with law and also follow the "underlying spirit" of law (Ostas, 2004). I adopt this definition of corporate ethics for the current study. Ethical decisions require compliance with regulation/law and cooperation with the underlying spirit of regulation/law.

Ethics and directors

Section 406 of the Sarbanes Oxley Act (SOX) requires that corporations disclose the existence of a code of business ethics or explain the reasons for not adopting a code of business ethics (Sarbanes and Oxley, 2002). These codes of ethics must promote honest and ethical conduct in the face of conflicts of interest and ensure compliance with government laws and regulations. Similarly, the NYSE the NASDAQ listing rules require the adoption of a code of ethics (SEC, 2003). Key aspects of the codes of ethics required by the NYSE and the NASDAQ rules include limiting conflicts of interest and promoting compliance with applicable law. Directors fall under the requirements of the regulations of the stock exchanges and SOX, and all of these regulations define ethics as compliance with applicable law and regulation. Neither SOX nor the listing rules contain legal requirements for directors to cooperate with the spirit of law or behave ethically beyond compliance with their legal duties.

Given that there is no legal duty for directors to seek social good or make ethical choices beyond legal compliance, researchers have investigated the ability of ethics programs and ethics training to promote social responsibility. Empirical research provides conflicting evidence about the potential for such ethics programs to promote ethical and responsible corporate behavior. While Felo (2000, 2001) found that boards that are actively involved in ethics programs disclose more credible financial information and tend to have fewer conflicts of interest, other researchers find no connection between ethics programs and improved corporate behavior. For example, Mathews (1990) discovered that firms with ethics training programs were no less likely to have civil actions brought against them than firms without ethics programs. Similarly, a study by Brief et al. (1996) found no correlation between the existence of ethics programs and the likelihood of fraudulent financial reporting.

Some suggest that new regulations requiring more independent directors are a major step in improving corporate ethics and social responsibility. Ibrahim et al. (2003) state that "the expectation on the part of practitioners, researchers, and governmental regulators is that outside directors will advocate greater corporate responsiveness to society's needs" than inside directors. However, the authors find no evidence for differences in concern for legal or ethical dimensions of corporate social responsibility between inside and outside directors (Ibrahim et al., 2003). All directors exhibit similar levels of concern for socially responsible actions and ethical decision-making. It appears that recent requirements for increased director independence may not change corporate attitudes towards ethics or social responsibility.

A final line of research into director morals and ethical standards has investigated potential differences between directors of for-profit and not-for-profit organizations. Intuition suggests that directors of for-profit organizations will demonstrate lower levels of moral reasoning than directors of not-for-profit organizations because non-profit directors serve on boards for altruistic purposes and do not have shareholder wealth maximization as their penultimate goal. Recent research, however, finds that directors of for-profit corporations use higher stages of moral reasoning than directors of not-for-profit corporations (Brower and Shrader, 2000). Given all of the above findings, it becomes difficult to argue that ethics training is what is needed to improve the ethical standards and social responsiveness of US corporations. Corporate directors demonstrate higher levels of moral reasoning than not-for-profit directors, the effects of ethics programs on firm behavior are questionable, and increased director independence does not appear to increase concern for social responsibility or ethical behavior. We need to examine the legal dimension of ethics.

Prospective rationality and social responsibility

Corporate managers and directors work in high-risk environments where legal threats are created by shareholder actions and government regulation. Directors are responsible for ensuring that management makes decisions that maximize firm value (Rechner and Dalton, 1991), and directors have specific duties of care and diligence to shareholders. Failing to act in the interest of shareholders, meet legal duties of care, or follow applicable law can place directors at personal financial and legal risk. Further, managers and directors should not knowingly harm society (Bansal and Kandola, 2004), but this duty is not legally encoded like the duties of care and diligence to shareholders, and protecting society involves following the spirit of law, rather than the letter of the law.

Duties to shareholders and duties to society are often conflicting, and business leaders can feel pressure to trade social good for shareholder wealth (Ostas, 2004). For example, assume that a manufacturing plant can only maximize shareholder value when the production process releases high levels of harmful toxins into the environment. Directors and management must choose between protecting society from the toxins by implementing costly technologies to limit toxic emissions or maximizing shareholder value by not implementing the technologies. This research proposes that decision-makers at the top of the organization can face greater legal threats from failing to maximize shareholder wealth than from failing to behave ethically and protect society. Even when managers and directors have standards of ethics and well-developed moral reasoning skills, the legal structure of the corporate entity often pressures and/or requires business leaders to ignore their personal morals and ethical beliefs.

Given the risky and litigious environment in which directors operate, directors are aware that they must be prepared to defend their decisions. Staw (1980) refers to this situation as prospective rationality, where decisions are made with foresight knowledge that decisions may need to be defended in the future. Faced with prospective rationality, a prudent director will attempt to identify the most defensible decision. The most defensible decision will, by definition, comply with federal and state statutes and corporate charters. Cooperation with the spirit of laws, however, provides relatively little defense in a court of law.

For managers and directors to behave ethically and be socially responsible they must comply with law and follow the underlying spirit of law (Bowen, 1953; Ostas, 2004; Preston and Post, 1975). Conflicts of interest between duties to comply with the letter of the law and meet the spirit of law create situations where business leaders may behave unethically. Consider again the example of toxins released by a manufacturing plant. If there are no federal or state regulations that specifically prohibit the release of large quantities of the dangerous toxins, then business leaders have the opportunity to choose to harm society in order to maximize profits. According to corporate social responsibility (CSR) theory (Bansal and Kandola, 2004; Bowen, 1953; Ostas, 2004; Preston and Post, 1975), this behavior is unethical, even though the business leaders are fully complying with applicable law.

According to Ostas (2004) and Williams (1998), a businessperson can ethically take advantage of loopholes in law and ambiguities in law, but only when the law prohibits *malum prohibitum*, rather than *malum in se* activities. A *malum prohibitum* activity is illegal by statute, but the illegal activity does not violate any moral standards or directly harm the public. Insider trading laws and the tax code are examples of *malum* *prohibitum* law. Activities that are innately immoral and harm society, such as murder and theft, are defined as *malum in se*. Ostas (2004) and Williams (1998) suggest that when laws prohibit an activity but are not associated with moral obligations, business leaders can ethically evade the law and risk financial penalties. For example, the authors consider taking advantage of tax loopholes to be an ethical activity, because tax laws make certain tax treatments illegal by statute, but tax laws do not prohibit innately immoral activities. When laws exist to protect the public good by preventing socially inappropriate behavior (i.e., *malum in se*); however, evading the spirit of the law through loopholes or other mechanisms represents unethical behavior (Ostas, 2004).

Directors have specific legal duties of care to shareholders, and they are required to ensure that shareholder wealth is maximized. Recent regulations promulgated by the SEC, the NYSE, and the NASDAQ have further emphasized the need for directors to act in the interest of shareholders and demonstrate independence. As a result, sensible directors who seek to make legally defensible decisions will make socially irresponsible decisions when their legal responsibilities to act in the interest of shareholders conflict with socially responsible choices. When there are conflicts between social responsibility and legal obligations to shareholders, prospective rationality cognition will take effect, and the legal obligations to shareholders will prevail.

H1: Directors are more likely to seek earnings maximization at the expense of socially responsible behavior when there are more legal liability threats associated with socially responsible decisions than when there are fewer legal liability threats associated with socially responsible decisions.

As the level of potential social harm that can result from a decision increases, business leaders will face increasing threats from adverse reactions by society. In addition, there should be a point at which social threats are so heinous that personal ethics and moral standards will outweigh legal obligations to shareholders (Ostas, 2004). Therefore, as the social threat of a decision increases, directors will be more likely to make socially responsible decisions and sacrifice earnings maximization.

H2: Directors' willingness to sacrifice earnings maximization will increase as the level of social threat increases.

Method

Design

The experiment involved a 2×2 design with one between-participants manipulation and one within-participants manipulation. The between-participants independent variable was the legal duty to maximize shareholder wealth (present or absent), and the within-participants manipulation was the level of social threat (environmental threat versus environmental threat that involves harm to human health). Participation in the study was voluntary.

Participants

The participants were 34 active directors of U.S. Fortune 200 corporations who were participating in a national director training seminar. The participants had served on an average of 6 boards of directors and had an average of 20 years of management experience. The average participant age was 57 years, and 94% of the participants were male.

Procedure

Participants were randomly assigned to the two between-participants treatment conditions (17 participants in each treatment condition). The experiment provided participants with an informed consent, general instructions, case materials and a post-experiment questionnaire. After agreeing to informed consent, the instructions emphasized the importance and confidentiality of participation. Afterward, the participants began reading the first ethics case and completing the task. The task was completed under controlled conditions and under the supervision of the experimenter.

Task

Participants read two ethics cases and responded to each case separately.[1] The first case included environmental and social considerations, but did not indicate a threat to human heath. This case represents the lower level of social threat. The case text follows:

> *You are [a director who serves on the board of directors of a corporation listed on the NYSE] [a partner in a privately held partnership] that owns one of the last remaining stands of old-growth forest in Oregon. Cutting the old-growth trees has historically been prohibited by the EPA, but recent changes in federal regulation have created a narrow window of opportunity for selling the old-growth forest for timber. The firm's attorneys, firm's accountants, and an independent actuarial firm have provided evidence to the [board] [partners] that selling the trees for timber would significantly increase short-run EPS, and the new alternatives for land use will generate meaningful long-term earnings growth opportunities relative to maintaining the old growth forest (after considering the potential positive publicity effects of maintaining the forest and the potential detrimental effects of negative public perceptions, publicity, etc. that could result from selling the trees for timber). [Management has approached the board to request the board's advice on this issue.]*

Respondents indicated whether or not they would vote for cutting down the large stand of old-growth forest. The case creates a situation where directors can meet the letter of the law (due to a loophole in current federal law) and also maximize shareholder value by cutting the forest. Meeting the spirit of the law and promoting social good would, however, require directors to preserve the forest and fail to maximize shareholder wealth. The manipulation of the duty to shareholders was accomplished by changing the decision perspective of the director. Half of the directors made decisions as directors, and half of the participants made decisions as partners of a privately held partnership. Partners do not have the legal duties of care and wealth maximization to shareholders.

The second case increased the level of social threat. The case follows:

> *You are [a director who serves on the board of directors of a corporation listed on the NYSE] [a partner in a privately held partnership] that manufactures plastic consumer products. The production process releases two toxic byproducts into the environment: Toxin A and Toxin B. The current plant emissions contain Toxin A and Toxin B at levels of 50 ppm each. Toxin A has just become regulated by the Environmental Protection Agency, and releases of the toxin into the environment will be limited to 25 ppm beginning January 1 of next year. Toxin B is not regulated by any government agency. Toxin A is known to be carcinogenic at levels over 25 ppm, and scientific evidence indicates that Toxin A represents a threat to the health of society. While there are no regulations that limit the release of Toxin B, recent scientific studies from University laboratories indicate that Toxin B presents as much danger to human health as Toxin A when released at levels above 25 ppm. Limiting the emissions of Toxin A and Toxin B require separate, new technologies for each toxin. The firm's attorneys, firm's accountants, and an independent actuarial firm have provided evidence that implementing the technologies needed to limit emissions of the toxins to 25 ppm are very costly, and each technology will substantially reduce pretax EPS every year for the foreseeable future (after considering the potential positive public reaction effects of limiting the toxins and the potential detrimental effects of negative public perceptions, publicity, etc. that could result from emitting the toxins). The legal team is confident that emissions of Toxin B will not be regulated in the short-run, and they feel that emissions of Toxin B may never be regulated. [Management has approached the board to request the board's advice on this issue.]*

Participants indicated whether or not they would vote to invest in each of the two technologies needed to reduce emissions of Toxin A and Toxin B to levels below 25 ppm.

Limiting the emissions of Toxin B represents the decision of interest. Similar to the first case, Toxin B creates a situation where directors can meet the letter of law while harming society due to a loophole in federal law. The manipulation of the duty to shareholders was again accomplished by changing the decision perspective of the director. Half of the participants made decisions as directors, and half of the participants made decisions as partners of a privately held partnership.

Independent variables

Duty to shareholders

The between-participants manipulation of shareholder duty varied the position of the participant. Half of the participants (17 directors) were randomly assigned to be directors of a public corporation, and half of the participants (17 directors) were assigned to be partners in a privately held partnership. Directors, by definition, have primary responsibility to the corporation and its shareholders. Partners are not legally bound to act as profit-maximizers for their partnerships at the expense of social responsibility.

Social threat level
The within-participants manipulation varied the human impact of the decision. The first case included damages to the environment and associated social effects (such as less enjoyment by the public and destruction of animal habitat). The second case included threats to the health and safety of other human beings.

Dependent variable

The dependent variable was a participant's decision to [sell the forest or not sell the forest] [invest in the technology to limit the emission of Toxin B or not invest in the technology].

Results

Preliminary testing

Frequencies
Table I presents frequency distributions for the forest cutting and emission reduction decisions. The pattern of responses is clear, and the differences appear meaningful. When the directors made decisions from the perspective of a corporate director, all but one director chose to cut the old-growth forest, and all but two directors voted to continue to emit 50 ppm of Toxin B. On the contrary, when directors made decisions from the perspective of a partner in a non-traded firm, 41% of the director participants voted against cutting the forest, and 82% voted to reduce the emissions of Toxin B.

Covariates
A preliminary pair of logistic regression models examined the covariance of demographic factors (i.e., age and director experience) to the two decisions. No significant correlations between demographic factors and decisions were detected. As a result, demographic factors were not included in the hypotheses tests.

Hypothesis testing

The two hypotheses are tested with Chi-square analyses. Hypothesis 1 predicts that directors are more likely to seek earnings maximization at the expense of social responsibility when making decisions from the perspective of a director, relative to making the decision from the perspective of a partner. The difference in frequencies of responses across the director and partner conditions to the decisions to preserve the forest (6% vs. 41%) and control the release of Toxin B (12% vs. 82%) are both significantly different across the director and partner conditions ($p < 0.001$ in both cases). The first hypothesis is supported.

TABLE I
Decision response frequencies – Ethics scenarios

Decision perspective[b]	Level of social threat[a]	
	Low (Forest)	High (Toxin)
Director (n = 17)	1 (6%)[c]	2 (12%)
Partner (n = 17)	7 (41%)	14 (82%)

[a]The level of social threat was manipulated within participants. The lower-threat case involved a decision to preserve or cut old-growth forest, and the higher-threat case involved a decision to reduce or not reduce emissions of a harmful toxin.
[b]The decision perspective was manipulated between participants. Half of the participants made decisions from the perspective of a corporate director (with legal duties to shareholders), and half of the participants made decisions from the perspective of a partner in a non-public partnership (without legal duties to shareholders).
[c]Cell means represent the number (percentage) of participants who voted to [preserve the forest] [reduce the toxic emissions] at the expense of significantly reducing shareholder wealth.

The second hypothesis posits that as the social threat of a decision increases, directors will be more willing to risk legal liability and sacrifice earnings maximization for social good. This hypothesis is tested with McNemar's Chi-square for within-participants designs. McNemar's test compares of the frequency of responses to the forest case to the frequency of responses to the toxins case. Overall, more participants chose the socially responsible decision in the high social threat case (47% in the toxin case) than the lower social threat case (24% in the forest case), and the difference is statistically significant ($p < 0.03$). The result requires further analysis because the majority of the variation occurs in the partner condition. Testing hypothesis 2 separately for the director and partner perspectives reveals that there is no significant difference in decisions from the director perspective (1 participant vs. 2 participants), but there is a significant difference in decisions from the partner perspective (7 participants vs. 14 participants, $p < 0.01$).[2]

Post-experiment debriefing and additional analyses

To fully understand why liability threats and legal requirements affect directors' decisions to favor earnings over social responsibility, the participants responded to additional scenarios and an informative series of debriefing questions. The ethics scenarios in the post-experiment questionnaire were the same as those presented in the experiment phase, but participants responded to the following question: How would the majority of other [board members] [partners] vote? The case involved a sensitive matter for directors, and there was uncertainty (*a priori*) about participants' willingness to express their true beliefs. The reason for asking the participants to reflect on how other [board members] [partners] might respond is grounded in the concept of *social projection*. According to social projection theory, when individuals are asked how referent others might respond to the same stimuli, they frequently project their own subconscious or repressed conscious beliefs onto the referent others (e.g., Clement and Krueger, 2000; Mikulincer and Horesh, 1999; Ruvolo and Fabin, 1999; Smith, 1997). Therefore, participants might indirectly project their true underlying beliefs onto referent other decision-makers, thus revealing any social-responsibility bias.

Results from these questions (presented in Table II) indicate that when the directors are acting as directors they make decisions that maximize shareholder value, and they believe that other directors would do the same. The results do not reveal any significant differences in decisions made by the directors or the decisions participants believe other directors would make. On the other hand, when directors make decisions from the perspective of partners, there is a difference between their decisions and the decisions they believe other part-

TABLE II

Decision response frequencies – Social projection

Decision perspective[b]	Level of social threat[a]	
	Low (Forest)	High (Toxin)
Director (n = 17)	0 (0%)[c]	1 (6%)
Partner (n = 17)	6 (35%)	8 (47%)

[a]The level of social threat was manipulated within participants. The lower-threat case involved a decision to preserve or cut old-growth forest, and the higher-threat case involved a decision to reduce or not reduce emissions of a harmful toxin.
[b]The decision perspective was manipulated between participants. Half of the participants made decisions from the perspective of a corporate director (with legal duties to shareholders), and half of the participants made decisions from the perspective of a partner in a non-public partnership (without legal duties to shareholders).
[c]Cell means represent the number (percentage) of participants who believe that other [directors] [partners] would have voted to [preserve the forest] [reduce the toxic emissions] at the expense of significantly reducing shareholder wealth.

ners would make under the same circumstances. There is some evidence of a social responsibility bias in the participants' responses to the second case.

While 82% of the participants indicated that they would vote to implement the technology to reduce Toxin B, only 47% believed that other partners would vote for limiting the toxic emissions. Following social projection theory, this could indicate that some participants made the decision to limit the toxic emissions because they were concerned about social image, and they may subconsciously believe that limiting the toxins is a poor business decision.

The second portion of the post-experiment materials included demographic questions and an open-ended question asking why the participants made their voting decisions. The responses to the open-ended question were collected through one-on-one interviews without the presence of a recording device. While the responses do not readily allow for statistical analyses, there were many common themes in reasoning behind participants' decisions. Every participant in the study recognized the ethical dilemmas, and every participant discussed trade-offs between social/environmental responsibility and shareholder value.

With the exception of one participant, all participants in the high duty to shareholders condition (i.e., those making decisions from the perspective of a director) had very similar explanations for their voting decisions. The directors indicated that a director's primary responsibility is to the shareholder. The directors stated legal responsibility as the driver of their decision-making in almost every case. Directors made statements such as: (1) ''Our corporate charter clearly ... indicates that we act in the interest of our stakeholders, but that the primary stakeholder is the shareholder,'' (2) ''We have specified duties to our shareholders,'' (3) ''I cannot violate my responsibility to owners because I have personal feelings about the decision.'' The director explanations indicate that prospective rationality cognition dominated their decision processes.

Most directors also indicated that the social responsibility issues were obvious to them and upsetting, but stated that they had to meet their legal obligations. Repeatedly, director participants viewed the decision as one of legal responsibility, not social responsibility, when acting as a director. One director, who was an attorney, spelled out the current legal situation very clearly: ''In the face of Sarbanes and new listing regs, I have to be more careful than ever to be independent. I have to go out of my way to demonstrate that I am acting in the interest of the shareholder and not my own self-interests. This means that my personal desires cannot drive my choices or appear to drive my choices.'' To some directors, new regulation and increased independence requirements equate to increased focus on shareholder wealth maximization at the expense of other responsibilities. This may be an unintended consequence of SOX.

The participant who voted against profit maximization in both scenarios approached the cases from a different perspective. Like the other participants, this participant indicated a legal responsibility to shareholders, but believed that the ''estimates were likely incorrect'' and ''did not account for the long-term negative'' effects of harming others in society. It appears that this one participant was so upset by the negative social consequences of the decisions that he was searching for a way to make the socially responsible decision while still protecting himself from liability threats created by not acting in the interest of shareholders. This participant was also the only director who indicated that he was a Social Responsibility Officer. In this capacity, the director may have felt a decreased legal duty to maximize shareholder wealth and an increased duty to protect society.

It is possible that partners perceive greater threats to the loss of personal wealth than directors when socially irresponsible decisions are made, because partners must personally cover losses of the partnership. This could partially explain the difference in results between the participants acting as directors versus partners. Additional analyses reveal some insight into the source of differences between decisions made from the director versus partner perspective. When directors made decisions from the perspective of partners, legal liability and responsibility were not discussed as reasons for decisions. In other words, these directors did not employ prospective rationality cognition. Participants gave two basic explanations for their choices. Those who voted in favor of profit over social responsibility indicated that they did not invest to achieve socially desirable outcomes; they invested to improve personal wealth. Many of these participants also made statements suggesting that businesses do not succeed by ignoring firm growth in favor of environmental concerns, and two participants offered longer lectures on economics. Those participants who voted against the profit maximizing decisions indicated that they could not live with decisions that seriously hurt others, even if their personal wealth suffered.

Two of the questions on the demographic questionnaire also reveal differences between the participants in the director versus partner perspective conditions. These questions asked participants to indicate their beliefs about the level of corporate responsibility for promoting social and environmental good. The questions and scales are presented below:

Do you believe that businesses should place environmental protection above profitability (circle your response on the scale below)?

0				5					10
|	|	|	|	|	|	|	|	|	|
Not at All									*Very Much*

Do you believe that businesses should place the protection of the public above profitability (circle your response on the scale below)?

0				5					10
|	|	|	|	|	|	|	|	|	|
Not at All									*Very Much*

Responses to these questions were not correlated to decisions made from the director perspective. However, when participants made decisions from a partner perspective, there was a significant correlation ($p < 0.05$) between the importance of promoting positive environmental impacts and decisions to preserve the forest, and there was a significant correlation between beliefs about the importance of protecting society and decisions to limit the emissions of toxins ($p < 0.01$). In other words, personal beliefs about the ethical and moral obligations of a firm to society were not relevant when directors faced legal obligations to shareholders, but were relevant when making decisions that affect only personal wealth. The participants were not concerned about legal liability when acting as partners, and their beliefs about the importance of social responsibility influenced their decisions. These findings indicate that the differences between decisions made as partners versus directors were driven by differences in perceived legal responsibilities, rather than differences in perceived personal losses.

Discussion

Corporate directors have legal duties to comply with federal and state laws and maximize the wealth of shareholders. This research finds that directors follow a hierarchy of legal compliance when making decisions that affect social responsibility. Directors first seek to comply with federal and state laws, and then they seek to meet their duties to shareholders. Directors employ prospective rationality cognition, and they seek to make legally defensible decisions that protect them from personal liability. When acting in a socially responsible manner requires violation of federal/states laws or violation of the duty to maximize shareholder wealth, directors may choose to intentionally harm society. Directors are aware of the ethical implications of their decisions, but they make decisions that offer the greatest legal protection. Corporate charters and stock exchange regulations place the shareholder above all other stakeholders in society, and directors rationally emphasize shareholder value over societal well-being.

The results of the study must be considered in light of its limitations. The sample included only well-established directors from large corporations, and almost all of the participants were male. It is possible that directors from smaller corporations or those with less experience will have different perspectives on social responsibility. There may also be gender effects that could not be analyzed in this study. The results are further limited to situations where legal loopholes allow directors to trade environmental and health consequences for earnings maximization. Other social threats may produce different reactions. In addition, tradeoffs between social responsibility and earnings in real-life situations are likely not as clear cut as the case scenarios developed for the experiment. The cases indicated that ignoring the threats to society maximized short and long-term earnings. The effects of decisions that harm society on long-term earnings are typically less clear. Next, time limitations prevented the collection of extensive demographic data, moral reasoning measures, or more thorough measures of ethical values, although the personal interview process revealed several insights into these issues. Finally, I have no direct measures of the faith participants put in the earnings numbers provided in the case or participants' histories with these types of estimates, and participants' beliefs about the earnings estimates could influence the results.

The results from the experiment and post-experiment materials suggest that additional ethics education may have limited influence on many director decisions. The director participants in this study recognized the ethical and social dilemmas. More importantly, the directors in the experiment were willing to trade wealth and growth for social good when their decisions were made from the perspective of a partner, rather than a corporate director. That is, directors were willing to make non profit-maximizing decisions, avoid harming society, and cooperate with the spirit of law when they did not face a duty to maximize shareholder value.

Prior research indicates that directors exhibit high levels of moral reasoning (Brower and Shrader, 2000), but the current research finds that directors suppress their ethical and moral values to meet their legal duties. Directors emphasize legal compliance in their decision processes, and they see little value in cooperating with the spirit of law. In addition, the directors view new independence requirements as signals that they must increase their focus on shareholder wealth, and decrease their attention to other stakeholders. Overall, the results suggest that our business leaders will not make more socially responsible and more ethical decisions until the business model and associated laws are changed to reflect the significance of stakeholders other than the shareholder.

The study also revealed a different decision approach adopted by a single director. One director in the study held the title of Social Responsibility Officer. Over the past decade there has been considerable growth in the development of board committees dedicated specifically to improve social responsibility. These committees have various names, such as: Social Responsibility Committee, Public Interest Committee, and Public Policy Committee (CSRI, 2006). Similarly, boards have begun to appoint social responsibility officers to the board of directors. The primary function of the special committees and dedicated officers is to inform the board about issues that affect the public interest (CSRI, 2006). Harvard University surveys of committees and officers dedicated to social responsibility at Fortune 200 firms indicate that their functions range from reactive legal compliance to proactive legal compliance to proactive protection of public interests (CSRI, 2006). That is, some committees and officers focus only on legal compliance, while others focus on protecting the public and nurturing the corporation's relationship with the public. Survey results indicate that the majority of current social responsibility committees focus on legal compliance (CSRI, 2006).

Interviews with the Social Responsibility Officer in the present study indicated that he served on two boards of directors in this capacity. As the Social Responsibility Officer, this director had a duty to inform other directors of the social and environmental implications of their decisions. He considered his role to be proactive, rather than reactive, and he indicated that his role was to protect the public interests (such as the environment), rather than to promote legal compliance. The director felt a duty to society that equaled or surpassed his duty to shareholders, and he believed that his position offered him additional legal protection from making decisions that failed to maximize shareholder value. In essence, the corporate charter made this director accountable to all stakeholders, rather than only shareholders. The director still employed prospective rationality cognition during the experiment, and he defended his decision from the perspective that the accountants and actuaries had failed to appropriately account for the negative consequences of socially irresponsible actions. However, he was the only director making decisions from a director perspective who was willing to breach his duty to maximize wealth in order to protect society in both case scenarios.

While there was only one such responsibility officer in the sample, his results suggest interesting opportunities for future research. Changes to corporate law and the U.S. business model are not likely to materialize in the immediate future, but changes to the structure of boards can be readily accomplished, and many changes to board structure have already been adopted to promote independence. Perhaps, increased use of responsibility officers or special committees within the board will aid in improving the board's ability to make socially responsible decisions. In addition, increased emphasis on public interests in the special committees, as opposed to emphasis on legal compliance, may allow corporate directors to more fully consider the interests of all stakeholders. Additional research will be necessary to determine how board structures and responsibilities of specific members may be altered to promote ethical behavior and social welfare, if these outcomes are desired.

Notes

[1] The order of the cases was varied across participants, and no effects of order were detected. As a result, all analyses collapse the evidence order manipulation.

[2] Confirmatory analyses using logistic regression models and mixed model analyses of variance produce the same qualitative results for tests of hypotheses as the Chi-square analyses.

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