

# Contemporary business issues

Business



1. According to Milton Friedman, corporations are responsible for using their shareholders funds in profitable ways. According to this view, the provision of public services is a matter for elected representatives. Explain what is meant by “ Corporate Social Responsibility”, and, referring to material in the case study, outline the main arguments for and against it.

Two issues have been considered in dealing with this issue. Firstly there has never been any dispute or doubt about the importance of profits in a business venture. Secondly, the profit objective of a business, if not controlled through social and governmental activism can result in great harm to society. Corporate social responsibility, particularly in organizations engaged in public utility services needs to be considered in this context.

Businesses in the UK have never in the past faced the pressures they do in today's rapidly changing economic scenario. The challenges of the enormously dynamic environment, with the emergence of equal skill competitors operating in fractional cost environments, from China, South Africa, India and other emerging economies, have resulted in astonishing changes in growth rates. While China and India are experiencing growth rates nearing 10 % every year, most European economies are growing flat. Infosys and Tata Consultancy Services, both Indian software service providers added approximately 20, 000 employees each to their payrolls last year[1] as well as more than fifty percent of last years figures to their already profitable bottom lines. The huge differential in salaries means a hefty profit to companies like these for every man effectively deployed for work emanating from the USA and Europe. Years of training and skills absorption have made their staff adept at taking on medium level software

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assignments with the result that just these two companies have caused 40,000 redundancies in one year in western economies. Medical tourism is being looked on as the next huge business area under threat. With medical costs including travel, five star accommodation and treatment by doctors qualified from the best American universities, costing a tenth of that available in the UK, hospitals in India are putting in huge money into western style facilities and tying up with corporates and even the smaller states in the gulf for medical treatment.

These examples just serve to illustrate Milton Friedman's concern when he states that the prime objective of business organizations should primarily be profits, and furthermore profit considerations should dominate other considerations, including social responsibilities. Friedman is merely restating the objective which has driven business down the ages and there has never been any argument with the necessity for a business to make profits. The problem arises when other considerations are denigrated and scoffed at openly or discreetly. The absence of social responsibilities at the level of organised business led to the slave trade, the East India Company, the flourishing of China's opium trade and the colonisation of Africa and Asia. The likelihood of such incidents occurring appearing again would have seemed far fetched today if it were not for Enron, WorldWide.com and the spate of corporate frauds and scandals that shook the business world in the last few years.

Apart from competition from low cost economies, modern day businesses are also challenged by rapidly shifting technology practices. Obsolescence sometimes makes businesses redundant even before they stabilise.

Developments like this create tensions and possibly motivate impulses that may not be responsible or ethical. The ignoring of business ethics or corporate social responsibility thus becomes very possible and statements like those of Milton Friedman serve to accentuate this possibility.

Corporate social responsibility is loosely seen to describe a corporate's obligations and duties towards all the stakeholders in the organization and who include apart from shareholders, financiers, employees, suppliers and customers, also the local community and other citizens who may be affected by the actions of the company. A more exhaustive description would be to refer to it as follows.

Corporate social responsibility is a concept with a growing currency ... around the globe. CSR is a concept that frequently overlaps with similar approaches such as corporate sustainability, corporate sustainable development, corporate responsibility, and corporate citizenship. While CSR does not have a universal definition, many see it as the private sector's way of integrating the economic, social, and environmental imperatives of their activities. As such, CSR closely resembles the business pursuit of sustainable development and the triple bottom line. In addition to integration into corporate structures and processes, CSR also frequently involves creating innovative and proactive solutions to societal and environmental challenges, as well as collaborating with both internal and external stakeholders to improve CSR performance. [2]

Public utilities dealing with water came into the private corporate domain in the UK in 1989 in a series of network utility sales. It created, in a free market economy, large, location-specific, private monopolies that were subject to a

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regulatory environment framed at the time of the sale, and intended to marry the interests of the consumers with those of the corporates managing the water supply. All the corporates who bid for the water supplying facilities did so with full knowledge of the regulatory framework and on the basis of assessments that their organizations would be able to turn in a decent profit even after meeting governmental regulations. Ostensibly their assessments would have been based on their confidence in improving efficiencies far beyond those that existed in the era of state control. These were undoubtedly profit making transactions entered into by moneyed corporates with aims that were primarily economic.

Analysed in this context there does not seem to be any reason to support Friedman's contention that the provision of public services is the responsibility of elected representatives, meaning the public services departments of the government. This argument could hold valid when the supply is being done as a non-profit function towards society and transactions are carried out without any economic objectives. It does not hold good at all when the whole process is treated as an economic transaction with buying companies being given operating monopolies in selected areas as well as the right to fix prices, subject to regulatory parameters designed to give the suppliers an adequate return on profit.

Apart from the above, the details of the case study reveal that pension funds, historically known as shrewd and safe investors of money, have started viewing utilities to be safe avenues for investing their funds, ostensibly because of the safety and surety of money flows.

Thames Water has been run like any other profit oriented organization subject to regulatory controls and has its owners have very recently announced its sale for a price of 4.8 billion GBP,[3] a price high enough to give its owners RWE a decent profit. This development gives rise to the following conclusions.

- RWE did not agree to sell Thames Water because it was a loss making proposition but because of its “ ‘ strategy to focus on its core strengths and concentrate on the converging European electricity and gas markets’, explained Harry Roels, CEO of RWE AG at the announcement of the transaction.”
- The transaction netted a good profit for RWE
- The new owners, Kemble Water Limited have brought the unit as a business decision.

In the light of these facts where corporates are making good profits from the water supply business, entering and exiting on normal profit making and business considerations, and that too in spite of being regulated by OFWAT, the case for considering supplies made by units like these to be the sole preserve of elected representatives just does not hold any water.

2. Are there likely to be any contradictions or tensions between the commitments Thames Water has made to its shareholders and those which it has made to its customers and local communities in its Corporate Responsibility Policy? How might these be resolved?

Issues like these, especially when concerning the interests of shareholders, other external stakeholders and the role of corporate social responsibility

have to be examined from perspectives that need to go deeper than what is stated in formal policy statements. The corporate social responsibility of Thames Water is clearly enunciated in its corporate website. The statements made regarding corporate policy are laudable and politically very correct. They state as follows.

Corporate responsibility means taking account of social and environmental issues in the way we operate.

Our business is reliant upon a healthy environment. Each day we abstract millions of litres of water from the environment to provide drinking water to our customers. We then return treated wastewater to rivers and streams. We have to work within environmental limits and the changing nature of our natural environment.

Socially we interact with a wide range of people:

- Customers and communities impacted by our operations.
- Charities through sponsorships, donations and the voluntary activities of staff.
- Communities through recreational, amenity and educational opportunities on our sites.
- Employees and prospective employees helping to build skills
- Suppliers, contractors and partners.

By managing our business responsibly, we contribute to sustainable development. This means making sure that the way we do business today

meets the needs of our customers and other stakeholders and will enable us to continue to do so far into the future.(WS)

Despite these clearly enunciated social responsibilities, an analysis of the case study also reveals the following.

- Thames Water has repeatedly been penalized by OFWAT for inefficiency
- It has not met its water leakage target for the last six years
- It has been identified as a major polluter by the Environment Agency
- It has a poor reputation for customer service.
- It has been penalized heavily for pollution, has just about escaped being penalized for inadequate water leakage control and has again been indicted for penalties for poor customer service.

It also needs to be considered that the company has made a net profit of 666 million GBP last year and as subsequent events have proved, is a desirable company to acquire and operate.

The company accepts, in its stated corporate policy, its duty towards its customers, its community and to the environment. In spite of this the company appears to be in serious breach of its duties. Even if the issue of excessive water leakage, which because of the substantial cost and time involved is considered separately, the company provides service of very poor quality and has been identified as a major polluter. In fact the discharge of its responsibilities in these areas has been bad enough to attract heavy penalisation.



The company needs to rectify this situation urgently and there should be no issue about its commitment on these fronts contradicting or creating tensions with the shareholders. In fact, the shareholders should insist that the company meet its basic commitments as a utility company to its customers and community. There appears to be a hidden cost dimension to this issue, which though not related to the leaking pipeline, could possibly involve costs for improvement of customer service and preventing pollution. There is no data available on the reasons for this sorry state of affairs to pinpoint whether the reasons for the failure are due to inefficiency or lack of funding. An examination of the operations of the company will reveal the reasons for the failure and the corrective action required, which most probably again will be a mix of repairs, a certain amount of capital investment and drastic changes in operational functioning.

It is thus obvious that while the issue of pipeline repairs can be considered separately the management of the company should get the full support of its shareholders in improving customer services and reducing environmental pollution.

3. The water industry is regulated by the government agency, OFWAT, which, as can be seen in the Case Study, is demanding that more of Thames' profits should be spent in repairing leaks.. Should private companies be subjected to regulation in this way?

The issue for discussion and analysis focuses on the necessity for conservation of water, a critical national and global resource, and the fixation of responsibility for conserving it; whether it lies fully with the government or should it be shared with water utility companies?

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The basic operational process handled by Thames Water involves abstraction of water, its purification, disposal of the waste and supply of purified drinking water to citizens in its area of operations. As stated before water utilities were sold off to private companies in the UK in 1989. This was a very comprehensive move designed to rid the utilities sector of the inefficiencies associated with public ownership, introduce the cutting edge efficiencies of the private sector in water supplies and conservation, provide money to the exchequer, and give the privately owned companies a reasonable return on their investment. The sector would be subject to regulation by the government agency OFWAT. Thames Water and other similar companies operate in similar conditions with determined geographic monopolies under the overall control of OFWAT.

The price of water has been increasing constantly ever since privatisation occurred in 1989 and while the price rises have been led by the implementation of technology needed to give pure drinking water and adhere to EU requirements on environmental needs, all water utility companies have been able to pull in more profits than was anticipated at the time of privatisation. A study by Karen Bakker (2000) of Jesus College, Oxford on “Paying for Water” [4] states that water companies retain monopolies and have been able to pull in significant profits in the post privatisation years because of lax regulatory practices.

On its part Thames Water has taken advantage of its position as a monopoly supplier of water and used the opportunity to make good profit. It has also not taken account of its responsibilities towards its customers and the environment by continuously providing very poor customer service, polluting

the environment significantly and not adhering to the leakage norms. On all these counts it is facing harsh penalties and public opprobrium as a profit seeking and socially irresponsible company. To be fair to the company, it has succeeded in reducing the incidence of pollution and has agreed to commit funds towards controlling of water leakage.

OFWAT recognises that the task of controlling water leakage is difficult because of the length and condition of its old pipeline but it is also a fact that considerations like these are taken into account when arriving at the water leakage targets and Thames Water has not met its water leakage targets for the last six years. Thames Water has agreed to spend an additional 150 million GBP every year on tackling the water leakage problem and agreed to replace an extra 230 miles of ageing water mains in London in addition to the 770 miles already planned.

The issue of the correctness of a private utility company being subjected to regulatory measures has to be considered from different perspectives. The utility service has been using the infrastructure by way of pipelines, reservoirs and other equipment it got at the time of privatisation. These facilities have been used regularly by the company in the post privatisation years and the company has been able to make very good profits. In fact, “ all the players in the water utility industry have been able to make higher than anticipated profits because of lax regulatory practices”.<sup>[5]</sup> The world over, water is treated as a scarce resource and some form of governmental control is maintained, much more so than that kept over power and electricity. England is one of the very few countries in the world where the management of water supplies is done fully by privately owned companies subject to

regulation by OFWAT. Commercial and productivity concerns were no doubt predominant causes behind the privatisation decision and it was presumed that it would be a win-win situation for all players.

Unfortunately, the results were somewhat different and while the government kept its promises on reducing interference, the companies took advantage of the monopolistic situation, lack of regulation and frequent price increases to make high profits. There is no basic argument against making profits but the issue of corporate responsibility and adhering to social commitments is also a matter of considerable concern. Responsibility is expected of corporates, especially those who have agreed to use government assets and take over monopoly business areas. The developments that took place in England's post-privatisation water utilities sector is also an example of the lack of corporate social responsibility. Corporate social responsibility is a concept that is talked about, put on websites and used as a Public Relations tool to earn brownie points. Very rarely is it adhered to in corporate spirit, and even less so when it involves a compromise with the earning of profits.

Considering all these issues, it does not seem incorrect at all for OFWAT to ask Thames Water to pay for a part of repair costs. The issue does not appear to bother either the current and proposed owners of Thames Water as terms of sale have been agreed to with full knowledge of these requirements. The amount of the sale price seems to be at great variance with the figure of 10 billion GBP mentioned in the case study. The actual sales figure has been finalised at about 4.8 billion but there are no indications in any communication or news item about it being a distress sale.

Corporate social responsibility, it appears, will always take a back seat when it has to contest with profits. Legislation, regulation and activism, both at the social and governmental level will continue to be essential for its manifestation beyond web sites and official communication. The same holds true for utility companies and while it seems to be fair to allow them to make profits regulatory agencies like OFWAT will need to be ever vigilant in their role of protectors of citizens interests. In many cases, punitive action will be needed and while each case will need to be considered individually, the correctness of enforcing commitment from suppliers should not be disregarded where there are episodes of delinquency in the discharge of commitments.

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