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LETTER FROM THE EDITORS

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ETHICAL IMPLICATIONS OF LANCE ARMSTRONG’S PERFORMANCE-ENHANCING DRUG CASE

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ABSTRACT

Lance Armstrong was ranked as the top cyclist in the world prior to his 1996 Tour de France win. After his battle with testicular cancer, Armstrong made an extraordinarily successful return to cycling, a stunning return that undoubtedly came with consistent accusations of unethical behavior on Armstrong’s part. Armstrong went on to break records after his battle with cancer, an accomplishment which also drew unwanted attention and accusations of performance-enhancing drug usage. This study addresses the ethical implications of Lance Armstrong’s confession of performance-enhancing drug use during his TdF wins and examines the views of respondents concerning PED use, respondents’ views regarding appropriate consequences for athletes accused of PED usage as well as respondents attitudes towards the Lance Armstrong foundation – LIVESTRONG.

INTRODUCTION

From his first big race win in 1993 to his seventh Tour de France (TdF) win in 2005, Lance Armstrong was a champion. In 1996, prior to winning the TdF, Armstrong was ranked as the top cyclist in the world (Martin & Rowen, 2013). Amazingly he battled testicular cancer later that year, which had spread through multiple sites in his body, yet he recovered and went on to break records. But according to Goff (2013), “extraordinary success invites extraordinary scrutiny.” Over the years, beginning with his return from cancer, Armstrong was accused of using performance-enhancing drugs – from cortisone cream to Actovegin (Weislo, 2013). An exposé was written by Walsh and Ballester in 2004 alleging the use of performance-enhancing drugs (PEDs) by Armstrong, but the evidence was circumstantial (Martin & Rowen, 2013). Floyd Landis, a former teammate, won the TdF in 2006, but was disqualified for the use of synthetic testosterone found in a drug test. Landis then targeted Armstrong and filed a whistleblower lawsuit (Sinnott & McGowan, 2013). From 1999 to 2012, Armstrong denied any
use of PEDs and was even featured on an advertisement for Nike in which he said, “Everybody wants to know what I’m on. What am I on? . . . I’m on my bike.”

On Jan. 17 and 18, 2013, Oprah and Lance Armstrong: The Worldwide Exclusive aired causing widespread discussion of the doping accusations. Armstrong was finally admitting to the use of PEDs. His seven TdF wins had been stripped from him by the United States Anti-Doping Agency (USADA) in August 2012, but many people continued to believe in his innocence. In October 2012, the USADA released a 202-page document detailing the agency’s evidence against him, and that report caused the International Cycling Union (UCI) to choose not to appeal the USADA’s decision to ban Armstrong for life (Macur, 2012). The president of UCI, Pat McQuaid, said, “Lance Armstrong has no place in cycling; he deserves to be forgotten in cycling” (Macur, 2012, para. 3). Not long after that decision, Armstrong removed himself from leadership of his foundation, LIVESTRONG.

Founded in 1997, the Lance Armstrong Foundation, now known as LIVESTRONG, has raised almost $500 million and has helped more than 2.5 million people dealing with cancer (McLane, 2012). The organization is known for its distinctive yellow bracelets printed with LIVESTRONG, which were introduced in 2004 in a joint effort with Nike (“Milestones,” 2013). On Oct. 17, 2013, Lance Armstrong broke the news that he would step down:

_I have had the great honor of serving as this foundation’s chairman for the last five years and its mission and success are my top priorities. Today therefore, to spare the foundation any negative effects as a result of controversy surrounding my cycling career, I will conclude my chairmanship._ (McLane, 2012, para. 4)

When his resignation statement was posted on the LIVESTRONG blog, most responses were positive and said things like, “There has been a LiveSTRONG band on my wrist since 2004. . . and there will be a LiveSTRONG band on my wrist for as long as the global war against cancer continues.” There were others who expressed support for LIVESTRONG for a different reason: “I am pledging $1200/year today as a result of the pathological cheater stepping down.” He disappointed many because of his apparent PED usage, his denials of such usage and his attempts to silence others.

Sports as a cultural artifact impacts culture and influences society values in a significant way and, in many ways, serves as a teaching and learning tool for ethical decision-making by holding athletes, coaches and their respective organization to a higher moral standard. Sports reflect society values like team building and fairness and serves as a tool for teaching moral values like work ethic, perseverance and commitment to young people. Scholars have argued that it is unethical for athletes to use performance-enhancing drugs to help them in competition, citing issues of fairness, harm, and the “spirit of sport” (Coakley, 1998; Lavin, 2001; Sandel, 2007; Simon, 2004). This study seeks to extend previous research done in the areas of sports and ethics by examining how the cycling community and general public have responded to the
doping allegations and confession of Lance Armstrong. In addition, this study considers the impact of Armstrong’s actions on LIVESTRONG donor contribution intentions. A review of relevant literature related to drug use, sports, and ethics is provided. This is then followed by an explanation of the method and results. Finally, the implications for cycling and LIVESTRONG are discussed.

LITERATURE REVIEW

The Role of Competition

Sports are about performance and the quality of such performance. The quality of the performance drives the popularity of athletes and elevates their celebrity status. History shows that great athletes are also the most popular athletes globally. Shining stars can be found in most any sport, such basketball’s Michael Jordan and Lebron James; golf’s Tiger Woods and Jack Nicholson; football’s Tom Brady and Peyton Manning; and tennis stars Stepheh Graph and the Williams sisters. The common thread running through the careers of these athletes is the fact that they excelled in their sports and consistently competed to the best of their abilities.

By excelling in their respective sports, these are some of the most revered, celebrated and highest paid athletes in the world. Athletes all over the world, especially star athletes, are also considered role models and, in some cases, as society’s heroes. As a result, society holds athletes up to higher moral standards and ethics. The excellence and celebrity attained by such athletes are accompanied by some of the best and most lucrative endorsement deals in the history of sports, thus making a strong case for excellence in performance when it comes to sports, an ability that eludes many athletes and attainable by only a few in the respective fields. Additionally, these athletes are considered important role models for society, especially by young people who also happen to be adoring fans of organized sports.

The drive to excel and perform at a high level and the pitfalls associated with celebrity, wealth, and star power have led some athletes to make unethical decisions that ultimately impact their income, endorsements, and celebrity status. It is also important to note here that the desire and motivation for excellence in sports is directly correlated to society’s demand for such excellence in sports performance. Volkwein (1995) sees society’s performance demands driving the development of modern elite sport. Prominent within the socio-cultural context for elite sport development are conditions such as winning at all costs and the emphasis on success driven by financial and material considerations (Volkwein, 1995).

Ethics, Sports, and Performance-Enhancing Drugs

Ethics are rules and guidelines in place within communities, families and organizations to aid in our everyday personal and professional decision-making. Farmer, Farmer, & Burrow
(2008) describe ethics as individuals and groups decisions and actions in relation to their understanding of right and wrong. Ethics transcend all professions and are important components of everyday life and decisions worldwide. However, ethics are also informed by our values and upbringing as individuals, concepts that differ from one person to another. In order for organizations to be on the same page concerning acceptable and unacceptable behaviors, organizations, groups, and communities develop ethical standards and guidelines to guide the decision-making of its members (Black & Roberts, 2011; Peck & Reel, 2013).

Sports organizations as a result of the above have established codes of ethics by which athletes, coaches and other stakeholders are expected to abide. Components of such codes of ethics range from public appearances or clothing choice to the use of banned substances and performance-enhancing drugs. In some cases, such codes are unwritten but well known by members of the sports organization. Violations of any part of such codes are considered unethical and, in most cases, lead to undesirable consequences for the organization and the athlete or athletes involved (Black & Roberts, 2011; Blaney, 2012; Peck & Reel, 2013 and Farmer et al, 2008).

When the stars of organized sports make choices that are morally unjustifiable, those decisions, to a large extent, are looked down upon by society and sports fans and, in most cases, negatively impact the popularity and, ultimately, the careers of athletes in question. Additionally, such events in many cases require some form of and level of image repair or rehabilitation to get the athlete back into the good graces of society and the community (Benoit, 1995; Coombs, 2012).

In November 2009, Tiger Woods’ ethical woes began when he crashed his Cadillac Escalade, after which came allegations of infidelity with multiple women. Infidelity is not illegal in the United States; however, it is unethical and goes against moral decision-making according to community standards and rules, and Tiger Woods certainly paid the price for his actions. As punishment, Woods lost lucrative endorsements from Gatorade, AT&T, Gillette and Accenture among others. Professional sports additionally lost big when Tiger, the face of golf at the time, took time off from the sport (Benoit, 2012). Kobe Bryant, Ben Roethlisberger, and Michael Vick faced similar off-the-field ethical issues that impacted their celebrity status, endorsements and on-the-field participation in their respective sports.

Violations go beyond just the images of athletes and their sport. Regulatory agencies can impose hefty fines and strip athletes of major awards as has been done with Lance Armstrong. Organizations such as USADA and the World Anti-Doping Agency (WADA) have increased investigations of PED use because of the danger they impose. Alexander (2013) compares the government anti-doping arms in Australia and the UK to “police bodies.” While other sports may follow different guidelines,

cycling has pushed harder than most because drugs were infesting their sport and occasionally killing riders; the Olympics has pushed a little harder in
order to keep whatever veneer of purity it can maintain. There isn’t a sport that hasn't seen doping distort it, either a little or a lot, because doping helps. If you want to be bigger, or faster, or quicker, or more agile, or jump higher, or recover faster, or find more endurance in workouts or in games, or deal with stress then PEDs will help you. (Arthur, 2013, p. B1)

Athletes who use PEDs gain unfair training and performance advantage over their opponents who do not use PEDs, and the integrity of sport is violated when competitors are deprived of a level playing field. Furthermore, Hemphill (2009) argues that athletes should comply with the established rules and guidelines of their sport, and using banned substances breaks this obligation resulting in the unfair situation where the conditions of the game change without the consent of other athletes. Not only is it unfair that the rules are changed without their consent, but athletes who do not use prohibited drugs may be coerced to use them to remain competitive when other athletes use banned drugs. Another argument is that ignoring or breaking the rules governing a sport is cheating, and cheating is wrong.

Athletes threaten the “spirit of sport” when they use PEDs. WADA identifies the intrinsic value of sport as the “spirit of sport” defined as:

*the celebration of the human spirit, body and mind which is characterized by the following values: ethics, fair play and honesty, health, excellence in performance, character and education, fun and joy, teamwork, dedication and commitment, respect for rules and laws, respect for self and other participants, courage as well as community and solidarity. (2009, p. 14)*

PED use is considered contrary to the ideal embodiment of sport. For the spread of PEDs to have increased, Jason Mazanov, a scholar at the University of New South Wales, points to the medical and scientific community involved in sports and suggests that medical ethics have been damaged. “Their principles are on one side of the balance, their livelihoods on the other” (Bull, 2013, p. 5). According to Sharkey (2013),

> *Ever since Lance Armstrong was stripped of his seven Tour de France titles, there's been a growing realisation that a) he couldn't possibly have operated alone and b) the probable extent and availability of PEDs across other sports is truly alarming.* (p. 42)


Using PEDs is not just unethical but can result in negative social consequences for the sports community. Hemphill (2009) argues that in addition to undermining excellence in sports,
PED use can “force ‘drug-clean’ athletes, for example, to justify their record-breaking performances to a suspicious public” (p. 318), or encourage lower expectations and ultimately “compromise the sport’s ability to promote its internal goods” (p. 318). Despite overwhelming evidence that PED use is rampant in many sports, including cycling, studies show a certain level of ambivalence on the part of sports fans and society when it comes to the use of banned substances and performance-enhancing drugs in sports. Additionally, studies show sports fans are equally divided on whether or not athletes should have the option to use PEDs or banned substances and how much punishment should be given to athletes who violate such rules.

The literature shows that PED use by athletes is perceived by society as unethical and justifies the focus of this study. Past studies examined for this paper did not specifically address cycling and PED use, therefore the research questions for this study are as follows:

**RQ1**  Will there be significant difference in views regarding PED usage and reporting based on (a) gender, (b) age, and (c) cycling participation of respondents?

**RQ2**  Will there be significant difference in views regarding appropriate consequences for athletes accused of PED usage based on (a) gender, (b) age, and (c) cycling participation of respondents?

Additionally, viewing PED use as unethical could impact organizations affiliated with an offending athlete. While sponsoring organizations can pull support to save face, organizations such as LIVESTRONG are inherently tied to founding athlete. Thus, the following research question is asked:

**RQ3**  Will there be significant differences in attitude toward the LIVESTRONG Foundation based on (a) gender, (b) age, and (c) cycling participation of respondents?

The ethical implications on behavioral intentions to donate to LIVESTRONG are viewed through the lens of the theory of planned behavior (TPB). TPB (Ajzen, 1985; 1991) extends the theory of reasoned action (Ajzen & Fishbein, 1980) by adding the concept of behavioral intentions. Individual behavioral intentions are indicative of the likelihood of actually engaging in the behavior in the future. Shaw & Shiu (2003) extended TPB to formulate a model for understanding ethical consumer choices, which was further extended to understand the ethical donor choices by Gerlich, Drumheller, Kinsky, and Sollosy (2012). Those who express a distrust of athletes who use PEDs and a desire to discontinue supporting those associating with the discredited athlete could indeed discontinue monetary and temporal contributions. In this case, LIVESTRONG could be an unwitting victim in the fall of Lance Armstrong.
METHOD

A nationwide online survey was administered in February 2013, soon after the broadcast confession Lance Armstrong shared with Oprah Winfrey. Respondents were required to be US residents and at least 18 years of age. The survey asked whether respondents thought PED use was wrong, what types of consequences they deemed appropriate for athletes caught using PEDs, and what impacts they saw from Armstrong’s use of PEDs and eventual confession. The sample was recruited via Mechanical Turk; a total of 399 usable surveys were collected.

The volunteer sample attracted more males (60%) than females (40%), with a mean age of 32. The sample was comprised of 81% white, 7% Hispanic, 3% African-American, 8% Asian, and 1% other, and hailing from 47 states and the District of Columbia. The largest concentrations of respondents were in California (15%), Texas (6%) and New York (6%). Thus, a fairly representative geographic sample was collected. The survey instrument also included scales measuring Attitude (ATT), Desire (DES), Intent (INT), Planned Behavior (PLAN), and other elements of the Theory of Planned Behavior (Shaw & Shiu, 2003; Shaw, Shiu, Hassan, Bekin & Hogg, 2007).

Scale items in the TPB survey were adapted to fit the Armstrong/Livestrong scenario, with the primary goal being to assess respondents’ plans to avoid or not avoid donating to Livestrong. Wording of these items was as consistent as possible to that set forth in Shaw et al. (2007). The original application of this scale explored purchasing products manufactured by sweatshop labor; these items were modified to reflect attitudes and intent toward donating to Livestrong in the wake of Armstrong’s admissions of guilt in using PEDs.

Consistent with prior studies (e.g., Ajzen & Fishbein, 1980; Ajzen & Madden, 1986; Shaw et al., 2007), overall attitudes toward Lowe’s were measured by asking respondents to evaluate the behavior using five 7-point semantic differential scales. Participants used the following adjectives to appraise Lowe’s: (a) positive-negative; (b) beneficial-harmful; (c) favorable-unfavorable; and, (d) good–bad. The attitude subscale of the TPB had a Cronbach’s alpha of .943.

Desire (DES) to avoid donating to Livestrong was measured on a scale that included two-items. Responses were made on a 7-point scale (1 strongly disagree to 7 strongly agree). The desire subscale of the TPB had a Cronbach’s alpha of .945.

Behavioral intentions (INT) (e.g., Ajzen & Fishbein, 1980; Ajzen & Madden, 1986; Shaw et al., 2007) were measured with two items. Participants were asked to indicate their likelihood of avoiding donating to Livestrong, as well as intent of avoiding donating to Livestrong. Respondents used a 7-point scale ranging from 1 very unlikely to 7 very likely. The behavioral intentions subscale of the TPB had a Cronbach’s alpha of .907.

Finally, planned behavior was measured using two-items utilizing a 7-point scale (1 strongly disagree to 7 strongly agree). The PLAN subscale of the TPB had a Cronbach’s alpha of .932.
RESULTS

T-tests for independent means (equal variances assumed) were calculated using three criterion variables, Gender, Age (<32 or >=32) and Cycling Affinity (whether the respondent had some connection to the sport, or not). These criterion variables were compared to respective mean responses for five individual items that assessed respondent views regarding the use of PEDs, the consequences of using PEDs, perceived pervasiveness of PED use, retroactive punishment for using PEDs, and whether it is OK to report teammates for using PEDs.

These three criterion variables were also used to compare respective mean scores for the summed items of each of the four TPB subscales. For example, the scores on the four ATT questions were added together to create the ATTSUM variable. Similarly, DESSUM, INTSUM and PLANSUM were created by adding the respective items in those subscales. Results from all nine sets of t-tests (by three criterion variables) are found in Table 1 below.

The results indicate that gender differences exist with regard to four of the five PED-related questions. Males were significantly more likely to be more forgiving of PED usage, while males and females were fairly equal in their assessment of most professional athletes using such substances.

<table>
<thead>
<tr>
<th>Item</th>
<th>Gender</th>
<th>Age</th>
<th>Cycling Affinity</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is morally wrong to use PEDs in sports.</td>
<td>t=-4.176; p=.000</td>
<td>t=4.554; p=.000</td>
<td>t=.745; p=.457</td>
</tr>
<tr>
<td>Athletes who are caught using PEDs should be banned from their sport for life.</td>
<td>t=-2.003; p=.046</td>
<td>t=5.334; p=.000</td>
<td>t=.496; p=.620</td>
</tr>
<tr>
<td>The majority of professional athletes use PEDs.</td>
<td>t=1.338; p=.182</td>
<td>t=-2.280; p=.023</td>
<td>t=.328; p=.743</td>
</tr>
<tr>
<td>Retired athletes who are found to have used PEDs during their careers should have all of their results forfeited.</td>
<td>t=-3.289; p=.001</td>
<td>t=5.102; p=.000</td>
<td>t=1.038; p=.300</td>
</tr>
<tr>
<td>It is OK to report teammates and others for using PEDs.</td>
<td>t=-1.956; p=.051</td>
<td>t=1.871; p=.062</td>
<td>t=.097; p=.923</td>
</tr>
<tr>
<td>Attitude Sum</td>
<td>t=-1.161; p=.246</td>
<td>t=2.550; p=.011</td>
<td>t=.414; p=.679</td>
</tr>
<tr>
<td>Desire Sum</td>
<td>t=-.465; p=.642</td>
<td>t=3.984; p=.000</td>
<td>t=.665; p=.506</td>
</tr>
<tr>
<td>Intent Sum</td>
<td>t=-.675; p=.500</td>
<td>t=4.738; p=.000</td>
<td>t=1.560; p=.120</td>
</tr>
<tr>
<td>Plan Sum</td>
<td>t=-.227; p=.820</td>
<td>t=3.250; p=.001</td>
<td>=-.684; p=.494</td>
</tr>
</tbody>
</table>

There were no significant differences reported using Cycling Affinity as a criterion, neither among the five individual items, nor among the four summed subscales from TPB. This suggests that connection to the sport is irrelevant. The ability to separate Lance Armstrong and Livestrong both from the sport of cycling may be of potential benefit for the sport…a sport rocked by controversy in recent years amid numerous allegations of PED usage.
By dividing the sample into two groups based on whether a person was younger than the mean age, or at or above the mean, t-tests for independent means could be calculated. In four of the five individual items, significant differences were reported in the mean scores. Younger respondents tended to be more dismissive of problems using PEDs than were older respondents. It was only with regard to turning in PED-using teammates that there was no significant difference vis-à-vis older respondents.

Age was also used to compare mean scores along the four summated TPB subscales. Younger respondents had significantly more favorable views toward Livestrong than did older respondents.

**DISCUSSION**

The results are interesting in that gender was only important with regard to the actions that Armstrong (and others in general) took regarding PEDs, but age was important with regard to both Armstrong-related activities and views toward Livestrong. It is possible there has been a cultural shift within the US, especially in the recent era of PEDs in sport. Armstrong being a professional cyclist may be immaterial; that he used PEDs may be irrelevant. Perhaps younger adults have become inured to this practice, and pass off drug usage as just another aspect of being a professional athlete. Given the number of disqualifications in cycling alone, as well as hints and allegations of many longstanding podium personalities being complicit, the fact that he was finally caught possibly came as no surprise to younger respondents. They have seen it throughout their adult life, they expect it, and are not surprised when someone is found out.

Older respondents and their tendency to be less forgiving of Armstrong, as well as having a dimmer view of Livestrong, perhaps are reflective of an earlier cultural milieu in which ethics were not relative, but in fact black and white. Forgiving and forgetting are not as likely to be outcomes when major transgressions occur, in contrast to the muddied waters plied by younger adults today. If anything, these findings suggest that, at least among the young, Armstrong may have a future in sport or other societally visible vocation, and Livestrong may indeed be able to continue as a champion of curing cancer.

**CONCLUSION**

The results reveal significant differences among the respondents with regard to age. Younger respondents were far more likely to be forgiving of Lance Armstrong and have favorable attitudes and other behavioral dimensions toward Livestrong. These differences may reflect a cultural shift within the US, especially with regard to the recent incidence of sports stars being associated with PEDs. Having grown up around the problem, it is possible that younger respondents are inured to such practice, and thus view it as part and parcel of professional sports.
Given these results, it is possible that organizations such as Livestrong may be able to weather storms such as the one precipitated by Armstrong’s admission of guilt.

**Limitations**

This study is limited in that it is but a snapshot of the general public’s views toward Lance Armstrong and their planned giving to the Livestrong Foundation. It is possible that the proximal nature of the survey with relation to Armstrong’s appearance with Oprah on national television may have inflated emotions. It is thus possible that were the survey administered in six months or a year following Armstrong’s admission of guilt, the results might be very different. The extensive coverage in the media of the incident ensured that many people were made aware of Armstrong’s practices, but may have also influenced the sentiments of the general public in ways that may not have occurred prior to the arrival of pervasive media formats.

It is thus possible that a forgetting and/or forgiving effect may become manifest as time passes. As Armstrong passes from the media eye, public emotion may wane, allowing the Livestrong Foundation to embark on a new chapter of its existence without the baggage of the current crisis.

Another limitation is that at the time of the crisis, Armstrong and Livestrong were virtually inseparable in the public mindset. Given Armstrong’s historic connections to the charity, it was impossible to treat the two as completely separate entities, even though this is indeed how the two will go forward. It is not the case that Armstrong merely had an affiliation with Livestrong; he was the reason the foundation was created in the first place.

Finally, it is possible that, although the sample had good geographic and gender representation, it skewed somewhat young (average age = 32) compared to the rest of the nation. Thus, findings may be similarly skewed.

**Areas for Future Research**

A longitudinal, or at minimum, follow-up, study may yield more clarification into respondent’s planned and actual giving. If emotions do subside and forgetting and/or forgiving occur, it is possible that a change in giving could result. Furthermore, as Livestrong goes forward without Armstrong’s involvement, it is possible that people will begin to see the foundation in a different light.

It would also be beneficial to analyze the components of the Theory of Planned Behavior within a structural equations model. In addition to the four subscales used above, participants also responded to subscales measuring Subjective Norms (SN) and Perceived Behavioral Control (PBC). These two subscales, along with the four above, comprise the complete TPB model. As such, it would be interesting to approach planned giving as if it were little different from ethical
consumer purchases as Shaw et al. (2007) reported. In many regards, the two activities involve similar thought processes.

Finally, it would be interesting to compare and contrast the Armstrong/Livestrong scenario to crises endured by other charitable organizations. While non-profits facing a crisis is not a new phenomenon, the Armstrong/Livestrong case is unique in that a central celebrity sports figure is in the center of the controversy. Analyzing the similarities and differences with other non-profit crises could yield important insights into how other non-profits should approach crises in the future.

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THE SHIFT FROM ECONOMIC TO SOCIAL RESPONSIBILITY: THE TALE OF TWO ARGUMENTS

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ABSTRACT

The choices human beings make today will determine the world in which they live tomorrow (DesJardins, 2007, p. xii). The arguments in this paper presuppose that the ideas of corporate social responsibility which embody the societal obligations of the firm have changed in the late twentieth and the early twenty-first centuries as compared to earlier years. This change is reshaping the face of today’s organization and creating a society of hope that is built on the closer organization-societal relationship.

While some believe that companies will do well by doing good, others argue that doing what's best for society means sacrificing profits. The research contributes to corporate social responsibility literature by detailing both arguments and providing several implications concerning the social responsibility of the firm. Finally, the paper suggests a research agenda for the future.

KEY WORDS: Corporate social responsibility, corporate citizen, personal social responsibility, corporate reputation, brand performance.

INTRODUCTION

The era of the 1960s America was very different from prior eras. It was characterized by an anti-business attitude developed as many criticized the vested corporate interests that controlled the society’s economic and political side (Ferrell, Fraedrich, & Ferrell, 2005). The same era observed the decay of urban America as parts of US cities became run down and undesirable to live in, contributing to economical, social, and environmental problems. It was also a time of growing ecological problems, namely pollution and disposal of nuclear and toxic wastes (Ferrell, Fraedrich, & Ferrell, 2005).

Accordingly, President John F. Kennedy was the first to articulate the concept of professional regulation serving the public interest that was outlined in the "Consumer Bill of Rights," as: (1) The right to safety “to be protected against the marketing of products and services that are hazardous to health or to life”; (2) the right to be informed “to be protected against fraudulent, deceitful, or grossly misleading information, advertising, labeling, or other practices, and to be given the facts needed to make informed choices”; (3) the right to choose “to have available a variety of products and services at competitive prices”; (4) the right to be
heard “to be assured that consumer interests will receive full and sympathetic consideration in making government policy, both through the laws passed by legislatures and through regulations passed by administrative bodies”; (5) the right to education “to have access to programs and information that help consumers make better marketplace decisions”; and (6) the right to redress “to work with established mechanisms to have problems corrected and to receive compensation for poor service or for products which do not function properly” (Consumer Bill of Rights, n.d.).

In his infamous book “Unsafe at Any Speed”, Ralph Nader (1965) severely criticized the US auto industry, particularly General Motors. He estimated that in 1964, auto accidents caused by the automobile manufacturers putting profit and style ahead of consumer safety cost our nation in $8.3 billion in property damage, medical expenses, lost wages, and insurance overhead expenses. These costs are equivalent to over two per cent of the US gross national product (Nader, 1965). Nader’s consumer movement known as “Nader’s Raiders” successfully fought for legislation that resulted in the passage of the Motor Vehicle Safety Act (1966), the option of seat belts in all cars (1967), and the mandatory seat belt in four states in 1984 (Marx, 1986; Ferrell, Fraedrich, & Ferrell, 2005; Carroll & Buchholtz, 2009).

The concept of “doing good” came to the US before the turn of the century in response to the challenges and forces facing society and businesses (Stroup, Neubert, & Anderson, 1987). Thus, since the 1960s, the expectations placed on business ethics have been steadily climbing. Society no longer looks at a firm’s productivity alone to morally and ethically justify the organization. The trend is to look at how a company’s wealth generation affects non-economic areas of society that include the welfare of the employees, customers, other stakeholders of the entire business system, and environmental concerns (Lantos, 2001).

Today, our world of the 21st century is filled with a variety of challenges such as population growth, globalization, world health crisis, poverty, the crisis of the environment, natural disasters (i.e. earthquakes, floods, etc.), climate change (global warming), water and food shortage, and diseases. Each challenge brings with it immense humanitarian consequences. These challenges require collaboration between government agencies and non-government organizations, innovative strategies, corporate social responsibility programs, and sustainability efforts to help reduce the combined impact on society. Strategic planning by companies included efforts to alleviate the negative impact of the challenges described above and encompassed solutions to some of these humanitarian and social problems. It is imperative that a discussion of contemporary corporate social responsibility programs reflects upon a company’s perceived ethical obligation to embark upon social problem solving balanced against its economic duty to be profitable.

In his masterpiece “Management Challenges for the 21st Century,” Peter F. Drucker (1999) described the social and political realities that must be addressed when formulating a responsible management strategy. These new realities facing the 21st century management include the declining birth rate in the developed world, the shifts in the distribution of disposable income, and increasing global competitiveness. Additionally, it is imperative that management
be positioned to survive the economic, social, political, and technological transformation that is taking place.

DesJardins asserted that “business in the twenty-first century be practiced in a way that is economically vibrant enough to address the real needs of billions of people, yet ecologically informed so that the earth’s capacity to support life is not diminished by that activity, and ethically sensitive enough that human dignity is not lost or violated in the process. Economics, ecology, and ethics form the three pillars of a sustainable society” (2007, p. 1).

The question whether business should be socially responsible or be restricted to “the profit motive”, still occupies a large share of the debates regarding business ethics (Ciulla, Martin, & Solomon, 2007). Today the big question before business executives is whether businesses should think past maximizing the bottom line and try to do good. Such debate received many answers varying from the extreme positive-meaning unconditional yes (French, 1977 as cited in Ciulla, Martin, & Solomon, 2007; Patty, 1994; Maitland, 2002; Hay & Gray, 2002 as cited in Newton & Ford, 2006; Barner 2007) to an extreme rejection stating that the role of business is solely to maximize profit (Friedman, 1996; Newton & Ford, 2006; Stone, 2007).

The purpose of this paper is to provide a balanced view of corporate social responsibility (“CSR”). In it, we will detail the traditional arguments against CSR as well as present the arguments that support corporate involvement in finding solutions to social problems. The format of this paper proceeds as follows: The next section provides a review of the literature on corporate social responsibility and contains arguments for and against CSR. The following section develops the research framework propositions. Finally, the last section presents the conclusion and proposes managerial implications as well as directions for future researchers.

THEORETICAL FOUNDATION AND DEFINITION OF CORPORATE SOCIAL RESPONSIBILITY

In today’s world, the expectation for businesses to behave ethically and morally is paramount. The bar has been steadily raised over the last fifty years, by creating the obligation for organizations to practice corporate social responsibility and accept some accountability for the welfare of society (Lantos, 2001). Researcher Archie Carroll (1979) and others believe that corporations should be judged on economic success combined with non-economic criteria. Due to the positive effects of CSR participation and the negative effects of non-participation, most companies today do more than merely pay lip service to CSR issues, and choose to actively engage in socially responsible activities (Chi-Shiu Lai, 2009).

Despite the proven positive effects of CSR, however, arguments against social responsibility, such as those enumerated by Griffin (2008) still exist, but with minimal support. These include: the purpose of business in U.S. society is to generate profit for owners; involvement in social programs gives business too much power; the potential for conflicts of interest; and business lacks the expertise to manage social programs (Griffin, 2008, p.101).
A few studies provide insight into the positive impact of an organization’s CSR and its reputation as measured by consumers’ perceptions of the corporation’s products (Brickley, Smith, & Zimmerman, 2001; Lai, Chiu, Yang, and Pai, 2010; Jones, 2005; Smith & Higgins, 2000; Varadarajan & Menon, 1989; Varadarajan & Menon, 1988). According to Brickley et al., (2002), “a company's reputation for ethical behavior is part of its brand-name capital” (p. 1821). Research has also shown that shareholders are making socially responsible investments (SRI) in companies that adopt CSR. However, these investments may not be based primarily on moral or ethical choices, but on self-interested economic reasoning since CSR is said to add economic value to a firm (Petersen & Vredenburg, 2009).

The benefit of engaging in CSR is related in a speech delivered at the 2003 Business for Social Responsibility Annual Conference, by Carly Fiorina, former CEO, Hewlett-Packard:

For many years, community development goals were philanthropic activities that were seen as separate from business objectives, not fundamental to them; doing well and doing good were seen as separate pursuits. But I think that is changing. What many of the organizations that are represented here today are learning is that cutting-edge innovation and competitive advantage can result from weaving social and environmental considerations into business strategy from the beginning. And in that process, we can help develop the next generation of ideas and markets and employees (Fiorina, 2003, para. 27).

Since 1982, UPS, its foundation, employees and retirees have donated $1 billion to United Way programs to improve lives and communities across the US (United Way, 2010-b). According to Scott Davis, UPS’s chairman and CEO, the spirit of giving is alive and well at UPS even when the economy is tough (UPS, 2008). Examples of successful sustainability programs initiated at UPS include a program designed to offset carbon dioxide emissions produced via small package transportation in the United States. This ingenuity helped reduce long-term effects on the carbon footprint by allowing UPS customers an opportunity to actually buy carbon offsets for purchases made on the internet. Another effort to promote environmental sustainability is exemplified through the company’s purchase of more than 101,000 vehicles world-wide which allowed UPS the opportunity to develop fuel efficiency for its own vehicle (UPS Sustainability Report 2009).

Another example of long-term solutions to community needs was exhibited by UPS, in 2010, as the world anxiously awaited the fate of 33 trapped miners. An internationally reported disaster occurred when 33 miners were trapped 2,000 feet below the earth’s surface in Chile, and experts on the scene determined that the only way to rescue the miners was by drilling a hole into the ground. The Chilean Embassy reached out to UPS for logistics assistance and the company was able to facilitate the shipping services necessary to transport ten tons of equipment from a factory in the United States to Chile in a few days, and deliver it to the site of the disaster. (Sustainability at UPS, 2010).

In 2010, United Way honored UPS for its outstanding record of charitable giving with a "Thanks A Billion" advertisement that ran in the July 26 issue of Fortune Magazine to commemorate UPS’s $1 billion in charitable giving (United Way, 2010-a).
In the honoring speech, Elise Buik, president and CEO of United Way of Greater Los Angeles said: "UPS is a driving force for positive change in our communities...Reaching a billion dollars in corporate giving is a remarkable milestone. In Los Angeles, UPS employees give more to our Creating Pathways Out of Poverty plan than any other company, providing evidence that being successful in business and giving back to the community can go hand in hand. We were proud to present them with our Spirit of L.A. award at this year's Corporate Philanthropy Summit." (United Way, 2010, para. 3).

UPS’s charitable contributions totaled nearly $100 million in 2009 alone. UPS has built its legacy as a caring and socially responsible corporate citizen since its founding in 1907. It supports programs that provide long-term (i.e. sustainable) solutions to community needs. UPS promotes community involvement through its ongoing volunteerism. Its employees and their families contributed more than 1.2 million hours of community volunteer service. Additionally, it provides grant programs, environmental sustainability and corporate philanthropy.

Taking issue with the concept that Corporate Social Responsibility should be institutionalized, Karnani (2010) argues that the idea that companies will profit by being socially responsible and doing what’s best for society is fundamentally flawed. In most cases, he argues, CSR results in a sacrificing of profits. Karnani asserts that “companies that simply do everything they can to boost profits will end up increasing social welfare. In circumstances in which profits and social welfare are in direct opposition, an appeal to corporate social responsibility will almost always be ineffective, because executives are unlikely to act voluntarily in the public interest and against shareholder interests” (2010, para. 8). Accordingly, the danger is tremendous when corporations become more focused on society as societal members look to them to address social issues and problems. This will discourage or delay more effective methods to improve societal problems when the corporation’s profits and enhancing social welfare are in direct competition with each other (Karnani, 2010). As Corporate Social Responsibility is institutionalized, its meaning needs to be defined.

While the structure of this paper is based on the presentation of two opposing arguments on the subject of corporate social responsibility, it is also necessary to include several distinct and opposing definitions of the subject. The review of applicable literature revealed many definitions. Milton Friedman defined CSR as a requirement to increase business profit (2007), Skapinker (2010) defined it as the corporate usage of its resources to engage in activities designed to solely increase its profits. On the other hand, many argue that business has obligations to society in addition to pursuing profitability and that corporations have other responsibilities to customers, to employees, and to the society as a whole (Shaw & Barry, 1998).

Ferrell, Fraedrich, & Ferrell (2005) defines it as “the organization’s obligation to maximize its positive impact and minimize its negative impact on the society” (p. 10); Kotler (2005) defines corporate social responsibility as an organization’s voluntary commitment to improve society’s well-being through its business practices and contributions of corporate resources (p.1); others define corporate social responsibility as the obligation of the firm to use its resources in ways to benefit society, through committed participation as a member of society, taking into account the society at large, and improving welfare of society at large independently of direct gains of the company (Kok, Van Der Wiele, McKenna, & Brown, 2001, p.287). Finally, in a narrowly defined position against CSR, “...the concept now lies on its deathbed... The
CSR concept’s looseness and generality enable it to encompass such a wide variety of ethical practices that it has become meaningless” (Ludescher & Mahsud, 2010, p.123). The real ethical or unethical actors according to Ludescher & Mahsud (2010) are the people and not the abstract firms. Accordingly, CSR is distracting us from the real issues and the unethical practices.

THE CASE AGAINST CORPORATE SOCIAL RESPONSIBILITY

Adam Smith, a noted eighteenth-century philosopher and political economist stated in his influential work “Wealth of Nations” that self-interest would lead to bringing about the healthiest economic conditions for everyone—that is a laissez-faire system, based on an absolutely free economy (Smith, 1776). Smith asserted that in a free-market environment, if all of us pursue our own economic gains, we are led by an “invisible hand” that promotes the general good of our society (as cited in Shaw & Barry, 1998). In his defense of laissez-faire, Paul Snowden Russell stated that “businesses have neither the right, in law or morals, nor the ability to meddle with social responsibility. Customers, employees, and the general public are best served when the company simply does its job with maximum efficiency (as cited in Newton & Ford, 2006, p. 76).

Milton Friedman, neoclassical economist, Chicago School of Economics, espoused the most widely acclaimed argument for a purely profit-based position regarding CSR. In his 1960 book Capitalism and Freedom, and in his famous 1970 New York Times Magazine article, “The Social Responsibility of Business is to Increase its Profits” (1996), Friedman opines that “[In] a free society …there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profit so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception and fraud,” (p.245). Friedman championed economic values, not social values, which he believed were outside the scope of a company’s requirement to maximize shareholder value while acting legally, ethically, and honestly. An important rationale of the argument espoused by Friedman was his belief that the solution to social problems is the responsibility of government and social agencies, not businesses. An example of Friedman’s position on this issue is further evidenced by his advice to corporate managers to refrain from infusing personal values in environmental and community matters if it would threaten shareholder wealth. For example, a responsible manager would close or relocate a plant if it improves profitability, even if it causes hardship to employees.

A profit motive argument distinguishable from Friedman’s, is the position on CSR taken by Albert Carr (1996). Carr asserted that the sole purpose of business is to produce a product at a profit. Along with this purpose, and the presence of competition and negotiation, Carr branched away from Friedman and posited that businesspeople have a lower standard of ethics and morals than the rest of society. Carr compared business to the game of poker, where anything goes within the accepted rules of the game. Applying this standard to business allows misstatements
and omissions of relevant facts during negotiations; described by Carr as bluffing other businesspeople. The only standard that Carr believed stands above economics is following the law. He argued that the morality of a person’s business life is separate from the morality of the rest of his or her life; a concept that is non-existent (Johnston, 1990). It is important to point out that Friedman’s position on economic CSR recognized ethical responsibilities in addition to legal responsibilities for businesses, and surpassed Carr’s by encompassing a range of moral duties to stakeholders. These duties included: avoiding deception and fraud, engaging in open and free competition, and practicing fair play within the rules of the game (Boatright, 2000). Thus, Friedman neither believed in nor promoted the poker game analogy. This is important to note since many of Friedman’s followers as well as his critics argued that his position was solely a no-holds-barred business approach. In accord with Friedman’s profit only CSR, Theodore Levitt (1983), professed that the only social responsibility of a business, besides being profitable, is to practice basic honesty in its day to day affairs (Levitt, 1983).

In following Friedman’s position, Anderson argued against the position that CSR costs should be treated as investments, rather than lost revenues (as cited in Stroup, Neubert, & Anderson, 1987). Investment is defined as “committing or use of (money, capital, etc.) for the purchase of property, securities, a business project, etc., with the expectation of a profit” (Anderson, as cited in Stroup, Neubert, & Anderson, 1987, p.24). The priorities of a company are to stay in business, to retain its employees, and generate a reasonable profit for the stockholders (Stroup, Neubert, & Anderson, 1987). According to Edward Harness, the Chairman of the Board of the Proctor and Gamble Company, “There is no charity for charity’s sake in our handing out the Company’s money or in asking the Company’s people to give of their time. Procter & Gamble’s support of civic campaigns is now and always will be limited to what we believe represents the enlightened self-interest of the business” (as cited in Stroup, Neubert, & Anderson, 1987, p.25).

A recent study to determine if environmentally friendly companies are rewarded in the financial markets showed support for Friedman’s profit motive only argument for businesses. A three year study analyzing stock price change showed an inverse relationship between environmental friendliness and financial performance (McPeak, Devirian & Seaman, 2010).

A similar position was taken by Skapinker (2010), in his support of the position that responsible companies’ first duty is survival. He argued that companies who are committed to both corporate social responsibility and sustainability can still fail. In his argument:

Enron was a benefactor to its home city of Houston. Lehman Brothers’ programme of support for an inner-city London school was one of the most impressive I have seen. BP, under Lord Browne, its previous leader, promised a sustainable future beyond petroleum. Tony Hayward, his successor, insisted hydrocarbons would remain central, but that the world needed a more sustainable mix of energy sources” (p. 11).
Ludescher and Mahsud (2010) argued that “CSR's gravest danger may be that it diverts our attention from the deeper ethical issues surrounding the real value of products and toward superficial considerations of business/society engagement and organizational ethics. CSR becomes nonsensical when it is applied to businesses whose mission is to create products that are addictive, hazardous, or destructive” (123).

Lantos (2001) argued that publicly-held companies that engage in what he described as “altruistic” CSR, participating in good works that are an expense to stockholders, is not legitimate CSR and should be avoided. Basically, good works done merely for the good of society should not be undertaken by companies. For example, if a business adopts an inner-city school and pours money and resources into it, what is the benefit to the company? There’s no guarantee that there will better educated students, and if the future workers are better educated, that they will work for the philanthropic firm (Singer, 2000). Similarly, if a business provides training for the unemployed, what is the likelihood that they will be productive individuals, or even work for the donor?

Lantos (2001) distinguished altruistic CSR from ethical CSR, where a business avoids societal harms, as an obligatory responsibility of all organizations. A third type of CSR, strategic CSR, which includes good works that are also good for the business, is the only type of CSR that companies should practice. This is because strategic philanthropy, which serves as a marketing tool, is beneficial to firms and stockholders as well, and genuine philanthropy only serves as an additional expense (Lantos, 2001). Further, throughout much of America, individual wealth is dependent on the performance of the stock market, forcing corporate managers to take the necessary steps to increase stock prices (Boatright, 1999). This phenomenon leads to a tug of war between those arguing for strict profit maximization versus those arguing for better social performance (Lantos, 2001).

Another objection to CSR is that involvement in social programs gives business too much power (Griffin, 2009). It is arguable that humanitarian acts by corporations could give them undue influence over society. Theodore Levitt took a novel position and argued that when corporations take responsibility for society’s welfare, it reduces pluralism and creates a monolithic society (Levitt, 1983). However, neither business nor government is a monolithic institution and it is unlikely that this will ever occur. The argument has minimum support in its position that if business takes on the societal responsibilities of the government; this will lead to the government’s takeover of business, resulting in a merger of government and business into one powerful entity, sacrificing our democratic institutions (Bowie, 1995). In today’s business climate, this argument is weak and unfounded, despite the government “take-over” of General Motors, which was due to a “bail out” of GM, and hardly related to GM’s social responsibility activities.

In arguments against CSR, Griffin (1999) gives examples of conflicts of interest that could occur when a corporation is deciding between several charities as recipients of grant money. He relates a simple proposal where an executive must decide between the local civic light opera company or other non-profit organizations in the community. If the manager is an opera fan, she might be tempted to direct the funds to the civic light opera, with the benefit of
front row seats for the opera season, rather than objectively considering the best interests of the company and the community (Griffin, 1999).

An expansion of this argument is evidenced by a position taken by Friedman (1996) that CSR endeavors can be an indication that an agency is experiencing a conflict between the interests put forth by managers and those held by shareholders. These situations can be seen through the use of CSR activities by managers to advance their own personal programs at a cost to shareholders (McWilliams & Siegel, 2001). Examples include corporate sponsorship of sporting events and the arts. These events might portray an appearance of corporate caring, but the primary motivator might very well be the non-pecuniary benefit experienced by managers by attending these functions, such as ego gratification (Cornwell et. al, 2001).

In deciding whether or not to engage in CSR, a well-founded argument against it is that corporate executives are lacking in the moral and social expertise necessary to make noneconomic decisions for the betterment of society (Freeman, 2001). An example includes the corporate giant, Exxon Mobil and its contribution to help save the Bengal tiger, the firm’s corporate symbol and a rare and endangered species. Exxon Mobil’s social responsibility efforts include donating money to zoos for captive breeding programs and educating the public about the tiger. Wildlife conservations argue, however, that Exxon Mobil’s money would be better spent on efforts to stop the poaching of Bengal tigers, the worldwide illegal trade in tiger parts and products, and the destruction of tiger habitat (Griffin, 2008), exemplifying the argument that the corporation is an “inept custodian,” (Shaw & Barry, 1998).

Friedman opined that CSR amounted to spending someone else’s money, such as the shareholders or the customers, which confused executive decision making by hindering the focus on profit and placing the firm at a competitive disadvantage. Friedman posed the following questions: Whether managers were even competent to participate in matters of social concern? Whether imposing their values in society was even important? Whether they were stepping in the shoes of the increasingly difficult in order to avoid offending at least one important constituency (Carroll, 2001)? Novak (1996) lends credence to this line of questioning by his assertion that a corporation is an economic entity with specific organizational responsibilities, and is not a welfare agency. Its managers do not have the expertise or skills to be profitable, serve customers, manage employees, and provide social services, traditionally the responsibility of government.

A highly publicized example of corporate involvement in philanthropic activities, in which the firm has no subject matter expertise, was the case of Dayton Hudson Corporation and Planned Parenthood. In 1990, Dayton-Hudson, a conglomerate of retail stores (predecessor to the giant Target Corporation) donated $18,000 to Planned Parenthood. Pro-choice advocates boycotted its stores, picketed outside of them, wrote letters to newspapers, and publicly tore up credit cards, in opposition to Dayton Hudson’s contribution (Gibson, 1992; DeWitt, 1990). Such actions produced a negative impact on the company’s bottom-line, furthering the argument of some that companies should avoid controversial issues, particularly in areas where they are lacking any expertise, which ultimately result in offending a vast and important societal constituency (Carroll, 2001). The Dayton-Hudson example is demonstrative of the pressures external stakeholders place on holding businesses accountable for social issues and the financial risks that accompany actions that are considered by some to be socially unacceptable.
Businesses have missed the mark and have responded to these risks with superficial public relations campaigns and sophisticated, glossy CSR reports that highlight environmental and societal good deeds, when in fact, corporations should document what and where the environmental benefits are on a regional basis, rather than for the company in its entirety. Further, philanthropic deeds should be described in terms of impact on society rather than in terms of dollars and cents (Porter & Kramer, 2002).

There also remains the argument that there is very little real substance to what some firms claim to do. Examples include tobacco giant, Phillip Morris and its spending of $100 million boasting its $75 million in charitable donations in 1999 (Byrne, 1999; Porter & Kramer, 2002). This is a prime example of a business not having the expertise to manage social programs, proving that in some situations, the amount spent touting the firm’s achievements is more than the amount spent on the so-called CSR activity itself (Alsop, 2002). Similar to the Phillip Morris example, Avon Products sent its 400,000, independent sales representatives in a door to door campaign to raise over $32 million to fund breast cancer prevention. It goes without saying that this is a good cause, but is not in an area that Avon has any inherent expertise. Even so, Avon generated favorable publicity, but failed to realize the full potential of its philanthropy to create any economic value for the company (Porter and Kramer, 2002). “As long as companies remain focused on the public relations benefit of their contributions, they will sacrifice opportunities to create social value” (Porter and Kramer, 2002, p.15).

THE CASE FOR SOCIAL RESPONSIBILITY

According to Robert Hay and Edmund Gray, “in the long run, businesses will only be successful if they are directed to the needs of the society. If they choose to ignore that advice, government regulation is likely to fill the gap between business operations and the welfare of the people the government is sworn to protect” (as cited in Newton & Ford, 2006, p. 76).

As businesses are directed more and more to address society’s needs, the total corporate social responsibility model delineated by Carroll (1979) warrants consideration. This concept, defined CSR as a continuum of business obligations to society that included economic, legal, ethical, and philanthropic components (Carroll, 1979). Carroll later incorporated his four-part categorization into a “Pyramid of Corporate Social Responsibilities” (Carroll, 1991), which also depicted a continuum of responsibilities. The responsibilities, included an economic category, located at the base of the pyramid, and defined as the obligation of a business to produce goods and services, sell them at a fair price, and make a profit. The legal component included the firm’s obligation to comply with laws and regulations, as required by the government and its own policies and guidelines. Ethical responsibilities related to a level of performance that society placed on businesses. The fourth and final category of CSR, located at the top of the pyramid, was philanthropic responsibilities, otherwise known as the good citizen component (Carroll, 1991).

As time progressed and CSR became more popular, interpretation and application of the pyramid to CSR initiatives was unclear and confusing to some scholars and practitioners. For
example, placement of the most important component of the pyramid, economic responsibilities, at the bottom, was interpreted by some as meaning least important. Also, the meaning of ethical responsibilities versus philanthropic responsibilities needed clarification and proposed that philanthropic responsibilities would be considered under ethical and/or economic responsibilities. (Schwartz & Carroll, 2003) This led Schwartz and Carroll (2003) to suggest an alternative continuum of components based on three domains - economic, legal, and ethical – depicted in a Venn diagram to better illustrate the overlapping responsibilities of each component. This most recent continuum approach to CSR appropriately sets the stage for an analysis of the case for social responsibility.

The foundation of every business is its economic responsibility to be profitable. Friedman posited that management is "to make as much money as possible while conforming to the basic rules of society, both those embodied in the law and those embodied in ethical custom" (Friedman, 1996). Today, the profit responsibility of business has evolved into more than just making money. Economic responsibility encompasses the profitability of the firm, but with commitment to various stakeholders including consumers, employees, suppliers, and community groups, in addition to stockholders. This component of the CSR continuum also relates to employee morale and the company’s reputation for goodwill (Carroll, 1979).

Today’s sophisticated business managers are very much aware of the increase in demands from employees, customers, suppliers, and government to engage in CSR. Stakeholders now expect firms to participate in societal issues such as unemployment, poverty, infrastructure, and to be proactive in addressing the effects of the business on society as a whole (Kok, 2001). How does a firm implement CSR and satisfy its various stakeholders, yet remain economically responsible over the long run? Kanter (2010) suggests implementation of a strategic plan containing a strong CSR directive compatible with the corporation’s ongoing mission. A company’s incorporation of social good into its business strategy leads to positive long-term performance. Thus, the company can “do well and do good”, (Kanter, p.2) when it integrates societal benefits that correlate with its existing business. This is based on a number of factors including a more positive and stronger perspective of the company from its customers, employees, and the general public. Kanter cites the Proctor and Gamble Company (P&G) as an example of a business that addressed societal problems, which resulted in the development of innovative profit-making products within its traditional business. P&G initiated a program where its employees lived in Brazil and through observation of low-income households, developed new products such as affordable, environmentally-sound, and hands-friendly laundry detergent. Thus, as a result of a corporate strategic plan that included a CSR component, a company served a societal benefit, satisfied various stakeholders, developed a new profitable product, and boosted employee morale (Kanter, 2010). Burke and Lodgson (1996) also advocated this position and stated that when philanthropic activities are closer to the company’s mission, they create greater wealth than other kinds of donations.

A few companies worthy of discussion have integrated CSR in their strategic planning. According to Marianne Barner of IKEA (a global home furniture retailer founded in Sweden), “corporate social responsibility is IKEA’s daily business. IKEA has set a sustainability objective requiring that all our activities have an overall positive impact on people and the environment. We have a list of key performance indicators to measure our progress on CSR issues, such as the
environment” (Barner, 2007, p. 59). While it is not easy to link IKEA’s CSR performance to its profitability, the belief is that their efforts have a positive impact on the company’s bottom-line (Barner, 2007). Its mission of creating a better everyday life for the many that they aim to serve has made it easy for IKEA to incorporate social and environmental goals into its strategic planning (Barner, 2007). Another major company that embraced CSR is Campbell’s Soup Company (2010). Campbell’s Soup has a set of CSR objectives for the next decade that is aligned with the company's mission. Its business strategy includes sustainability and corporate social responsibility as one of its seven cores (Anonymous, 2010).

CSR has an effect on all aspects of a company’s business. Consumers would rather purchase goods from companies they trust, just as suppliers want to form relationships with firms they can depend on. Employees today would rather work for a company with a strategic plan that includes social responsibility and warrants their respect. A firm’s primary responsibility is to make an acceptable return on its owner’s investment. CSR encompasses the requirement that while making a profit, the business has a duty to act within the legal guidelines established by the government and its regulating agencies. An extension of this legal responsibility of a firm is its ethical responsibility to not harm its stakeholders (Werther & Chandler, 2006). According to Freeman’s stakeholder theory, corporations have responsibilities to their shareholders and other interest groups (Freeman, 1984).

“Corporations can use their charitable efforts to improve their competitive context - the quality of the business environment - in the location or locations where they operate.” (Porter and Kramer, 2002, p.6) A few companies have initiated context focused charitable giving to achieve both social and economic gains. The argument put forth is that investing in philanthropic activities may be the only way to improve the context of competitive advantage and still create greater social value than individual donors can (Porter and Kramer, 2002). One example is Cisco Systems and its investment in the Cisco Networking Academy, a philanthropic education endeavor established to train computer network administrators. The context of this social endeavor was that the training academy would help alleviate potential strain on Cisco’s growth while providing employment options to high school graduates. By focusing on social needs that will also affect its corporate context, and utilizing its own unique and sophisticated business attributes, Cisco began to demonstrate the true unrealized potential of CSR. (Porter and Kramer, 2002) It is well-founded that businesses don’t operate in a vacuum and must consider the societal structure that surrounds them. Although education has historically been addressed as a social issue, better managed by government agencies, today we are seeing private sector charitable involvement in our educational system at an increased rate. (Ibanez, 2010) In the case of Cisco, its managers considered the fact that the education level and expertise of the local workforce could affect the competitive aspect of a business in the area. More specifically, Cisco Networking Academy focused on education and training needed to produce employment-ready network administrators, a skill contributing to its competitive edge (Porter and Kramer, 2002). Similarly, Apple has donated its computers to schools for many years as a means of introducing its product and system to young users. This philanthropic endeavor is a clear social benefit to the schools that receive them, and at the same time, allows Apple to expand its product market and develop more sophisticated buyers (Porter and Kramer, 2002).
To what extent does corporate social responsibility influence institutional investors? Waddock and Graves (1997) found a positive link between institutional investors’ stock preferences and socially responsible organizations. They argued that CSR added value to an organization over the long term, which attracted leading institutional investors. Empirical testing of the relationship between CSR and financial performance has shown positive results (Beurden & Gossling, 2008; Margolis & Walsh, 2003; Orlitzky, Schmidt, & Rynes 2003). The premise of the research was the parallel that CSR improves a company’s financial performance by improving its relationship with its major stakeholders. From the cost side, as relationships improve, a certain degree of trust is built between the two sides, which ultimately lower certain transaction costs and associated risks. From the revenue side, when stakeholder relationships improve, this opens the door for new customers and investment opportunities, allowing the company to charge premium prices (Barnett, 2008). Margolis and Walsh (2001) found that approximately 100 studies looked at the relationship between corporate social performance and corporate financial performance over the last thirty plus years. Most of these studies showed a positive relationship between CSP and CFP (Margolis & Walsh, 2001). Generally, it is inferred that CSR does produce financial dividends for businesses, but this should be considered with caution, in view of the methodology used in such studies (Smith, 2003).

Although these studies showed a positive association between investors seeking financial performance and CSR; the economic value in the companies practicing CSR was not addressed. Petersen and Vredenburg (2009) posed the question: What did these investors perceive or measure that was of economic value in the companies that practiced CSR?

Many studies have been conducted on the relationship of CSR to long-term financial performance. Griffin and Mahon (1997) reviewed studies since the early 1970s pertaining to the CSR and shareholder value link (Belkaoui, 1976; Clarkson, 1995) finding the impact on the bottom line vague. Walley and Whitehead (1994) even considered the proposition that environmental initiatives increase a firm’s profitability, but found the costs so high, that little to no economic payback was possible. More recent studies, however, suggest a positive correlation between corporate social responsibility and a company’s financial performance (Frohman, 1997; Waddock and Graves, 1997). The research of Petersen and Vredenburg (2009) sought to determine why CSR and corporate financial performance appear to be correlated. They explored the who through perceptions of institutional investors of socially responsible firms in the oil and gas industry. These corporations believed that social and environmental issues were strategic imperatives in the survival of their organizations, which led to investments in education, health, public infrastructure, and other activities not related to their primary economic interests. Institutional investors responded that social responsibility was directly correlated to financial performance. The investors and managers identified specific activities that they believed added value to the companies. In relation to stock valuation, these investors did not identify a premium that they would be willing to pay for a socially responsible firm, but they believed that these socially responsible firms were positive assets for their portfolios (Petersen & Vredenburg, 2009).

In considering the perceived value of the stock of these companies, the function of risk-management was value determinative. CSR seemed to be valued as a means of achieving risk mitigation or enhancing the company’s access to resources, rather than establishing its own
financial worth. Investing in local communities in education, medical facilities or other socially oriented projects unrelated to the company’s day to day business, was an important activity if it related to an economic outcome such as reducing terrorism, increasing market opportunities, or reducing the risk of being cut-off from resources (Petersen & Vredenburg 2009).

Kenneth J. Arrow, a prominent twentieth century theorist and a 1972 Noble prize winner examined and rejected the firm’s profit maximization argument (Arrow, 1973). Maximizing profit has a major negative implication to society; it takes firms and people away from the altruistic motives expression. The wide spread argument that profit maximization is an obligation and that firms do it not because they like to do it, but it is a social obligation is merely not accurate (Arrow, 1973). While the assertion by some that profit always represents the firms net contribution or the value add to the product or the service, and that the profit should be as large as possible; this argument assumes that competition is fierce and the presence of competition leads firms to provide its social good (value add) at a lower price. Therefore, social justification for profit maximization by monopolies cannot be supported (Arrow, 1973).

Another component of Schwartz and Carroll’s (2003) three domain approach to CSR is the corporation’s ethical responsibilities. In view of the higher societal expectations placed on businesses, and the high visibility of even a hint of corporate wrongdoing, consideration must be given to the moral and ethical aspects of CSR. Davis contends that “… social responsibility begins where the law ends. A firm is not being socially responsible if it merely complies with the minimum requirements of the law, because this is what any good citizen would do. A profit maximizing firm under the rules of classical economics would do as much. Social responsibility goes one step further. It is a firm’s acceptance of a social obligation beyond the requirements of the law” (Davis, p.313). In considering Davis’ position, one might ask, what motivates a business to engage in CSR? The motivation behind a company’s decision to implement a CSR policy or plan is as varied as the companies themselves. Graafland and van de Ven (2006) contend that a business is more likely to become involved in CSR when the impetus is moral, or intrinsic; as opposed to a strategic motive for CSR which is based on a long-term profit making belief. Albeit a laudable motive, support for this somewhat naive position is minimal.

In light of Carroll’s definitions of philanthropic responsibilities, giving to charitable organizations readily fits under the ethical domain, and doesn’t warrant separation into its own domain (Schwartz and Carroll, 2003). When analyzing the continuum of components included in an argument for CSR, corporate philanthropic responsibilities might be based on ethical as well as economic motives (Shaw and Post, 1993). Making charitable donations to organizations can help sustain the corporation’s bottom line in the long run. When its strategy includes goals to increase sales, improve its public image, or raise employee morale, as the reasons for philanthropic deeds, then it is apparent that the business is motivated by economic reasons, rather than philanthropic responsibility (L Etang, 1994). The three domain continuum is exemplified by arguments put forth as early as the 1960s by advocates of CSR, who argued that it would limit regulation, in addition to improving corporate reputation, and employee recruitment and
retention (Davis, 1960; Whetten, Rands, & Godfrey, 2002). Finally, although the legal component of CSR can be costly to a business that must comply with government regulations; failure to comply is even more expensive. It can lead to financial disaster as well as irreparable damage to the company’s reputation (Pinkston & Carroll, 1996).

PUTTING IT TOGETHER: WHY SHOULD ORGANIZATIONS BE SOCIALLY RESPONSIBLE?

In his address to the National Industrial Conference Board, Sol M. Linowitz, the then chairman of the board of Xerox Corporation stated:

To realize its full promise in the world of tomorrow, American business and industry—or, at least, the vast portion of it—will have to make social goals as central to its decisions as economic goals, and leadership in our corporations will increasingly recognize this responsibility and accept it (as cited in Shaw & Barry, 1998, p. 195).

Accordingly, the institutionalization of the Corporate Social Responsibility “CSR” concept requires a better understanding of its meaning. Therefore, the question before us is whether corporate social responsibility is merely to maximize profit or to be construed broadly to include other responsibilities. These responsibilities include ethical conduct, avoiding harm to society and actively contributing to the well-being of society.

While the first expression of corporate social responsibility took the form of philanthropic contributions in most firms, many of these philanthropic contributions were related to causes of direct interest or benefits to business leaders, its employees, or its communities (Stroup, Neubert, & Anderson, 1987). Since these contributions are voluntary, many business owners, managers, employees, and even recipients believe that corporations are giving something away (Stroup, Neubert, & Anderson, 1987). Accordingly, some managers view philanthropic giving as competing for scarce resources. It is merely expenditure. Similarly, corporate shareholders view it as competing for dividends (Stroup, Neubert, & Anderson, 1987).

This paper takes the position that when looking at social responsibility, the total corporate social responsibility of business is: “Economic Responsibilities + Legal Responsibilities + Philanthropic Responsibilities” (Carroll & Buchholtz, 2009, p. 46) in addition to its ethical responsibilities. This broad definition emphasizes the firm’s relationship to its stakeholders and society. Therefore, this paper supports the view that those who argue against corporate social responsibility are viewing the concept very narrowly by limiting their viewpoint to the philanthropic category, rather than focusing on the unified concept of social responsibility.

Milton Friedman asserted that in a free enterprise system (like ours), corporate executives are employees of the owners of the corporation and therefore have direct responsibilities toward their employers. These responsibilities summate doing business according to owners’ (or
shareholders in publicly traded corporations) wishes or desires, including maximizing profit and conforming to the societal rules (Friedman, 1996). In arguing the economic responsibilities of management to its owners, corporations might commit resources (financial and non-financial) to provide amenities to its community. By doing so, it will be in the long term interest of the company to attract desirable employees (Friedman, 1996). This is perfectly fine and ethical. Corporations exist to provide value. Through the concept of value providing for the social good, managers have the right to pursue the economical goals of profit making while pursuing altruistic motives.

According to Arrow (1973), altruistic motives are those in which gratification is as legitimate as the selfish motives behind them. While the expression of such motives needs to be fostered in our society, a selfish profit maximizing form of economic behavior does not help express altruistic motives. Accordingly, while there is no argument about the profit motive of the corporation, it has other responsibilities to its employees, its customers, and its society. Corporations are not merely deserted islands; they affect their societies and are affected by these societies. Therefore, a larger societal role is expected from these corporations.

As far as legal responsibilities, Adam Smith called it a fundamental pre-condition of social order. It is a system of positive law that embodies the rules of conduct based on justice (Smith 1776).

As the violation of justice is what men will never submit to from one another,
the public magistrate is under necessity of employing the power of the
Commonwealth to enforce the practice of this virtue. (Smith, 1773, p. 10).

In the pursuit of profit, the action of some managers is reflected in a caveat emptor philosophy—meaning, let the buyer beware (Newton & Ford, 2006). This philosophy and behavior is characterized by managers who are not concerned with product quality or safety. They are only concerned with the proceeds from selling the goods. As far as their relationship to their employees, managers of this type view labor as a commodity that will be sold and bought at a price in the marketplace. On the contrary, the philosophy of socially responsible managers is caveat venditor—meaning, let the seller beware (Newton & Ford, 2006). This is a belief that the corporation is responsible for making and selling safe and quality products and services to customers. Additionally, it treats employees with dignity, respect and as long term investments for the good of the company. As far as accountability, managers are responsible to the owners (or shareholders), to their employees, and to society at large (Graafland, J. & De Ven, 2006; Newton & Ford, 2006). In a broader sense, it also means embracing the federal and state equal employment opportunity laws applicable to employees and the society in general. The strategic and moral motives are important in the firm’s relationship to its stakeholders (Graafland, J. & De Ven, 2006).
By being ethical and going beyond legal requirements, firms will gain many advantages including insulation from changes that may result in new legal constraints and requirements. Ethical responsibilities require firms to engage in business practices in a fashion that is acceptable with societal values and norms including the fair employment and the environmental implications of its production and services (Gallagher, 2005; Cascio, Young, & Morris, 1997). Socially responsible firms and their executives and managers will agree that the profit motive is important for the corporation’s sustainability. However, a firm’s ultimate survival is built on achieving the interests of society based on respecting the law and refraining from cheating or misleading its employees, customers, or other stakeholders. While some business practices are perfectly legal, its adherence to societal values and norms could be ethically unsound (Cascio et al., 1997; Chen, Patten, & Roberts, 2008).

**IMPLICATIONS AND SUGGESTIONS FOR FUTURE RESEARCH**

As this study attempts to contribute to the literature on corporate social responsibility through presenting the arguments and the counter arguments based on an extensive review of literature, this paper has several practical implications for managers and practitioners.

First, it is important to view the CSR concept as an integrated one that encompasses corporate economic responsibilities to its owners or shareholders, corporate ethical responsibilities, corporate legal responsibilities, and corporate philanthropic responsibilities to its communities. It suggests that the integrated the sum of social responsibility of business is equal to: “Economic Responsibilities + Ethical Responsibilities + Legal Responsibilities + Philanthropic Responsibilities.

Second, the corporation is a citizen in the broader society, which impacts many groups and is impacted by society. This interaction and the corresponding impact must create a social bond that governs the corporation’s relationship to its society. Accordingly, organizations must have an adequate control and cost benefit analysis to ensure that its CSR efforts are producing the results that meet its planned objectives.

Third, corporations should institutionalize ethics as the first step towards broadening corporate social responsibility. Institutionalized ethics and ethical behavior are paramount in ensuring ethical behavior towards employees, customers, and society at large. Doing so requires that organizations must mandate that all employees read and understand the organization’s code of ethics and sign a statement regarding their commitment to it at a minimum.

This paper suggests that further research with focus on the integrated approach to corporate social responsibility--economic responsibilities + legal responsibilities + philanthropic responsibilities is required to assess the organizational overall successful performance. Additionally, case studies of corporations that adapt the broader definition of CSR and semi-structured interviews with key executives should be conducted in order to examine the causal applicability of such a concept.
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CORPORATE SPEECH AND THE PROBLEM OF CORPORATE PERSONALITY IN CITIZENS UNITED V. FEDERAL ELECTION COMMISSION

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ABSTRACT

The United States Supreme Court in Citizens United v. Federal Election Commission lifted prohibitions against direct contributions to political campaigns on the grounds that First Amendment free speech protections for political speech extended to for-profit corporations. The majority opinion, however, did so without explicit reference to any legal theory of the corporation that warranted the granting it the same free speech rights given to natural persons. Although the Court has discussed the issue of corporate personality in earlier cases where corporations sought to invoke constitutional rights to defeat government regulation, its failure to do so in this instance resulted in flawed decision.

INTRODUCTION

As the Citizens United v. Federal Election Commission (2010) decision reverberates throughout the American political system, controversy over the role of corporate political campaign contributions has intensified accordingly. In its majority opinion, the Supreme Court held that corporate political speech in the form of direct contributions to political campaigns is entitled to First Amendment protection.

This decision raises a number of fundamental questions about the nature of corporations. When a corporation makes a political campaign contribution from its general treasury who, exactly, is “speaking”? Is it the shareholders, directors, officers or other employees? What about the political interests of other stakeholders, such as creditors, suppliers, customers and members of the affected communities? Whose political interests warrant the financial support of the corporation that will reduce the firm’s profits dollar-for-dollar? When the political interests of these corporate stakeholders conflict, which ones can legitimately claim superiority?

As a practical matter, the corporate directors will most likely decide because in the structure and governance of for-profit corporations, they have the responsibility to mediate among the conflicting interests of the various corporate constituencies. The fundamental question remains, however, whether any corporate speech on a political issue can fairly represent the widely divergent interests of all who comprise the corporation.

Thus, this paper argues that the origin, nature and structure of a for-profit corporation make it inherently incapable of the kind of speech that the Court sought to protect.

Part II considers the Citizens United opinion and the Court’s focus upon the importance of First Amendment protection for political speech, regardless of its source. Part III discusses
legal theories of the corporation and how the concept of corporate personhood, whether considered implicitly or explicitly, has influenced issues concerning the recognition of legal rights for corporations. Part IV presents an argument that while it is sometimes necessary to grant corporations the same legal status or protections as those given to natural persons, the right to First Amendment protection for political campaign expenditures is not such a situation.

It is important to note at the outset that this article does not address concerns that direct corporate political campaign contributions would distort or otherwise unfairly tilt election contests in favor of corporate interests; rather, it contends that for-profit corporations are incapable of the kind of speech about which the Court expressed such concern in Citizens United.

THE EXPANSION OF CORPORATE FIRST AMENDMENT FREE SPEECH RIGHTS IN CITIZENS UNITED V. FEDERAL ELECTION COMMISSION

In Citizens United v. Federal Election Commission (2010), the U.S. Supreme Court extended the First Amendment free speech rights of for-profit corporations with respect to the use of general treasury funds for political advocacy and electioneering communications.

Citizens United, a non-profit corporation that accepted money from for-profit businesses, planned to run advertisements promoting its documentary film Hillary: The Movie, about Hillary Clinton, then a candidate in the 2008 Democratic presidential primary. Citizens United wanted to make its film available within 30 days of the 2008 primary elections, but feared that doing so would violate federal campaign contribution laws because the group had accepted funds directly from for-profit corporations to make the movie. Had the for-profit corporation funds come through a Political Action Committee, a separate organization established by the for-profit corporation to collect and distribute money raised by voluntary contributions from the corporate shareholders and employees, no legal issue would have arisen. Bipartisan Campaign Reform Act (2002). Thus, Citizens United sued the Federal Election Commission, seeking declaratory and injunctive relief on the grounds that the applicable federal campaign contributions restrictions were unconstitutional Citizens United v. Federal Election Commission (2010, pp. 887-888).

A 5-4 majority of the Court held that federal bans on use of general treasury funds by for-profit corporations to make direct contributions to political candidates or support independent advocacy of the election or defeat of a candidate violated corporate free speech rights under the First Amendment Citizens United v. Federal Election Commission (2010, p. 917). Justice Kennedy, writing for the majority, and Justice Scalia in a concurring opinion, both focused upon the importance of protecting particular forms of speech itself, rather than the source of that speech. They cited the first amendment free speech right of the electorate to hear the broadest possible range of views, regardless of their sources. Citizens United v. Federal Election Commission (2010, pp. 898, 929).

The Court emphasized that the government could not ban political speech simply because it comes from a corporation:

… the Government may commit a constitutional wrong when by law it identifies certain preferred speakers. By taking the right to speak from some and giving it to others, the
Government deprives the disadvantaged person or class of the right to use speech to strive to establish worth, standing, and respect for the speaker's voice. * * * The Court has thus rejected the argument that political speech of corporations or other associations should be treated differently under the First Amendment simply because such associations are not "natural persons." *Citizens United v. Federal Election Commission* (2010, pp. 899 - 900).

The Court also based its concern for protecting the rights of citizens to hear the broadest possible range of speech upon the same implicit assumption about corporations:

The Government may not … deprive the public of the right and privilege to determine for itself what speech and speakers are worthy of consideration. The First Amendment protects speech and speaker, and the ideas that flow from each.” *Citizens United v. Federal Election Commission* (2010, pp. 899 - 900)

Although the free speech clause of the First Amendment unquestionably protects the rights of citizens to speak, the Court proceeded to apply this principle to for-profit corporations without careful consideration of whether such institutions should be regarded as “persons,” or given the same status as natural persons, for this constitutional purpose. The majority merely presumed that a for-profit corporation should have the same status as a natural person with respect to First Amendment free speech rights. This unarticulated assumption does not stand up to close analysis of the underlying nature of a for-profit corporation, as discussed in Part IV. Thus, the majority did not provide an adequate rationale for protecting corporate political speech in the same way as that of natural persons under the First Amendment. Its failure to do so calls into question the basis for its holding in this case.

The majority did note in passing the problem of protecting dissident shareholders from being compelled to fund corporate political speech, but it brushed aside this concern as something correctable through the procedures of “corporate democracy.” *Citizens United v. Federal Election Commission* (2010, p. 911) Such a correction would be unlikely in a publicly-traded firm where shareholders have little if any influence on operational decisions. Moreover, as explained in Part IV, the existence of dissenting shareholders is not the only reason for saying that a corporation is incapable of the same type of political speech as a natural person. Other corporate constituencies, including both internal and external stakeholders, may also oppose the candidate or issue that receives money from the company treasury.

Justice Stevens dissented from the majority’s dismissal of the shareholder protection issue in his defense of carefully regulating corporate participation in political campaigns. He observed that those shareholders who disagreed with the corporation’s political speech were nonetheless “effectively footing the bill” for it. Even if an unhappy shareholder were to sell his stock as a result, the damage would have already occurred *Citizens United v. Federal Election Commission* (2010, pp. 977 - 978).

Stevens further referred to a “… conceit that corporations must be treated identically to natural persons …” as “inaccurate” and “inadequate.” He noted that corporations are not actual members of our society, cannot vote or run for office and may be run by outsiders with interests
that conflict with those of eligible voters. He also suggested that important distinctions exist between corporations and human speakers when it comes to elections. *Citizens United v. Federal Election Commission* (2010, p. 930).

He did so not on the basis of corporate theory, however, but out of a concern about possible negative effects of corporate contributions on the political process *Citizens United v. Federal Election Commission* (2010, pp. 930, 971). Stevens did devote some of his dissent to the legal and regulatory treatment of American corporations, but only to bolster his contention that the Framers of the constitution never intended to extend First Amendment free speech to corporations. Nonetheless, he explicitly declined to use any corporate theory in making this point *Citizens United v. Federal Election Commission* (2010, pp. 949, 950; n. 72, p. 971).

**LEGAL THEORIES OF THE CORPORATION AND THE PROBLEM OF CORPORATE PERSONALITY IN AMERICAN LAW**

Whether the law should grant the same Bill of Rights protections to a corporation that it does for a natural person turns upon which theory of corporate personality a court adopts, whether it does so explicitly or implicitly. In *Citizens United*, the Court faced the specific issue of whether for-profit corporations warrant the same First Amendment free speech protection for political campaign contributions as natural persons. Although it did not explicitly address the nature of corporate personality it its decision, this issue cannot be resolved without making some assumptions about the nature of a corporation. This is not the first time that the Court has dealt with the nature of corporate personality, even though it did so implicitly.

In some instances, the courts have granted the same constitutional rights to corporations as they have for natural persons. In others, courts have treated corporations as though they were persons for certain purposes, but have not regarded them as natural persons. The distinction is important.

As a matter of positive law, courts can grant rights to a corporation that are similar to those of natural persons, but only need to do so for specific purposes that are more limited in scope and rationale than those given to natural persons. Thus, a court can extend first amendment free speech protection to corporations for commercial speech without holding that a corporation has all the speech rights of a natural person *Central Hudson Gas & Electric Corporation v. Public Utilities Commission* (1980). This fits with the nature and purpose of a for-profit corporation. Extending political free speech rights to a corporation does not, as explained in Part IV.

The Court has not maintained a single view of corporate personality in cases involving constitutional challenges to legislative and regulatory actions. Alternative views of corporate personality, also referred to as theories of the corporation, rest upon underlying assumptions, whether stated explicitly or made implicitly, about whether the corporation exists only as a creation of the state that grants its charter or has some form of independent existence as an autonomous, self-directed economic being that possesses inherent rights, including certain constitutional rights. (Mark 1987, p. 1443) The latter approach grants personhood status to the corporation and thereby establishes a specific normative framework with respect to how corporations are viewed and treated. (Ripken 2009 pp. 99, 100) As such, it becomes a natural
entity entitled to the same natural rights as a real person, as opposed to an artificial being that is entitled to no more than what the state decrees.

The earliest legal theory of the corporation viewed it as a creation of the sovereign. Known as the “grant” or “concession” theory, it regards the corporation as an artificial entity, one that exists at the pleasure of the state. It comes into existence when the state grants its charter and has no rights or standing beyond what its charter allows. There is neither room nor need to endow the corporation with full-blown personality, i.e., give it all the legal rights of a natural person; but, the state may nonetheless choose to recognize its legitimate participation in the legal system for certain purposes. Rather than having the same status as a natural person under the law, it is a legal abstraction, often referred to as a legal fiction, the status of which depends upon how the law defines it. (Ripken 2009, pp. 106, 107) Contemporary social scientists would refer to this as a legal construct, something that comprises whatever traits the law ascribes to it.

Under this approach, the state can use corporate charter provisions to regulate corporations with respect to such things as its specific purpose, the scope of its operations, its maximum size and even its duration. Corporate agreements and activities that go beyond these limits would be declared ultra vires, unenforceable and invalid. (Horwitz, 1992 p. 75) A corporation’s rights therefore extended only as far as its charter and the state corporate codes allowed. Corporations were not regarded as natural persons and could not invoke constitutional rights on that basis.

For example, a Georgia corporation could not claim rights as a citizen under the privileges and immunities clause of Article IV of the U.S. Constitution when it brought an action to enforce contracts made in Alabama. Although a corporation was a legal person for certain purposes in contemplation of law, that did not put it on the same plane as a natural person. Bank of Augusta v. Earle (1839, pp. 586 - 588)

With spread of industrialization and the rise of Jacksonian democracy in the latter part of the nineteenth century, a new legal theory of the corporation emerged. (Horwitz, 1992, pp. 80 – 85; Gevurtz 2000, p. 21). Commonly referred to as the “aggregation of individuals” or “aggregate theory,” this approach held that corporate existence and identity derived from the natural persons who comprised the organization, apart from any recognition by the state. Thus, the corporation “[was] not in reality a person or a thing distinct from its constituent parts” (Morawetz 1886, p. 3). As such, the corporation possessed the same natural rights that warranted the same legal protections as did natural persons.

The U.S. Supreme Court embraced this aggregate theory and its principle that corporations could have the same constitutional rights as natural persons in Santa Clara v. Southern Pacific Railroad (1886). A frequently-cited headnote famously declared:

One of the points made and discussed at length in the brief of counsel for defendants in error was that "Corporations are persons within the meaning of the Fourteenth Amendment to the Constitution of the United States." Before argument Mr. Chief Justice Waite said: The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws, applies to these
corporations. We are all of opinion that it does (Santa Clara v. Southern Pacific Railroad 1886, p. 394).

This apparently followed the reasoning of a previous circuit court opinion (Horwitz 1992, pp. 177-78), County of San Mateo v. Southern Pacific Railroad Company (1882), wherein the court stated:

It would be a most singular result if a constitutional provision intended for the protection of every person against partial and discriminating legislation by the states, should cease to exert such protection the moment the person becomes a member of a corporation. (County of San Mateo v. Southern Pacific Railroad Company 1882, p. 744).

The Court thus reasoned that the corporation’s fourteenth amendment private property rights derived from the rights of the individual shareholders, as would be the case if the individual investors had formed a partnership instead of a corporation, rather than from a grant or concession by the state. As an association of individuals, the corporation had the same equal protection rights as the natural persons that owned its shares (Horwitz 1992, pp. 71 – 74). The Court reached this conclusion despite the fact that although the fourteenth amendment refers specifically to “persons,” it does not define that term to include corporations. Nonetheless, the Santa Clara decision effectively personified the corporation.

As the overall size and the operational scope of railroad and industrial corporations continued to expand through the turn of the twentieth century, yet another corporate theory emerged. Shareholders became distanced from corporate managers, making the analogies between the aggregate theory and partnership principles less appropriate. Courts began to recognize the “real person/real entity” or “natural entity” theory (Mayer 1990, p. 580), which held that the corporation has a natural existence, apart from that granted by the state, and as such possessed the same rights as natural persons that the law must recognize and protect (Ripken 2009, p. 116; Horwitz 1992, p. 104). This view, unlike the aggregate theory, did not maintain that the corporation’s rights derived from those of the shareholders; instead, its status as a natural entity placed it on the same plane as a natural person.

The U.S. Supreme Court explicitly used this natural entity theory when it held in Hale v. Henkel (1906) that corporations had fourth amendment rights to be free from unreasonable searches and seizures. In the same opinion, however, the Court invoked the artificial entity theory to deny to the corporation a fifth amendment right against self-incrimination:

… the corporation is a creature of the State. It is presumed to be incorporated for the benefit of the public. It receives certain special privileges and franchises, and holds them subject to the laws of the State and the limitations of its charter. Its powers are limited by law. It can make no contract not authorized by its charter. Its rights to act as a corporation are only preserved to it so long as it obeys the laws of its creation. There is a reserved right in the legislature to investigate its contracts and find out whether it has exceeded its powers. (Hale v. Henkel 1906, p. 75.)
How the Court could reconcile the use of these alternative corporate theories in the same opinion constitutes a mystery of American jurisprudence.

In 1950, the Court reaffirmed its use of the artificial entity theory in *United States v. Morton Salt Company* (1950). In upholding the Federal Trade Commission’s demand for the production of a corporation’s pricing data, the Court stated:

… corporations can claim no equality with individuals in the enjoyment of a right to privacy. … They have a collective impact upon society, from which they derive the privilege of acting as artificial entities. The Federal Government allows them the privilege of engaging in interstate commerce. Favors from government often carry with them an enhanced measure of regulation. [citations omitted] *United States v. Morton Salt Company* (1950, p. 652).


Thus, it is not surprising that neither the majority in *Citizens United* nor Justice Stevens in his dissent neglected to make direct references to corporate personhood theory when the Court held that corporations had first amendment free speech rights which allowed them to contribute directly to political campaigns.

Notwithstanding his refusal to endorse the artificial entity theory by name *Citizens United v. Federal Election Commission* (2010, n. 72, p. 971), Stevens nonetheless noted that:
It might also be added that corporations have no consciences, no beliefs, no feelings, no thoughts, no desires. Corporations help structure and facilitate the activities of human beings, to be sure, and their "personhood" often serves as a useful legal fiction. But they are not themselves members of "We the People" by whom and for whom our Constitution was established. (Citizens United v. Federal Election Commission 2010, p. 972)

Even without explicitly invoking the theories of corporate personhood by name, however, courts cannot avoid consideration of the inherent nature of the corporate entity whenever they encounter issues related to legal rights of corporations. The corporation will be whatever the law says it is. Notwithstanding the aggregate of individuals or natural entity theories, neither of these corporate personalities has legal force without recognition as a principle of positive law. Courts may choose to adopt such views of corporations, but ultimately the corporation exists only in the contemplation of law, i.e., as a construct of positive law.

Moreover, the problem of corporate personality unavoidably raises consideration of fundamental questions about the nature of a corporation, including: What is the proper purpose of a corporation? What interests should a corporation serve? Who, if anyone, can speak for a corporation? As described below, the answer to this last question undermines the conclusion of the majority in Citizens United.

THE ORIGINS, NATURE AND REALITIES OF THE AMERICAN CORPORATION

Corporations originated as a communal means of owning property that could survive the death of any natural person who possessed an ownership interest. Cities, guilds, universities and religious orders began to incorporate in medieval Europe in order to avoid having to dissolve upon the death of a key person, such as a mayor, president or abbot. Corporate property ownership insured that no heirs could come forward to claim inheritance rights of a deceased title-holder; thus, the death of any natural person could not disrupt the organization’s property rights. (Lieberman and Siedel 1988, pp. 950-995; Story and Ward 1989, pp. 886-887). The Church under Pope Innocent IV during the thirteenth century allowed individuals to organize such institutions and granted recognition accordingly. By the end of the 17th century, the right to exist as a corporation required a royal charter (Mark 1987, p. 1469).

From their inception, therefore, corporations were creatures of the sovereign, inferior to the power that created them. Early American jurisprudence recognized this in Dartmouth College v. Woodward (1819):

"A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created"( Dartmouth College v. Woodward 1819, p. 636).

Subsequent cases have sometimes taken other views of corporate personality, as described in Part III, but the fact remains that without recognition by the sovereign a corporation
can have no legal status as a matter of positive law. Moreover, regardless of the view of corporate personhood that a particular court opinion has taken, corporate structures and internal governance rules are dictated by the statutes that comprise the corporations codes of each of the 50 states. Under all of them, the business corporation includes shareholders, directors, officers and other employees.

These groups may be seen as separate constituencies of the corporate body, with some shared interests and others that conflict. These conflicting interests may arise between corporate constituencies, as when shareholders sue officers and directors over executive compensation packages (In Re Walt Disney Company 1988), employees mount a class action gender discrimination against the corporation itself (Wal-Mart Stores, Inc. v. Dukes 2010), or when shareholders sue directors over the adoption of a poison pill designed to thwart a tender offer. (Loventhal Account v. Hilton Hotels Corporation 2000, affirmed Del. 2001).

Even within a particular constituency, conflicting interests may arise. Minority shareholders have sued a majority shareholder to force a dividend distribution (Dodge v. Ford 1919). In Schlensky v. Wrigley (1968), a disgruntled minority shareholder sued the majority shareholder because he believed that the latter was not running the business so as to maximize profits, but had instead chosen to forego revenue by not installing lights in a baseball stadium.

Thus, it is difficult if not impossible to identify an interest that will remain common to all corporate constituents under all circumstances. Notwithstanding a common assumption by many economists, profit maximization for the benefit of shareholders does not drive the behavior of all corporate constituencies:

Contemporary economists challenge the traditional notion of a corporation as simply a profit maximizing enterprise. The corporation, rather, is torn by contradictory motivations and interests, including the self-serving programs of corporate officers. Instead of pursuing the optimal, textbook goal, of increasing share value, the modern firm often sets different goals, including increased sales volumes, management returns, market share, stability, or growth. (Mayer 1990, pp. 642 - 643)

Given these challenges posed by conflicts among corporate constituencies, the economics and management literature provide views of corporate behavior that go beyond the assumption of maximizing shareholder gain as the primary purpose of managers and directors. Such theories commonly invoke the practice of “satisficing,” whereby managers and directors provide earnings sufficient to placate shareholders and then proceed to use corporate assets to pursue their own objectives (Cyert and Marsh 1992; Simon 1997; Williamson 1981).

A widely-shared, related view of corporate purpose and behavior consists of stakeholder theory. This regards the corporate purpose as serving the interests of both internal stakeholders, such as shareholders, directors, officers and employees, and external stakeholders, a group that might include vendors, customers and members of the surrounding communities. Under this approach, corporate directors must resolve the often-conflicting interests of all stakeholders, i.e., every group recognized as being affected by a corporation’s actions. The maximization of shareholder gain is but one of these goals that managers and directors must take into account in setting and pursuing corporate objectives (Freeman 1997).
Under “other constituency” provisions, the corporations codes of 33 states either allow or require boards of directors to consider stakeholder interests when exercising their powers. (Sneirson 2009, p. 998). Although Delaware does not have such a statute, its case law holds that directors in pursuit of long run corporate (and shareholder) value may be sensitive to the claims of other "corporate constituencies" (In Re TW Services, Inc. Shareholders Litigation 1989, p. 23). Permission for the directors to consider “the impact on constituencies other than shareholders” when making its decisions derives from the business judgment rule, which gives wide discretion to directors so long as they act in good faith. (Ivanhoe Partners v. Newmont Mining Corporation 1987, p. 1341, 1342).

The nexus of contracts theory that emerged from the law and economics movement likewise recognizes both common interests and conflicts among those groups that comprise a corporation. From this perspective, the stakeholders or constituencies described above enter into contracts designed to advance their shared economic interests. The resulting set of interrelated contracts comprises the corporation, driven in part by the shareholders’ interests as owners (Jensen and Meckling 1976). Thus, no “real” corporate entity exists, let alone a corporate person in any but a metaphorical sense. (Jensen and Meckling 1976, p. 311). This suggests that the task of managers and directors is one of mediating these interests and conflicts through the negotiation of contracts, some literal and others metaphorical (Gulati, Klein and Zolt 2000, pp. 895, 947). The nexus of contracts theory further maintains that nothing in that view of the corporation requires the assumption that officers and directors pursue a goal of maximizing shareholder gain (Blair and Stout 2006, p. 739).

To the extent that all constituencies are likely to share in the results of revenue increases, market share gains and improved brand recognition, it may often be possible for directors to act on common ground with respect to some economic interests. The most widely shared objectives of all corporate constituencies are connected to commercial goals, so a corporation can reasonably exercise a commercial free speech right under the First Amendment. Consumers likewise gain by having access to unfettered, truthful information about prices and products.

The same does not hold for political and regulatory interests of the various corporate constituencies. Employees will favor laws and regulations that protect workplace safety, job security, pensions and health benefits. Officers and directors will want fewer constraints on their employment policies and fewer restrictions on practices that increase worker productivity. Institutional investors will push for greater financial transparency and accountability, while corporate officers frequently seek to employ accounting practices that maximize the value of their stock option compensation, often at the expense of shareholder returns. It is even more difficult to imagine a common position among all constituencies in support of political candidates who take positions such issues as gay marriage or abortion.

Who, then, can “speak” for the corporation with respect to a political issue? Stevens considered this question generally along with its specific implications prohibitions on corporate political campaign contributions:

“It is an interesting question "who" is even speaking when a business corporation places an advertisement that endorses or attacks a particular candidate. Presumably it is not the customers or employees, who typically have no say in such matters. It cannot realistically
be said to be the shareholders, who tend to be far removed from the day-to-day decisions of the firm and whose political preferences may be opaque to management. Perhaps the officers or directors of the corporation have the best claim to be the ones speaking, except their fiduciary duties generally prohibit them from using corporate funds for personal ends. Some individuals associated with the corporation must make the decision to place the ad, but the idea that these individuals are thereby fostering their self-expression or cultivating their critical faculties is fanciful. It is entirely possible that the corporation's electoral message will conflict with their personal convictions. Take away the ability to use general treasury funds for some of those ads, and no one's autonomy, dignity, or political equality has been impinged upon in the least (Citizens United vs. Federal Election Commission 2010, p. 972).

His analysis indicates that no one can legitimately speak for a business corporation in political campaigns.

Thus, the complex web of corporate constituency interests, with its myriad conflicts both within and between constituencies, makes it unrealistic to expect that a corporation has the capacity to articulate a political opinion that embodies the shared interests of all its constituencies, i.e., to “speak” on a political issue.

**CONCLUSION**

Unlike natural persons, the corporation does not have a legal existence independently of the sovereign that recognizes it; therefore, the corporation is subordinate to the state. As a mere legal construct, the corporation is no more or less than the state decrees. Thus, the state may choose to recognize that a corporation has legal interests to the extent necessary to carry out such activities as allowed by its charter, but need not necessarily grant the same rights to it that it recognizes for natural persons.

Moreover, regardless of the lens through which the courts might view a for-profit corporation, whether drawn from a legal or economic theory, the corporation has too many conflicting political interests among its varied constituencies to be capable of political speech that represents a unified position of all its stakeholders.

The law must therefore take great care with the assumptions it makes about corporations when considering whether those entities should have any of the rights enumerated in the Bill of Rights, including First Amendment free speech rights. Therein lies the problem with the majority opinion in Citizens United.

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United States Constitution, Article IV, § 2 (1789).
THE GENDER PAY GAP IN THE UNITED METHODIST CHURCH

Simon Medcalfe, Georgia Regents University

ABSTRACT

The Supreme Court ruled in Hosanna-Tabor Evangelical Lutheran Church and School v. Equal Employment Opportunity Commission et al., (2012) that employment-discrimination laws do not protect church ministers. However, little is known about the extent of discrimination in church settings. Using data from a United Methodist Church Conference this study finds no evidence of gender discrimination in pay.

Leviticus 27: 3-4
Set the value of a male between the ages of twenty and sixty at fifty shekels of silver, according to the sanctuary shekel; for a female, set her value at thirty shekels (New International Version)

INTRODUCTION

On January 11th, 2012 the Supreme Court ruled unanimously that employment discrimination laws do not protect church ministers. In the case, the court ruled that the First Amendment, “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof,” ensured that the Federal government would have no role in filling ecclesiastical offices. Moreover, they stated in an opinion written by Chief Justice, John Roberts, that “since the passage of Title VII of the Civil Rights Act of 1964 and other employment discrimination laws, the Courts of Appeals have uniformly recognized the existence of a “ministerial exception,” grounded in the First Amendment, that precludes application of such legislation to claims concerning the employment relationship between a religious institution and its ministers.”

Although ministers are not subject to discrimination laws, it is not known to what extent ministers may be subject to discrimination, as defined by labor economics. Using a data set of over 700 churches in the United Methodist Church (UMC) this research note examines the extent to which female pastors may be paid less than their male counterparts. At least in this study there is no evidence that female pastors are paid less than male pastors. The note is set out as follows: the next section introduces the topic within the context of the Supreme Court ruling. The next section summarizes the literature. The following sections describe the data and results.
of the analysis. The final section provides a conclusion including policy implications and some suggestions for future research.

THE SUPREME COURT RULING AND DISCRIMINATION

The Supreme Court case, *Hosanna-Tabor Evangelical Lutheran Church and School v. Equal Employment Opportunity Commission et al.*, (2012) concerned a woman, Cheryl Perich, who worked as a called teacher at the Hosanna-Tabor Evangelical Lutheran Church and School. A called teacher is regarded as having been called to their profession by God (as opposed to lay teachers). Called teachers have to have had some theological training and receive the title of “Minister of Religion, Commissioned” once called. Perich developed narcolepsy and took disability leave in 2004. Informing the school of her desire to return to work in February 2005 she was told a lay teacher had been hired in her stead for the remainder of the school year. Following some confrontation the school terminated her contract citing “insubordination and disruptive behavior.” The Supreme Court ruled that “because Perich was a minister within the meaning of ministerial exception, the First Amendment requires dismissal of this employment discrimination suit against her religious employer.”

Employment discrimination can manifest itself in many ways (Hyclak, Johnes, and Thornton, 2013):

- *At the hiring stage, employers may prefer not to hire persons of a particular group.*
- *Employers may not promote members of a certain group.*
- *Employers may pay lower wages to persons in a particular group even though they are equally qualified as other workers.*
- *Consumers may prefer to be served by a certain group.*
- *Fellow employees may prefer to work with certain groups.*

These groups may be based on any characteristic not related to job performance such as gender, race, ethnic group, age, etc. This analysis concentrates on the third type of employment discrimination and asks whether female ministers in the UMC earn lower wages than equally qualified male pastors.

LITERATURE REVIEW

Previous studies have analyzed gender employment discrimination in all of the above categories but with mixed results. Neumark, Bank, and Van Nort (1996) found that females applying for jobs at high end restaurants had a probability of receiving a job offer that was about 0.40 lower than a job application of a man. McDowell, Singell, and Ziliak (2001) found that there were no differences in promotion between female academic economists and their male counterparts. Blau and Kahn (2000) using a large and representative U.S. sample found that the
gender pay gap had declined over the past 25 years but there was still a substantial unexplained difference. Studies of individual occupations have found mixed results: there was no evidence of the gender pay gap in English family doctors (Gravelle, Hole, and Santos, 2011) but there was in economics departments at Japanese universities (Takahashi and Takahashi, 2011). Ranson and Lambson (2011) found that female teachers in Missouri are paid about 6 percent less than male teachers. Parrett (2011) found that female servers in restaurants received smaller tips than their male colleagues if service was less than exceptional. Ragan and Tremblay (1988) found no evidence of employee discrimination using data from the National Longitudinal Surveys.

THE DATA

The North Georgia United Methodist Church Conference is the largest UMC conference in America. Data from 2005 on over 700 individual churches in this conference provide the opportunity to analyze compensation differences between male and female pastors. The log of pastor compensation is the dependent variable and a dummy variable equal to unity identifies a church with a female pastor. Other variables which may impact compensation include a dummy variable equal to unity of the church is in a charge or in a rural county. Charges are made up of one or more churches and share a pastor. The 2005 per capita income of the county in which the church is located is also included. Some attributes of the congregation included in the analysis are the percentage of members who are female or white: female percent and white percent. Two measures of the size of the church are used: the total membership in the church and total assets (in $000’s).

RESULTS

The results of ordinary least squares regression are presented in Table 1. Column 1 of Table 1 shows the unadjusted wage gap, which is about 37 percent (The true value is $e^{(-.37)}-1 = 31\%$). This is curiously similar to the opening verses from Leviticus which suggests a 40 percent gap. However, adjusting for the other factors that may affect compensation this wage gap falls to about 10 percent and is not statistically significant (column 2). The other independent variables (apart from assets) are all statistically significant at the one percent level and have the appropriate sign. Pastors in churches that are part of a charge earn compensation that is 52 percent lower than a pastor not in a charge. Pastors of churches in rural counties earn compensation 30 percent less than those in non-rural counties. Counties which have higher income are associated with churches that pay higher compensation; a $1,000 increase in per capita income in the county is associated with pastor compensation that is $1,500 higher. The larger the percentage of a church’s membership that is female corresponds to lower pastor compensation but the dollar effect is small. A larger white membership is associated with higher compensation; a ten percentage point increase in the white percentage of membership is associated with an increase in pastor salary of over $4,000. Larger churches in terms of
membership also pay higher compensation; this is in line with previous research that finds larger employers pay higher salaries (see Brown and Medoff, 1989, for a review). However, church size as measured by assets is not associated with pastor compensation.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Coefficient</th>
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</thead>
<tbody>
<tr>
<td>Female pastor</td>
<td>-0.371***</td>
<td>-0.106</td>
</tr>
<tr>
<td></td>
<td>(3.19)</td>
<td>(1.07)</td>
</tr>
<tr>
<td>Charge</td>
<td>-0.729***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(8.22)</td>
<td></td>
</tr>
<tr>
<td>Rural</td>
<td>-0.361***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(3.68)</td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td>0.015***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(3.43)</td>
<td></td>
</tr>
<tr>
<td>Female percent</td>
<td>-0.014***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2.63)</td>
<td></td>
</tr>
<tr>
<td>White percent</td>
<td>4.128***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(3.44)</td>
<td></td>
</tr>
<tr>
<td>Membership</td>
<td>0.0004***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(4.53)</td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>5.04</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.55)</td>
<td></td>
</tr>
<tr>
<td>intercept</td>
<td>9.982***</td>
<td>9.993***</td>
</tr>
<tr>
<td></td>
<td>(227.61)</td>
<td>(25.22)</td>
</tr>
<tr>
<td>R-squared</td>
<td>.02</td>
<td>.41</td>
</tr>
<tr>
<td>n</td>
<td>729</td>
<td>729</td>
</tr>
</tbody>
</table>

Note: Heteroskedasticity robust absolute t-statistics in parentheses
*** Statistically significant at 1 percent level

CONCLUSION
The Supreme Court ruling in *Hosanna-Tabor Evangelical Lutheran Church and School v. Equal Employment Opportunity Commission et al.*, (2012) obviously has important implications for religious organization and their employees. The ruling makes it clear that it is not just ministers who are exempt from employment discrimination laws but includes workers such as teachers in “called” ministerial positions. Churches have control over who they wish to employ, to reflect its beliefs, free from government interference.

Other aspects of the ruling are less clear. For example, the ruling does not define how far the ministerial exception extends. The language of the ruling suggest that the case may have wider implications depending on how the phrase “internal church decisions that affect the faith and mission of the church itself” is interpreted in future cases. It is not clear what the extent of “internal decisions” is or what is meant by the qualifier “affects the faith and mission of the church itself”. For example, does the federal government’s decision to require religious employers that provide health insurance to provide contraceptive services fall under an internal decision that affects faith and mission? (McConnell, 2012) Moreover, the court took no view on whether the exception prohibits other types of suits such as breach of conduct or tortious conduct.

Although the Supreme Court ruling exempts churches from complying with federal employment discrimination laws, it does not necessarily mean that churches will discriminate. In fact, the evidence from this study is that the United Methodist Church in North Georgia does not pay female pastors less than male pastors. Although the unadjusted wage gap is over 30 percent it clearly does not take into account productivity differences and should not be used as an indicator of discrimination. It is reported to identify a benchmark. Once other independent variables are included to reflect productivity the wage gap declines and is statistically insignificant.

The lack of gender discrimination in the North Georgia UMC conference may be comforting but this initial study does not necessarily mean there is no discrimination. There are several opportunities for future research on this subject. First, traditional discrimination studies attempt to identify equally productive persons by controlling for their experience and education. Since pastors have some form of advanced theology degree there will be little difference in education but a pastor’s years of experience may make them more productive. Even without data on experience the R squared value of .41 in column 2 of Table 1 is only slightly lower than in other discrimination studies. Future studies should, nevertheless, account for different experience levels in pastors. Second, this study used data from one conference in the UMC. That does not mean there may not be discrimination in other conferences or denominations. Particularly, other denominations that employ both male and female pastors should be analyzed in future research to determine the extent, if any, of gender discrimination. Third, there are other forms of discrimination that would be exempt from federal law under the Supreme Court’s ruling. One obvious example would be racial discrimination: are black or Latino pastors, for example, paid less than equally productive white pastors? Fourth, as noted earlier, discrimination can take on
many forms including pre-employment discrimination. To what extent is discrimination present in the pastor hiring decisions of churches?

REFERENCES


MARKOPOLIZING CONVERSION FRAUD: UNDERSTANDING AND IDENTIFYING OPPORTUNITIES FOR US FINANCIAL REPORTING CONVERSION FRAUD

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ABSTRACT

This paper gives a history and overview of Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). The industrial revolution led to the creation of local standards in many countries, such as GAAP in the US, and globalization has been met with a call to create a single universally applied financial standard for accounting information. IFRS is being adopted internationally and the US is planning to transition over to the new system as well. The effects of the switch in European countries are examined in order to determine likeliness of an increase in accounting manipulation. Key differences between the two reporting standards are listed and potential fraud opportunities for the US conversion to IFRS are explored. The Bernie Madoff fraud-finder Harry Markopolos is used as an example of the type of dedication needed to explore this issue further.

Keywords: GAAP, IFRS, IFRS Conversion Fraud, SEC Enforcement, Fraud Triangle

INTRODUCTION

Harry Markopolos discovered the largest fraud in US history, while working as a derivatives portfolio manager at Rampart Investment Management. His co-worker and marketing representative, Frank Casey, asked him to analyze Bernie Madoff’s “investment” plan in hopes of creating a similar financial product that would rival the stunning moneymaker. Upon review, Markopolos came to the conclusion that Madoff’s plan was in fact a fraud and reported his findings to the SEC, but his warning fell upon deaf ears. For almost ten years, he resubmitted warnings to the SEC, but to no avail (Markopolos, 2010). The result of his ordeal uncovered extreme negligence by the US Securities and Exchange Commission (SEC), all while under fear of duress for nearly a decade. The SEC repeatedly refused to thoroughly investigate Bernie Madoff, the former NASDAQ chairman, but Markopolos continued sounding the alarm.

The United States is now embarking on a potential fraud explosion: the conversion from the US standard of General Accepted Accounting Principles (GAAP) to the universal standard of International Financial Reporting Standards (IFRS). The former has more stringent accounting practices that the latter; GAAP are rules- and principles-based with a compliance-based focus,
while IFRS is purely principles-based, which allows for managerial discretion, and has an economic-based focus (Cancino, 2010, p. 34). To mitigate the risk of fraudulent activities—such as accounting manipulation and earnings management—originating from this conversion, a greater understanding is needed in order to identify such practices when they are present, and create processes that will deter such fraudulent behavior from beginning in the first place.

In the spirit of fraud-fighter extraordinaire Harry Markopolos, we must “Markopolize,” potential GAAP/IFRS conversion fraud. This term can be defined as:

Markopolize: (v) to identify with gusto; to identify with single-minded determination; calling for justice with wanton abandon for self; doing what’s right/ethical in face of adversity.

In order to carry this out effectively, our understanding of GAAP and IFRS must be strengthened.

**PURPOSE OF REGULATION AND ESTABLISHMENT OF GAAP**

Regulation of financial records has developed in the United States since the end of the 19th century. Leuz (2010) determines that there are four core reasons for regulation, “the existence of externalities, market-wide cost savings from regulation, insufficient private (or stricter public) sanctions, and dead-weight costs from fraud and agency conflicts that could be mitigated by disclosure” (p. 231). The origin of regulation in the United States reflects Leuz’s rationale.

The industrial revolution of the late 19th century spawned a need for common accounting principles which was addressed when the Joint Stock Companies Act of 1884 required an audited balance sheet from firms incorporated under the act. With the stock crash of 1929, “There was a growing realization that a company’s stock price was a function of its earnings potential rather than the value of its assets. Hence, the concept of matching revenues and costs became the accountant’s primary task and focus” (Close, 2007, p. 38). Following the crash, the Securities and Exchange Commission (SEC) was established by the Securities Act of 1933 and the Securities Exchange Act of 1934. The SEC drew on private organizations for the establishment of accounting standards, namely the American Institute of Accountants, predecessor of the American Institute of Certified Public Accountants. In 1973, the Federal Accounting Standards Board (FASB) became the designated accounting standard setter in the United States, developing the Generally Accepted Accounting Principles (GAAP) that comprise the accounting standards practiced in the US today (SEC, 2012b).

**CALL FOR INTERNATIONAL STANDARD**

As the US developed GAAP, many countries also developed their own local standards. With the expansion of globalization many countries started issuing financial statements using GAAP, “Foreign companies trading on US stock exchanges currently reconcile their financial statements to US Generally Accepted Accounting Principles (GAAP) if the statements are not
prepared in accordance with US GAAP. In an effort to achieve consistency and transparency without undue cost, national standard setters recognize the need for convergence” (Close, 2007, p. 41). Local reporting standards were sometimes viewed as having gaps in financial reporting (Callio & Ignacio Jarne, 2007). Globalization and the need for common, comparable financial standards are widely acknowledged to be the main reasons for the development and adoption of the International Financial Reporting Standards (IFRS) (Dask, Hail, Leuz, & Verdi, 2008; FASB & IASB, 2002; Leuz, 2010; SEC, 2008; SEC, 2012a).

**RULES VS. PRINCIPLES**

While GAAP and IFRS share some similarities, there are core differences between the two financial reporting standards. As mentioned previously, GAAP are more rules-based, while IFRS are purely principles-based. Leuz (2010) states that conversion difficulties are created as:

Rules-based standards tend to be more bright-line and are generally easier to apply, but they are likely to invite more gaming behavior...compared to principles-based standards. Principles-based standards in turn give more discretion to firms, which can enable managers to convey private information to the markets in a less costly fashion, but the discretion also allows managers to pursue ulterior reporting motives. (p. 235)

So, while IFRS allows for more flexibility, this flexibility can be taken advantage of, and situations may arise where a central authority is needed to interpret the new standard.

One example of the difference between GAAP and IFRS involves timing and recognition of revenue and expenses. GAAP allows usage of Last in First Out (LIFO) costing methodology for inventory, while IFRS does not permit LIFO. LIFO allows firms to attribute costs to inventory based on the inventory most recently received, which can impact the balance sheet because of changes in market price. The Internal Revenue Service (IRS) allows methods of accounting for income tax purposes, as long as the same method is used for financial reporting. The LIFo method is one of the IRS-accepted methods, meaning conversion to IFRS would eliminate the tax provisions LIFO provides, unless a change was introduced. This could greatly impact US organizations by increasing income taxes payable (SEC, 2012a, p.16).

Another divergence between the standards involves the usage of fair market value versus historic cost of an item. The former introduces variance from discretion, while the latter is an incontestable benchmark. IFRS also allows for significant components of property, plant, and equipment to be depreciated annually in relation to the item’s total cost. This process is known as asset componentization. GAAP generally does not allow this, but depreciates the item as a whole over its useful life (SEC, 2012a, p.17).

Difficulties can also be introduced from a lack of guidance between the two rules. The SEC (2012a) states IFRS requires additional requirements in the accounting for extractive, insurance, and rate-regulated industries (p.4). GAAP requires further attention in the areas of push-down accounting and governments grants (p.4).

GAAP principles provide the foundation for US governmental rules and regulations and private sector contracts (SEC, 2012a, p.3). Converting to IFRS would require a fundamental shift in our current practices. GAAP was birthed from practices and reform brought about from
US-specific circumstances. These changes would require both public and private sector cost increases, such as additional manpower and overtime pay, because of additional training and auditing required by the switch. The increased costs to comply with IFRS may outweigh the benefits derived from conversion.

BASIC GAAP GUIDELINES

The basic assumptions of GAAP are: separate economic entity, going concern, periodicity and monetary unit (Spiceland, Sepe, & Nelson, 2011). The organization being reported under GAAP is assumed to be a separate economic entity; the financial activities are completely independent. Going concern assumes an organization will be an on-going entity. The monetary unit used in GAAP financial reporting is assumed to be US dollars. The time periods the financial statements are divided into must be specified, artificial time frames, such as annual and quarterly; “external users need periodic [emphasis in the original] information to make decisions” (Spiceland et al., 2011). The fiscal year an organization uses for recording purposes does not have to follow the calendar year.

The principles of GAAP are: historical cost, full disclosure, matching principles and revenue recognition (Spiceland et al., 2011). The historical cost principle dictates that the recorded value of a purchase be listed as the purchase price. Under this principle, the use of fair market value is not permissible. Under the full disclosure principle, all information deemed useful for investment purposes must be included in the financial reports, though omissions are acceptable in certain circumstances. The matching principle “states that expenses are recognized in the same period as the related revenues” (Spiceland et al., 2011).

Revenue recognition has very specific guidelines, not only to standardize practices, but also to alleviate the possibility of revenue manipulation. In a 2008 study by the Research Advisory Board on “the Accounting and Auditing Enforcement Releases (AAERs) filed by the Securities and Exchange Commission between 1982 and 2005,” the Board found that within financial statement fraud “revenue recognition schemes were by far the most prevalent, occurring in 53% of cases” (Deloitte and Touche, LLP, 2011). According to the FASB Accounting Standards Codification, “revenue and gains generally are not recognized until realized or realizable” or until they are earned (FASB, 2012).

To further illustrate this principle, common practice is that prepaid revenue should be placed in a deferred revenue account, with funds being transferred to a revenue account once earned; this is known as the accrual basis for accounting.

The information presented in the financial statements must follow the constraints of materiality, conservatism, cost-benefit and industry practice (Burbage, n.d.). This information must be material, or of relevance. If the information is of importance to a decision maker, it should be included (Burbage, n.d.). Reporting practices must be conservative; if two reporting options exist, the more conservative approach should be chosen. If no valuation difference exists between the two options, either would be acceptable.

The cost-benefit constraint allows organizations to exclude information from their financial reports. The full-disclosure principle requires an organization to report any and all
information that would be helpful to investors. However, if the cost of providing certain information outweighs its usefulness, inclusion is not required (Spiceland et al., 2011). Financial reports can also be industry-specific. Some organizations “require their own way of accounting for certain aspects of their business transactions...such as those in the oil and gas, utilities and mining industries” because they are so unusual (Burbage, n.d.).

**BASIC IFRS GUIDELINES**

Financial statements prepared under IFRS must include “fair representation and compliance with IFRS, along with a going-concern, accrual basis of accounting, materiality and aggregation, offsetting, frequency of reporting, the provision of comparative information, and consistency of presentation” (Weets, n.d.). Fair presentation and compliance with IFRS “requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework” created by the IASC (Deloitte & Touche, LLP, n.d.). If organization follows IFRS and includes additional notes when necessary, it is presumed that their financial statements are fairly presented (Deloitte & Touche, LLP, n.d.). The principles of growing concern and accrual-basis accounting in IFRS are identical to GAAP.

Materiality and aggregation state that “each material class of similar items must be presented separately in the financial statements. Dissimilar items may be aggregated only if they are individually immaterial” (Deloitte & Touche, LLP, n.d.). Another unique IFRS aspect is offsetting. Under this rule, “assets and liabilities, and income and expenses, may not be offset unless required or permitted by an IFRS” (Deloitte & Touche, LLP, n.d.). Materiality and aggregation principles allow for information to be grouped into relevant classes and restriction of offsetting prevents revenue from one account being shifted into another account in order to diminish the appearance of costs.

The frequency of reporting in IFRS is similar to that of GAAP. Financial reporting from an organization must be done at least annually. If a deviation exists from the previous reporting period, the organization “must disclose the reason for the change and a warning about problems of comparability” (Deloitte & Touche, LLP, n.d.). The provision of comparative information states that information from the previous accounting period that effects the current period shall be disclosed both in the financial statements and in notes (Deloitte & Touche, LLP, n.d.). This helps to increase the understanding for investors of financial statements.

**IMPLEMENTATION OF IFRS IN EU**

In 2002 the Norwalk Agreement was signed between the FASB and IASB to identify and remove differences between GAAP and IFRS in preparation for convergence (FASB & IASB, 2002). As of 2008 over 100 countries had moved to IFRS or made a commitment to do so (Dask, Hail, Leuz, & Verdi, 2008). Many studies have analyzed the transition to IFRS in the European Union, which required compliance starting in 2005 (Narktabee & Patpanichot, 2011). This analysis could foreshadow potential effects of a transition in the United States.
Several studies noted the potential for earnings manipulation due to the expansion of managerial discretion in the new standards. Callao and Ignacio Jarne (2010) write, “It is also quite possible that levels of discretionary accounting would be expected to increase in the early years after the regulatory change in comparison to the situation under local standards, given the novelty of the new rules and potential difficulties with interpretation” (p. 161). Daske, Hail, Leuz, & Verdi (2008) state that, “IFRS (like any other set of accounting standards) provide firms with substantial discretion. How firms use this discretion is likely to depend on their reporting incentives, which are shaped by many factors, including countries' legal institutions, various market forces, and firms’ operating characteristics” (p. 1092). Effects of these incentives were measured in several studies.

Narkatabee and Patpanichchot (2011) examined the effect of country and firm-level factors and found that countries that had high use of managerial discretion could counteract those factors with a high level of enforcement and investor protection (p. 90). In their study of the effects on IFRS on market liquidity Daske, Hail, Leuz & Verdi (2008) concur with the importance of strict enforcement regimes, finding that the market liquidity benefits only in countries with strict enforcement regimes. Leuz (2010) counters that, “While strict enforcement limits what managers can report, it does not eliminate the discretion built into the rules” (p. 249).

Callao and Ignacio Jarne (2010) examined discretionary accruals of 1,408 firms from 11 EU countries and found that there was a statistically significant increase in discretionary accruals at the time of the switch in Belgium, France, Greece and the UK (p. 172). Since these countries come from various legal backgrounds, the findings counteract the country-level factors, but they did find a significant positive relationship between firm size and earnings manipulation (p. 178). Further, the study found a rise in long-term discretionary accruals in all countries studied excepting Italy (p. 180). This indicates a rising trend in earnings management. However, Aubert & Grudnitski (2012) examined the difference between reported earnings and ex post estimates, positing that a rise in differences would indicate a rise in accounting manipulations. In their analysis of 15,034 firm-year observations from 20 European countries, they alternatively found a decline in differences, indicating a decline in accounting manipulations.

An SEC staff report published in July 2012 argued that an important factor for the success of IFRS is its universal application and enforcement (2012a). They found that enforcement structures vary widely by legal jurisdiction and that “the structure of the regulator can impact the enforcement mechanisms available” (p. 30). The question of comparability of IFRS within and among different countries and legal structures was analyzed in a study by Cole, Branson and Breesch. In their study they surveyed 426 analysts, auditors and other financial officials at European firms. Of those surveyed, they found that only 41% believed that IFRS financial statements were comparable across countries and industries. 13% believed they were comparable only within the same country, 20% believed they were only comparable within the same industry and 17% believed they were not comparable (2011). One of the key purposes of an international accounting standard is to make financial statements universally comparable for shareholders, and in order for this to be achieved IFRS has to have a body ensuring that the standards are universally applied and enforced among firms, industries, and legal jurisdictions.
FEARS OF FRAUD FOR IMPLEMENTATION IN US

For fraud to occur there must be “(1) a perceived pressure, (2) a perceived opportunity, and (3) some way to rationalize the fraud as acceptable” (Albrecht, Albrecht, Albrecht, & Zimbelman, 2009, p.33). Each of these three requirements for fraudulent activity is portrayed on the Fraud Triangle (see Figure A). While perceived pressure and rationalization vary from person-to-person, the GAAP/IFRS conversion does provide opportunities for fraud due to the differences between the two financial reporting guidelines.

Figure 1

Fraud Triangle

The overall differences in focus between the two create major difficulties. When starting with a more rules- and compliance-based focused, moving towards a more discretionary, principles-based model creates fundamental problems. The presence of discretionary valuation in IFRS gives management the ability to determine asset valuation. Management could overvalue assets to give the firm the appearance of a higher asset balance, ultimately creating higher current financial ratios. For example, a 2006 Hellenic Capital Market Commission study found the average after-tax profit was 6.16% higher and equity was 2.44% higher under IFRS versus Greek Accounting Standards (GAS) (Maggina and Tsaklanganos, 2011, p.4).

Recognition and timing differences between GAAP and IFRS are particularly troubling. Management could manipulate the recognition of revenue and expenses to give the firm an appearance of fiscal strength. This false strength could persuade the public to invest money into a company that could actually be in a weak state. The return from their investments could potentially be unrealized. For example, the GAAP guideline for recognition is when revenue is realized, realizable, or earned (FASB, 2012). Under IFRS, revenue can be recognized when it is probable it will flow to the organization (Bohusova and Nerudova, 2009, p. 17).

Human error from transition can also increase the appearance of fraud and/or create an opportunity for fraudulent activity to occur. The wide-sweeping changes will require considerable regulator training; the effectiveness of this training will take time to perfect. While conversion is in its infancy, errors will undoubtedly occur. They can be committed innocently, while others are knowingly committed by fraudsters. The influx in potential fraudulent activity
will increase the case levels of regulating agencies. This in turn increases the probability of overlooking real fraud occurrences.

To measure the effect of a transition in US enforcement under IFRS, SEC staff analyzed a sample of enforcement actions in the US conducted by the Commission over the last several years and found that a “significant majority” of the actions would have still been made under IFRS (2012a, p. 31). However, the legal issues stemming from a conversion create enforcement problems. The US GAAP is birthed from common law, while most countries using IFRS follow a code law system. The former system allows for independently created laws, which become a series of best practices through precedent, which are then enforced through litigation; the latter are laws set by the government and essentially set in stone, with precedent not being a factor (Rappeport, 2008). Core differences between these laws provide an additional level of difficulty in creating a worldwide accounting standard.

There seems to be a growing awareness by the SEC of the problems associated with US GAAP/IFRS. In their recent statements, terms such as “incorporating” and “comparability” are used versus “conversion.” However, since a formal decision on the topic has not been disseminated, the level of changes cannot be determined.

**CONCLUSION**

There is a very real potential for an increase in financial statement fraud due to US IFRS conversion. While there are similarities between GAAP and IFRS, the differences between the standards create a perceived opportunity for potential perpetrators of fraudulent activities. Differences include the overall structure of the two standards and application. Research from application of IFRS in the European Union has been mixed, with some locating evidence of increased manipulation and others finding no effect. The SEC is actively working with international regulators to identify and align differences between the standards in preparation for a US conversion.

Also, the current US climate may not be optimal for wide-sweeping accounting changes. There has been a loss of investor confidence within the US after such high-profile accounting scandals such as Adelphia, Enron, Worldcom, and of course Bernie Madoff. Such drastic changes could deter the already cautious investor from making any investments until the new system is firmly established, which could take a number of years.

In order to prepare for a smooth transition firms should hire IFRS experts to guide the IFRS conversion process. A financial professional that has participated in converting a domestic accounting system to IFRS can help mitigate potential problems, particularly one hailing from a country with a domestic system similar to our own. Also, education and training of accounting professionals revolves around US GAAP, so familiarity with IFRS standards is a unique skill.

Another means of preparation would be running dual systems in anticipation of the GAAP/IFRS conversion. A multitude of errors will occur as the conversion process is initiated: human errors, technical problems, etc. Running dual systems will allow the organizations to correct these errors, and identify potential ones, before a required SEC change.

While this paper highlights the potentials for fraud resulting from a conversion, it is limited by the lack of empirical evidence of IFRS conversion within the US at the time of...
writing. There are multinational corporations (MNC) that have begun creating IFRS compliant financial statements at this time; further research on the differences and effects of these actions is needed after the “learning curve.” Currently there has been no firm deadline for US GAAP/IFRS conversion set by the SEC and organizations are in limbo as to when these changes should be implemented. However, there is additional pressure to make changes, as our neighbors and NAFTA trade partners Canada and Mexico have adopted IFRS.

With a greater understanding of GAAP and IFRS, in addition to dedication similar to Harry Markopolos showed during his near-decade information gathering and reporting of Bernie Madoff, the potential fraud opportunities from the US conversion can be effectively “Markopolized.”

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INTERNET SALES USE TAX: A STORY OF EVOLUTION

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ABSTRACT

The purpose of this investigation is to address complexities in requiring remote Internet vendor collection of use taxes from distance out of state customers and distributing same back to an original customer state agency. The U.S. Supreme Court has concerns about this practice relating to the Interstate Commerce Clause, the U.S. Congress has been generally inactive in passing legislation, and states are collecting less sales tax revenue because of increasing non-taxable Internet sales. There is no federal law on the topic, but there are several viable substitutes that have had profound influences in developing relevant solutions that will be reviewed from the perspective and theme of “change” factors that have evolved over a 60 year period.

INTRODUCTION

The primary topic of this paper pertains to the issue of whether or not the law provides a state legal authority to collect use taxes directly from remote Internet retailers located outside the boundaries or jurisdiction of the customer destination state for Internet sales of tangible personal property. The short answer is that states generally are not able to collect use taxes beyond their own borders from out-of-state remote Internet vendors because of U.S. Supreme Court interpretations of the Interstate Commerce Clause of the U.S. Constitution.

Interstate Commerce Clause

The Constitutional concern to overcome is that of placing a substantial burden on interstate commerce, considering there are approximately 9600 state sales/use tax jurisdictions among the states of the United States(Bibb, 1959; Raymond Motor Transportation, 1978 Quill Corp., 1992). A second factor is determining the minimum physical nexus or relationship in the business transaction required between the customer state and the remote Internet vendor located outside the jurisdiction of the customer state (International Shoe, 1945; National Bellas Hess, 1967). Finally, there is the question of U.S. Congress participation in devising legislation as to collecting use taxes from beyond the boundaries of the customer state, as implied by the
Supreme Court since Congress has the sole power to regulate interstate commerce under the Constitution, but continues to be silent on this matter (Quill Corp., Volti, 2010).

Additional Constitutional issues include the Due Process Clause, Federalism, and tax, duty, and import and export clauses. Also addressed in this paper are relevant legal principles relating to developing state legislative actions, bills, and laws, federal legislative bills and regulations, public/private alliance agreements, interstate agreements, and court actions.

Theory of Change

During the past several decades an often overlooked but compelling influence on these issues is the dramatic impact brought forth by the speed and force of societal change from advances in technology, data retrieval, communication, and business practices, along with changes in the political climate (Volti, 2010). The goal is to conduct a review of the important change factors in developing an understanding of the available options of state sales and use tax collections from out-of-state vendors in Internet sales.

In the context of change, advances in technology and communication even in the last several years have been remarkable (Volti, 2010). These advances and how they apply to use tax present a legal conundrum as to how to define physical presence within a state and the underpinnings of a sale. This paper shall also follow the journey of (i) states’ need for additional revenue; (ii) the possible need to level the “playing field” between Internet businesses and local small and large businesses as to sales and use taxes requirements; (iii) the necessity of local autonomy of states in attempting the continuing grappling to resolve these issues; and (iv) political interests with their own history of changes that interrelate with all these change factors. Finally, there are primary and secondary stakeholders—including individuals, groups, organizations, government entities, communities, and the list continues—that are influenced by the above listed changes, and they also play a significant role influencing these changes.

Teaching Perspectives

The presentation of this paper is designed to offer supplemental materials in preparation for chapters incorporating Constitutional Law, administrative law, cyber law, and consumer law for instructors of second or third year university students taking a course in Legal Environment of Business. The themes are multi-disciplinary and suitable for instruction of (i) business law, various levels of accounting and auditing courses, and business and society; (ii) political science courses, such as Constitutional Law; (iii) public administration courses, such as administrative law and public policy; and (iv) economics courses, such as urban and regional economics and public finance. Learning techniques and methodology for students’ application is formatted for instructor strategies. These include developing skills for analyzing complex subject matter through a comprehensive systematic approach of investigating, evaluating, and assessing each core component of the content, substance, and context of each issue. Other strategies include demonstrating the interconnectedness of these components, and how each contributes to understanding the particulars involving constructing or formulating answers, resolving issues, solving problems, or making decisions (Paul & Elder, 2006; Nosich, 2008).
BACKGROUND INFORMATION

Internet sales are well over $400 billion a year in North America and one trillion dollars throughout the world (eMarketer, 2013) It is estimated that state and local jurisdictions may be losing about $12 billion or more in state revenues because, as previously addressed, the question of collecting Internet sales/use tax from remote vendors in remote states in the U.S. with federal approval through a valid legal process has not materialized and remains stalled (Bruce et all, 2009).

In the 1940s, the basic legal issues pertaining to minimal physical contacts and forming a nexus relationship in an interstate commercial transaction, a key element in overcoming major impediments for requiring collection of Internet sales use tax from remote state vendors, ensued as a Due Process of Law issue (International Shoe, 1945)and has been evolving ever since. Other relevant background topics addressed below include defining sales, use, and excise taxes, U.S. Constitutional principles relating to taxes, Interstate Commerce, and the Due Process of Law, related U.S. Supreme Court Cases, review of Internet sales, proposed streamlined approaches for simplification of Internet sales use tax collection, and the political environment.

State Sales Tax
The idea of “sales tax” has a long history. Ancient paintings on the walls of Egyptian tombs depicted sales tax collection on specific commodities, such as cooking oil, as far back as 2000 BC. Fast forward to 1921, West Virginia became the first state in the United States to enact a state sales tax followed by Mississippi in 1930(Buehler, 1941). Today, 45 states have enacted their own state sales tax requirements. The sales tax function, traditionally and legally, is usually that of the states and not federal government. Those states without sales taxes include Alaska, Delaware, Montana, New Hampshire, and Oregon (Rice & Simpson, 2012; Sales Tax Institute, 2013).

State sales taxes are generally imposed on the sale of goods and services calculated separately on a percentage of the total selling price of each item with the end purchaser paying the seller at point of location of the purchase, within the boundaries of the taxing jurisdiction. The seller acts as an agent of the government in collecting and sending sales tax amounts to the proper government entities. A single sales tax may be combined from city, county and state sales tax requirements. It should be noted here that there are sales tax exemptions for items such as food in most states (Nelson, 2012).

State Use Tax
Use tax is applicable when a buyer from one state purchases a tangible personal property consumer item from a remote seller in another state, usually a sale via catalog, mail, telephone, or Internet. If the buyer purchases the same item locally within his or her resident state, the buyer pays a sales tax, and if the buyer purchases from a remote retailer in another state, the buyer is responsible for use tax. Normally, use tax is assessed and paid at the identical rate as the sales tax.
that would have been paid had the same goods been purchased within the state of the buyer (Nelson, 2012).

Generally, states that have sales tax also have a *use tax* component applying to remote retail sales. There are no federal provisions for collecting taxes from the remote retailer due at the time and location of sale in the retailer state owing to Supreme Court rulings pertaining to the burdening of interstate commerce transactions. Theoretically, the buyer remains responsible for paying the use tax, but rarely does. In 22 states, including California and New York, consumers are responsible for calculating the amount of use tax liability and declaring such purchases on their annual state income tax form. Again, even though this is the legal requirement, there is little compliance (Nelson, 2012).

**Excise Taxes**

The significance of addressing *excise taxes* is to understand the difference between state sales tax and state use tax. Basically, the excise tax is used in federal, state, and local jurisdictions and is considered an indirect form of taxation on use and consumption of a specific and narrow range of goods. Excise taxes are not directly paid by the customer. They are usually included in the price, but not listed separately from the total of the goods, and are collected by an intermediary such as a producer, manufacturer, or merchant paying said taxes to the government as a per unit or volume tax on the items purchased. State sales taxes or use taxes are added directly at time of sale according to value of the item sold. Items with excise taxes included in the original price may also have sales or use taxes added. Items with excise taxes include gasoline or diesel fuels, tires, coal, firearms, tobacco, alcohol, telephone services, air transportation, and unregistered bonds (Institute on Taxation and Economic Policy, 2011).

An excise tax may be applied locally for items sold in the state or in tax jurisdictions within the state and collected for that state or jurisdiction. Excise taxes originated by states for use between/among states in interstate commerce are prohibited by the Constitution through the Interstate Commerce Clause. In the federal arena, the Constitution gives authority for excise taxes as long as said taxes are geographically uniform throughout the U.S., and many times they are coordinated among the states through the federal government (Zimmerman, 2007).

There may eventually be a nexus relating to the excise tax theory that will provide justification for states to collect *use taxes* across state lines for Internet sales. The National Taxpayers Union (NTU) has stated through its Executive Vice President, Pete Sepp, that “the U.S. Constitution was designed to provide each state a high degree of sovereignty within its own border, while affording citizens of other states a high degree of protection against predatory policies from outside their boarders” (Sepp, 2013). At this time most U.S. Constitutional arguments suggest addressing the burden on interstate commerce through the Interstate Commerce Clause and the Due Process Clause. That is the perspective of this paper. However, the issues raise questions of how the rulings equate to doing business on the Internet with remote out of state locations and how much physical presence is needed to trigger sales and use taxes.
U.S. Constitution

There are several relevant Constitutional provisions that may have application relating to the validity of Congress formulating federal laws requiring collection of use taxes from remote out of state vendors: (i) Article I, Section 8, Clause 1 states, “The Congress shall have the Power to collect Taxes, Duties, Imposts, and Excises . . . ; but all Duties, Imposts, and Excises shall be uniform throughout the United States”; (ii) Article I, Section 8, Clause 3 serves “To regulate (Interstate) Commerce among the several States”; (iii) Article I, Section 8, Clause 18 acts “To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all Powers vested by this Constitution . . . .”; (iv) Article I, Section 9, Clause 5 states, “No Tax or Duty shall be laid on Articles exported from any State”;(v) Article I, Section 10, Clause 2 states, “No State shall without Consent of Congress, lay any Imposts or Duties on Imports and Exports . . . . and all Laws shall be subject to the Revision and Control of Congress”; and (vi) Amendment 5 states, “. . . . “No person shall be of life, liberty, or property without due process of law”(U.S. Constitution, 1789) The above principles have varying degrees of influence in establishing the public policies that meet the interests of the stakeholders.

Simple History of the Internet

Serious Internet research started in 1962 with the first Internet transmissions in 1969 by the U.S. Defense department’s Advanced Research Projects Agency on ARPANet with UCLA Network Measurement Center, Stanford Research Institute, UCSB, University of Utah, and expanding to Harvard, MIT, and Bolt, Beranek, & Newman of Cambridge, MA. International interests started in 1972 with the University of London and NORSAR of Norway. There were 28,000 Internet hosts by 1987 and commercialization and launch of AOL in 1989. In 1990, ARPANet ended and the World Wide Web began. By 1994, there were three million Internet hosts and shopping malls. In 1995, there were 16,000,000 users and 587,000,000 in 2002, There were 20 million web sites by the year 2000 and 92 million by 2006. The Internet celebrated its 40 year anniversary in 2009 (Poloian, 2009; Volti, 2010). The Global Village Internet usage is populated at over 2.7 billion, 39% of the world population, as of March 2013 (New Media Trend Watch, 2013).

Internet Sales Today

Global Internet sales topped $1 trillion for the first time in 2012. There has been continuous growth in Internet sales for the past several decades. North American sales were $400 billion-plus from 167 million consumers accounting for 5.2% of all retail sales in 2012. This was up from $82 billion in 2004. The expectation is for 192 million consumers by 2016 (eMarketer, 2013).

Amazon.com posted its first profit in 2003 and brought in sales revenue of $6.92 billion in 2004. There were 17,000 employees in 2007 and 88,400 in August 2013. Sales revenue for 2012 came in at $61.09 billion. Presently, approximately 65 million U.S. customers visit the Website each month (The Wall Street Journal, 2013).
2012 Internet sales numbers beg the question of how much use tax was received as part of the $400 billion North American sales total. Since compliance rates are low, many states believe that they are missing out on a large chunk of revenue that they are due. In 2011, the California Board of Equalization estimated that taxpayers only paid 1.4% of use taxes due from online purchases (Viard, 2012). A recent study by the University of Tennessee estimated that states lost $12 billion in sales and use taxes from On-line sales in 2012 alone (National Public Radio, 2012).

“The rest of the story” is a return to the years 1967 and 1992 for two decisive and pertinent U.S. Supreme Court cases that have defined specific principles related to the collection of state use taxes from remote state vendors.

**PRECEDENT CASES**


This U.S. Supreme Court case, in a 5 to 4 split decision, strengthened the precedent that the Interstate Commerce Clause of the U.S. Constitution generally prohibits the buyer’s State from requiring the duty of use tax collection and payment from a seller in another State for a typical direct sale between the buyer and seller. In these earlier cases the buy/sell transaction was usually a catalogue mail-order sell between the buyer and seller. The concept is that a State cannot enact and impose laws that unduly burden the flow of commerce between the states. The Supreme Court strongly suggested that only the U.S. Congress has the power to regulate and control in instances involving the Commerce Clause (Sheppard, et al, 2002).

The Supreme Court was concerned that in multistate tax issues, the Due Process Clause of the 14th Amendment of the U.S. Constitution needed to be addressed. It states that no State shall “deprive any person of life, liberty, or property, without due process of law.” The interpretation here is that a State is prohibited from taxing a corporation/business unless there are “minimal contacts” between buyer/seller states (Swain, 2003).

In answering the Commerce and Due Process Clause concerns, the Supreme Court re-established that the seller/taxpayer must have a “substantial nexus” with the taxing buyer/State in order for the buyer/State to impose its tax on the seller. The so-called “nexus” is established by some type of physical presence. The controversy is in defining what a “nexus” is. It is usually a retail location, warehouse, office, employees, or vehicles of the seller located in the buyer/State (Swain, 2003).

From a historical perspective, this decision was issued the year floppy disks were invented by IBM and one year prior to plans being developed at MIT to create ARPANET, the foundation of the Internet (Volti, 2010). The precedence of this case has had a ripple effect for 46 years, in effect obviating the obligation of collecting sales and use taxes from remote out of state retailers by arguing it places too many burdens on businesses and interstate commerce.

**Quill Corporation v. North Dakota** *(Quill, 1992)*

Here, the Supreme Court revisited the previous National Bellas Hess case. In this catalogue mail-order case, revisited about 24 years later, the decision allowed a more flexible
outcome as to possible alternatives to collecting use taxes, but still ruled in favor of the vendor. First, North Dakota’s requirement of the use tax did not violate the Due Process Clause because Quill, the Supreme Court stated, had sufficient contacts with the North Dakota residents and benefited from the state’s tax revenue. This ruling came just before the eruption of E-commerce and E-tailing, and 10 years before Amazon.com started selling books over the Internet (Maeda, 2013).

Quill lost the case for violation of the Interstate Commerce Clause. The Supreme Court stated, in a 8 to 1 spit decision, that "the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail," as cited from Miller Brothers Co. v. Maryland (Miller Brothers Co, 1954.) For the purposes of the Interstate Commerce Clause, there was neither a “substantial nexus” with the taxing state nor proof of a “minimum connection.” The Court also noted that it was unreasonable to force Internet retailers to be in compliance with 7,500 taxing jurisdictions and that such would be a burden on Interstate Commerce. The stated substantial burden was in the complexity of collecting and distributing use taxes to the numerous jurisdictions. The real essence of the judgment appeared to be the reluctance to impose an overall required state sales/use tax system because of the many complications when a state had no physical presence in the imposing state. There apparently needed to be a simplification of the process. The Supreme Court hint was inviting the U.S. Congress to address the various complexities in creating a law that would grant states authority to require such taxes be collected. Today, it is estimated that there are over 9600 taxing jurisdictions (Novack, 2013).

**Federal Legislation, Commissions, Alliances**

The Federal Internet Tax Freedom Act (FITF) was signed into law by President Bill Clinton on October 21, 1998, originally to promote commercial, educational, and informational advancements of the Internet as administered the U.S. Communications Commission. The basic provisions provide exemption from federal, state, and local taxation of Internet access, discriminatory Internet-only taxes (such as bandwidth and E-mail taxes) and multiple taxes on electronic commerce. The law was extended by the Internet Tax Freedom Act Amendment Act of 2007, signed on November 1, 2007, and extends certain exemptions to November 1, 2014 (Poloian, 2009).

Of interest here is that the law did not exempt Internet sales from taxation nor did it repeal state sales or use tax relating to Internet sales. Secondly, the law authorized the establishment of the Advisory Commission on Electronic Commerce to study Internet tax policy. In 2000, the Commission issued a final report opposing Internet taxation (Advisory Commission on Electronic Commerce, 2000).

The Streamlined Sales Tax Project (SSTP) was organized in March of 2000, as a voluntary effort among a number of states along with the Federation of Tax Administrators, the National Conference of Legislators, and the Association of Governors in response to “Quill” Supreme Court case and Congress’ effort to permanently prohibit states from collecting sales/use
taxes for On-line business transactions, an action posing possible serious financial consequences for the states.

The purpose of the Project was to develop recommendations for approaches that would simplify, modernize, and “de-complicate” sales/use tax definitions, tax administration, and use of technology for sales tax collection. An implementing group representing the states within the SSTP accepted, rejected, or modified the proposed recommendations. The provisions finalized by the implementing group were the origin and foundation of the Streamline Sales and Use Tax Agreement (SSUTA) by member states. The intent was to create a Uniform Commercial Code for remote sales and use taxes among the states. Following this action, the basic STPP was dissolved on October 1, 2005. The Streamlined Sales Tax Governing Board, Inc. continues to administer and promote the basic projects that were addressed under the SSTP, including the SSUTA (Maguire, 2011; Maeda, 2013).

The Streamlined Sales and Use Tax Agreement (SSUTA) is a cooperative effort among 44 states, the District of Columbia, local governments, and the business community. Simplification of sales and use tax collection as administered by states and retailers is the key intent of the process through minimizing administration and cost burdens of retailers, including those operating in multiple states, that collect sales/use taxes. Remote sellers of mail order and Internet are encouraged to collect taxes from customers living in “streamlined” states. The goal is to address the operation and practice of state sales/use taxes for remote sellers and local “brick and mortar” stores under the same rules, advancing business for both in a fair and competitive environment. 22 states, through their laws, regulations, rules, and policies, are in substantial compliance with the SSUTA and are considered full members. Two states are considered associate members that have not achieved substantial compliance at this point (Maguire, 2011; Maeda, 2013).

Prior to Senate passage of the Market Fairness Act (MFA), two previous bills were introduced in 2011 that addressed streamlining, simplifying, and granting authority of states to collect use taxes from Internet sales in remote states. The first was the Main Street Fairness Act, and it was introduced in the Senate and House of Representative at the same time. The bill listed 18 minimum specific simplification requirements for SSUTA in its implementation by member states. The Senate Bill “died.” The MFA, in response, narrowed the number to five simplification requirements (govtrack S1452, 2011).

The Market Equity Act was submitted solely by the House of Representatives three months later. The simple framework of this bill did not link SSUTA as an option for membership and had fewer requirements than the Main Street Fairness Act. Definitions of “sales tax” and “use tax” were not employed because a few states, such as Illinois, do not recognize “use tax.” States not members of SSUTA no doubt found this approach more appealing because there was more discretion in implementing the provisions. The status of the Bill has been declared by the House as “died.” The proposed MPA is a hybrid of the Main Street Fairness Act

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and the Marketplace Equity Act. It is now the task of the House to address the MPA with the Senate and attempt a consensus bill (govtrack HR3172, 2011).

The Marketplace Fairness Act of 2013 is pending U.S. Congress legislation that was passed by the Senate on May 6, 2013 as Senate Bill 336. Identical legislation was introduced in the House on February 14, 2013 as House Bill 684, but has not been passed. When passed, the Act would authorize authority to state members of the SSUTA to collect and remit sales/use taxes for remote sales under various provisions of the Agreement to buyer/customer states. A second option for state participation in the alternative for non-member SSUTA states is for said states to meet the criteria of five simplification sales/use tax mandates that are similar to the required SSUTA membership qualifications such as minimum simplification standards for administration of tax, audit, and streamline filing.

Specifically, the Act would grant state governments the right to collect sales/use taxes directly from remote Internet retailers. As part of the simplification process, each state would have only one collection point for all incoming sales/use taxes that would then be distributed to various taxing districts within that state. There are several exemptions, including small businesses that earn less than $1,000,000 in U.S. remote sales (govtrack S743, 2013).

The MFA, when it becomes law, would legitimize SSUTA provisions from an agreement status among several states to granting each state enforcement rights to collect sales/use tax from remote vendors at the time of the actual transaction, no matter where the said transaction is consummated. 46 years following the National Bellas Hess case and 21 years following the Quill case, there is certainty that the retail industry is in a very different place today. To satisfy Supreme Court concerns, a key factor is to assure that simplification of sales tax reporting systems is no longer a burden on remote Internet sales businesses. Keeping records on approximately 9600 state and local tax rates appears not to be an insurmountable technical, administrative, or financial burden with use of appropriate software for collecting sales/use tax data from multiple states (Novack, 2013; Sepp, 2013)

**The Political Environment**

Oliver Wendell Holms, Jr. stated, “I like to pay taxes. With them I buy civilization.” An old Greek proverb indicates “Milk the cow, but do not pull off the udder.” George H.W. Bush proclaimed, “Read my lips, no new taxes.” Leona Helmsley thought that she didn’t pay taxes because only the “little people” pay taxes. The proponents of limiting taxation believe that “there is no such thing as a good tax.” Adam Smith stated that “the subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities.” The diversity of convictions about taxation and the tenacity of their supporters render prediction of political outcomes for the collection of *use taxes* for Internet sales challenging and uncertain. Mark Twain stated that, “Prophecy is a good line of business, but it is full of risks.” Still, relevant features of the political environment are known.

Marketplace Fairness Act (MFA) concepts have the backing of the National Governors Association along with other state and local organizations such as the National Conference of
State Legislatures, the Federation of Tax Administrators, the National Retail Federation, the Retail Industry Leaders Association, and the Multistate Tax Commission. Other formidable supporters include an alliance of large and small brick-and-mortar retailers from big box stores Target, Wal-Mart, and Best Buy to publicly and privately owned shopping centers, outlet centers, and independently owned shops, and, at this time, even On-line retail giant amazon.com. These proponents may be influenced by an assortment of competitiveness issues as to those presently collecting sales taxes and those not collecting sales taxes, arguing that on-line-only retailers have an unfair advantage and the playing field needs to be leveled. Other concerns relate to state and local sources of revenue collecting, where the perception is that local buying of consumer goods on the Internet stops the flow of tax revenue from sources that would normally be going to the local jurisdictions. And finally, sponsors of the idea may acquiesce to the idea that use tax collection requirements are inevitable and that non-uniform state approaches may create confusion and complicated compliance obligations (Poloian, 2009; Novack, 2013; Sepp, 2013).

A main argument of opponents against a federal legislation solution for a centralized system of collecting Internet use tax, including several states and local governments, is that it would still be too burdensome, too costly to overcome, and may exceed the potential revenue gain, even with streamlining the process. eBay, Google, Yahoo, and numerous technology trade groups have expressed opposition believing implementation would be costly and burdensome for small On-line businesses. The Securities Industry and Financial Markets Association believes a precedent may develop that would allow states to collect taxes on other out-of-state activities, such as legal and financial services. Many conservatives and anti-tax activists address the cost of integrating a new accounting system and argue that states are competing to attract customers and their business through lower tax rates and that such competition is good for consumers (Poloian, 2009).

The U.S. Senate version of the MFA does not require states to enforce the collection of their sales tax from none-resident retailers selling to their residents. Each state makes that determination. Finally, the House of Representatives 2011 bill entitled the Marketplace Equity Act has a number of features that address streamlining, simplifying, and granting authority to collect use taxes from Internet sales in remote states. Yes, there are differences between the MFA and Marketplace Equity Act, but the overall concepts between the two address many of the core ideas, such as simplification and streamlining, that are compatible. The ultimate step is for the Senate and House of Representatives in conference to negotiate finalization of the MFA (govtrack S743, 2013; Sepp, 2013).
THE CALIFORNIA EXPERIENCE AND INFLUENCE

California Internet Sales/Use Tax

It should be noted that California is not a member under the Streamlined Sales and Use Tax Agreement and may not be eligible to participate under provisions of a future Marketplace Fairness Act unless the state meets the option 2 criteria of the listed five simplification sales/use tax mandates specified under the Act. California legislature passed AB155 to collect and remit use tax on sales of tangible personal property. The California State Board of Equalization has defined required sales/use tax collection and a Certificate of Registration by businesses located outside of California if said businesses have a permanent or temporary business location in California, including a warehouse, sales room or office, or any kind of representative or agent in the state, even temporary, who makes sales, takes orders, installs or assembles merchandise, or makes deliveries. Even if an out of state business is not required to participate in program, California accepts voluntary registration and collection of sales/use taxes from such businesses (CBOA, 2012; National Public Radio, 2012).

Amazon Tax and the State of California v. Amazon.com, Inc.

There has been escalating criticism, along with legal and political pressure, of Amazon.com from state governments, traditional retailers, and other groups for refusing to collect sales tax in 36 of 45 states that have statewide sales taxes. In several of the states, Amazon has a definite physical nexus through distribution centers and wholly owned subsidiaries. “Amazon Tax” laws that are designed for compelling Amazon to collect use taxes from customers have been passed or are being considered by several states. An additional feature of the laws applies to so-called “affiliates” of Amazon: local businesses linked up to Amazon’s site and receiving a percentage of sale if a visitor of an affiliate site clicks on the link and makes a purchase. This provision is the basis for establishing and constituting the nexus that is required for collecting state tax. Amazon disagrees, believing this provision to be unconstitutional (Maede, 2013).

In California, the war between brick-and-mortar business and Internet business reached the “playing field” when California put in place a sales tax requirement in June 2011. This Bill treated Internet retailers the same as brick- and-mortar stores that collect the state’s 7.25 percent levy. The Bill was signed to help the State balance its budget.

California claimed if Amazon has affiliates in California, those affiliates represent a physical presence and, therefore, Amazon must collect taxes. Physical presence is established by the fact that these affiliates are all local businesses in California that make money simply by linking to Amazon's site. If a visitor to an affiliate site clicks on the link and makes a purchase, the affiliate gets a percentage. These businesses in turn pay state taxes on that revenue. In California and other states where this concern is relevant, Amazon has threatened to drop the affiliates.
In response Amazon severed its ties with approximately 10,000 web-based operators, in California, in July of 2011. In addition, Amazon started a tax measure, in California, through a referendum, to repeal the implementation of this sales tax for Internet retailers. (Wholsen, 2011).

A stand-off thus resulted. However, common sense prevailed and reconciliation followed. California Governor Jerry Brown signed a bill (AB 155) on September 23, 2011 in a compromise with Amazon that gives the world’s largest online retailer a one-year reprieve from collecting sales taxes on Internet transactions in the state. Under the Bill, Amazon would begin turning over taxes on California transactions in September 2012 if no national standard is in place by then (Maede, 2013). Amazon also agreed to reinstate the affiliates, to create 10,000 fulltime jobs and 25,000 seasonal jobs, and to invest over $500,000,000 in various facilities in California over the next few years (Wholsen 2011).

In the meantime, the validity of Amazon Tax was upheld in New York, enabling state taxation of Web sites that requires out of state retailers to collect state tax on purchases by New York residents (Amazon.com v. New York State, 2009). A second case in Colorado addressed a different topic on requirements for out-of-state Internet retailers, including (i) retailers that did not collect Colorado use taxes were required to notify customers of obligation to self-report and remit use tax on their purchases to Colorado; (ii) Internet retailers were required to provide Colorado Internet customers with yearly assessment and report by January 31 of each year, via first-class mail, describing each customer’s Internet purchases and notifying said customer that the Internet retailer was required to report the Internet customer’s name and amount of Internet purchases to Colorado; and (iii) remote Internet retailers were also required to report directly to Colorado the names, billing addresses, shipping addresses, and total amount of Internet purchases made by Colorado customers by March 1 of each year. The Court rendered Colorado’s notice and reporting requirements unconstitutional and a violation of the Commerce Clause of the U.S. Constitution (Direct Marketing Association, 2012). This 2012 Federal District Court in Colorado limited the issues to remote Internet retail reporting requirements to Colorado and did not question the validity of remote Internet retailer collection of use tax collection.

THE FRAMEWORK OF CHANGE

. .the only certainty in life is change. . .”, (Wallace, 1953) “Solum certum nihil esse certi” (The only certainty is uncertainty). (Melmoth, 2001)

Each of the components described above has its own web of complexity with respect to developing and implementing an integrated system of requirements for collecting use taxes from remote out-of-state Internet vendors. These component building blocks also have performance variables that typically (i) change at a slow, continuous, and gradual pace, such as government and law, versus (ii) change at a faster, more rapid, and accelerated pace, such as advanced technology/communication progress and many business practices (Toffler & Toffler, 2006). It is imperative to understand the intricacies of balancing slow changes and faster changes when
confronting public policy issues, such as use tax collection from remote Internet vendors, which apply to a wide array of interests and a multitude of stakeholders.

In continuing the theme of change, there are a number of applicable “Theory of Change (TOC)” approaches suitable for analyzing public policy actions that represent multiple interests and stakeholders as described above. A major feature here is the appreciable mismatch between evolutionary patterns of “long-term change” and “short-term change” differences among the contingency of pertinent decision makers and the extreme difficulty of reforming needed use tax policy because of these change differences. The model used here is an evolutionary theme of “traditional gradual long-term change” and “short-term punctuated equilibrium change,” as described below. This approach appears throughout the literature relating to a number of topics, such as business, economics, political science, public policy, history, advanced technology development, and even music (Gould, 2007).

**Traditional Framework of Gradual Long-Term Change**

The framework of change comes in several forms. The traditional gradual *long term* change type evolves in a slower-paced process of interventions, practices, and activities that is usually planned and strategic and may address core values with predictable and clear outcomes, results, accomplishments, or goals. It is usually perceived as a regular or conventional pattern of developments built with collective power and may be a single program to a comprehensive community initiative (Dawkins, 1996). Examples include (i) planning and building the national interstate highway system; (ii) improving air quality of Los Angeles County through initiatives of the Clean Air Act; (iii) development and use of the Uniform Commercial Code; (iv) development and use of a comprehensive tax codes; (v) industry practices; (vi) Supreme Court cases addressing specific topics, such as the Interstate Commerce and Due Process Clauses; (vii) and government actions. Typically, this slow socio-cultural change process equates with the slow gradual changes of human thought processes as these topics slowly evolve. Also, at times, there may be an integration of “short-term changes” within the structure of the long-term approach that keeps the traditional framework on its path.

**Framework of Short-Term Punctuated Equilibrium Change**

The significant feature of short-term *change* explicitly relates to the time frame: that of accelerating momentum during the evolutionary process of transformation, the so-called punctuated equilibrium sequence. It invokes the images of stability interrupted by major alterations to a system. This biological term denotes fast short-term changes following initial development (Somit & Peterson, 1994; Eldredge & Gould, 1972). Examples include present day advances in science, technology, communication, transportation, and globalization (Abernathy & Utterback, 1978).

The general foundation of many of these innovations was motivated by transitions from designs and development of requirements to successful launches in the devices/products from such programs instigated by NASA, the Space Program, and commercial spin-offs. The tipping point was the early 1970’s with continuation of an extraordinarily innovative dedication and
spirit, and ingenious approaches to commercialization. Unprecedented growth in an incredibly short term would range from telemetry requirements of spacecraft to cell phones to present day smart phone technology, with numerous short term (fast) periods of punctuated equilibrium during and in between the many requirements in the transformation of the basic cell phone. A sampling of other “short-term punctuated equilibrium changes,” though there may be connections to the advancement of cell phones, during the past several decades have included smart-cars, Apps, iPads, Windows 8, Xbox, Android, PlayStation Vita, and Wilocity, with new, updated, and improved products to follow soon. Other interconnected formidable factors influencing the individual, social, and socio-cultural changes include developing of high speed, wireless and interactive media networks, control and management of the flow of data, information and knowledge, real-time virtual reality software, and integration and coordination of evidence based research (Volti, 2010).

This continuous improvement of communication technology leading to broadband Internet use and management of data during the past two decades has changed our lives forever, including how we (i) study, learn, think and make decisions; (ii) choose careers and earn a living; (iii) build and cultivate relationships; (iv) determine life style, social activities, entertainment, and gaming; (v) govern, handle diplomacy, and plan and execute wars; and (vi) conduct business and commercial activities. Contrary to long-term changes addressed above, short-term changes typically promote faster socio-cultural change processes and rapid changes of the human thought processes as technology quickly evolves (Somit & Peterson, 1994). An added powerful feature in approaching socio-cultural changes is to have an understanding of population demographics and its diversity and the impact it has in influencing 300 million plus people and their groups in the United States and several billion throughout the world because of the advancing technologies discussed above (NewMediaTrendWatch, 2013).

Media, mass media and its various delivery systems have contributed spectacular advancements in communication capabilities throughout the history of the United States. Contributions have included delivering information via sailing ships from England, horseback, trains, telegraph, telephone, radio, television, computers, the Internet, and high speed, including wireless, interactive media networks. A related and integrated feature of the above is the astonishing enhancements of control and management of the (i) flow of data; (ii) information and knowledge acquisition; and (iii) preservation of the same (Volti, 2010).

The progressive trends alluded to above, more than likely, will continuously improve to augment expansions to the next generations and life cycles of technological advancements in the same manner as have been experienced during the last two decades of short-term changes. Eventually these short-term changes may evolve into long-term evolutionary changes and something else will replace these short-term changes. The competitive nature of our local and globalized world will influence the outcome (Volti, 2010).
The Framework of Change for Business

Business and commerce has witnessed its own framework of change and transformation during the past several decades, some of it influenced by the examples alluded to above. There have been meaningful and useful changes in business organizations through adopting new technologies, major strategic shifts, process reengineering, mergers and acquisitions, restructurings into different sorts of business units, downsizing and right-sizing, quality programs, attempts to significantly improve innovation, and addressing cultural renewal within business units. Add to this social media tools such as LinkedIn, Facebook, Twitter, and YouTube that are helping businesses reach a broad audience and accomplish branding, advertising, and customer development goals as never before. The so-called New Future is rethinking robotics, addressing business intelligence and Big Data, advancing IT strategies toward revenue growth, additional development of the customized cloud, and expanding approaches and leveraging of competitive advantage (Poloian, 2009, pp14-15).

The dynamic trends alluded to above have had a dramatic impact on the retail industry and, more explicitly, for Internet Retailing due to short-term cutting-edge strategies developed during the past decade that have created extraordinary change. High speed Internet (also known as “broadband”) usage (sometimes referred to as “broadband penetration”) and home networking are forces throughout the world that are capturing customers and market share through Internet Retailing. They are faster, more efficient, becoming more global, and creating new and additional distribution supply chain channels. All indications are that Internet Retailing will continue its fast paced growth, changing the competitive landscape dramatically, details of which are beyond the scope of this paper (Poloian, 2009).

The question of the short-term punctuated change patterns identified above for business is interrelated with issues of interest for numerous stakeholders, including local and state governments, their customers, and their local businesses. The changes have challenged the ability of many states and local governments in maintaining a consistent source of revenue resources that were previously available and, in some instances, their ability to provide state and local government services previously offered or desired for present needs. The major concerns of the stakeholders with differing points-of-view are the secondary effects subordinated from actual Internet Retail sales, particularly the failure to collect use taxes from remote vendors/retailers and distribute them to customer states. In most instances, the crossover of buying products from remote Internet sales exempts sales/use taxes that were previously collected when customers purchased to same item locally and collection sales tax for those states. This change factor has had a continuing impact on states in collecting revenue resources as Internet sales have continuously increased during the past decade plus.

Framework of Short-Term Change for Law, Alternative Dispute Resolution, and the Judicial System

U.S. law and its judicial system have the well-deserved reputation of operating at a slow pace within the evolutionary category of traditional framework of gradual long-term change
(Toffler & Toffler, 2006). There has been some transformation of short-term changes brought forth by many of the technology and communication changes and advanced business practices described above. There are hints of law firms becoming or attempting to be more efficient, productive, and competitive with quicker responses and agility in responding to the issues of the day, a practice that will continue to improve. Part of this process includes the addition of legal process outsourcing (LPO), which transfers work of attorneys, paralegals, and other legal professionals to external vendors located domestically or overseas to minimize costs, increase flexibility, and expand in-house capabilities. The future will see a continuing increase of legal specialists and specializations with sub-specialties within specialties and specialties within those specialties (Susskind, 2010).

In the background, Alternative Dispute Resolution (ADR) and the idea of negotiation and conflict management have taken a path of faster short-term changes in development and acceptance of ADR within and outside the legal environment through use of non-litigious approaches in resolving disputes. Interactions with technology and communication advancements have contributed to streamlining the process during the past two decades. The legal profession has taken advantage of the practice in representing clients through the ADR methodology, including negotiation, mediation, and arbitration. Within the remote Internet use tax arguments, ADR techniques have provided several solutions in establishing public/private alliances and negotiated agreements among stakeholders until more formalized laws are implemented through the typical traditional long-term change process (Goldberg, et al., 2012).

Legal risks for organizations, governments, and customers will continue to expand at a faster rate as complexities increase within society, extending conflicts and the need for dispute resolution. The changes alluded to support the possibility of augmenting legal representation through (i) more efficient in-depth research of issues requiring special expertise; (ii) reinforcing, supplementing and strengthening client issues and concerns before formal and informal forums and tribunals; and (iii) various approaches of ADR for developing “stop-gap” measures and solutions (Goldberg, et al., 2012).

Within the federal judiciary technology influences have streamlined practices within the legal community through use of electronic discovery (E-discovery) amendments to the Federal Rules of Civil Procedure (FRCP) introducing the concept of generating electronically stored information (ESI) that is discoverable in litigation along with being able to file various motions electronically, thus addressing electronic realities of the digital age. State and federal courts are also pursuing opportunities of employing ADR techniques on a more consistent basis. These factors may influence more short-term changes that will override existing laws relating to collection of remote Internet use taxes (Paul & Neary, 2006).

**Framework of Long-Term Change of the Federal Government**

Formal finalization of a federal law explicitly defining compliance requirements of remote Internet vendors collecting use tax for states of customers is the sole function of the United States government. Some believe this to be an entanglement of the Gordian knot and
Pandora’s Box. There is certainly complexity in dealing with the trifurcation of activities dealing with the formation, implementation, enforcement, and interpretation of federal laws and the structural breakdown of responsibilities within the branches of government (U.S. Constitution, 1789).

As discussed previously, the U.S. Supreme Court theoretically determined in the Quill Corporation case in 1992 that the U.S. Congress, per the U.S. Constitution, is solely responsible for legislating Interstate Commerce Clause issues for granting states the authority for requiring collection of use taxes from remote vendors in other states. The Court’s concern has been the developing complexities involved in deciding what establishes the minimal nexus relationship/contacts required between and among states that do not violate interstate commerce principles. Generally, the court is stating that appeals relating to the topic have been exhausted and it cannot make future decisions until new legislation and laws/regulations are ripe for review. As far as the court is concerned there is a vacuum in the system until the U.S. Congress, the mandated U.S. Constitutional source for determining and passing Interstate Commerce Clause laws does so. To date, that change has not taken place (Maeda, 2013).

There has been an apparent stalemate within the U.S. Congress for several decades as to how to proceed. The silence and inactivity speaks volumes. As stated above, the Federal Internet Tax Freedom Act of 1998, extended to November 1, 2014, does not address Internet sales taxation nor does it repeal state sales or use tax relating to Internet sales (Poloian., 2009). The Main Street Fairness Act was introduced in the Senate and House in 2011, listing 18 simplification requirements relating to state use tax collection for SSUTA states, but was never finalized and voted on. The Market Equity Act was submitted to the House three months later with fewer requirements, but never advanced toward passage (govtrack S1462, 2011).

The Marketplace Fairness Act of 2013 was introduced to both House and Senate on February 14, 2013, with Senate passage on May 6, with 46 Democrats, 2 Independents, and 21 Republicans voting for it. The bill gives authority to member states of SSUTA and an option to non-member states, with five simplification standards similar to SSUTA, for administration of tax, audit, and streamline filing. At this point, there has been little House action, but if the bill becomes law it would add over $12 billion sales tax revenues. A dispassionate review of the three proposed legislative acts reveals enough similarities amongst them to derive a consensus in the future. But politics may not allow for this change (govtrack S743, 2013; Novack, 2013; Sepp, 2013).

If Congress passes the needed legislation for vendor collection of remote Internet use tax, the traditional approach of change continues. The package, as enabling legislation, will be directed to a federal executive/administrative agency for implementation. Regulations, guides, and organizational structure will be formulated and enforcement will begin. At this point the judiciary, including the U.S. Supreme Court, will be able to continue the process addressing the validity of whether or not the legislation, regulations, guides, and administration meet minimal
standards of Constitutional principles of the Interstate Commerce Clause, thus continuing the
cycle of long-term change of the federal government.

**Framework of Short and Long Term Changes of the Political Environment**

The “wild card” in this situation may be the interests, influences, and various forces
within the political environment. Predictability appears illusive because of the increasing
polarization of American politics, political factions becoming less tolerant of ideological
diversity, and continuing gridlock and dysfunction in formulating and improving the process of
developing public policies, all adding-up to various factions being more interested in energizing
their base rather than building consensus or achieving compromises with their counterparts in the
actual process of governing. One of the politically toxic issues of the time is taxes, including *use*
taxes.

As previously discussed, the U.S. Congress has not finalized federal legislation
authorizing remote state collection of use taxes from remote Internet vendors. The Democratic
Senate passed a *use tax* bill with support from 22 Republican Senators and is awaiting action in
the Republican House. In 2011, a bill was introduced in both the Senate and House and a
follow-up bill was introduced three months later in the House, all with no action. Provisions
amongst the three bills are similar, slightly different, and some differences in the said provisions,
but there may be the possibility of building consensus in finalizing legislation. This long-term
(slow) change game continues.

Within the political arena, an overwhelming obstacle is addressing the interests of
approximately 9600 state and local taxing jurisdictions and their justifications, individually and
collectively, for collecting remote Internet use taxes throughout the U.S. Over the long-term an
average of 34% of state and local revenues are generated from general sales taxes. The
estimated loss of additional new tax revenues last year was $1.7 billion from Internet sales. This
loss has been increasing each year. U.S. Internet sales are about $400 billion a year and
geosometrically rising. With anticipated Internet market share increasing, under the present system
there is a corresponding anticipated loss of tax revenue for state and local jurisdictions, at least in
the short-term. Public expectation is that state and local governments maintain and pay for roads
and highways, public education, water and sewer services, public safety, and so on. Downward
spiraling tax revenues to support local projects create a political dilemma for those seeking long-
term solutions, or even immediate short-term solutions.

To counteract this long-term change problem of losing tax revenue due to inaction on the
part of Congress, a number of states are pursuing more short-term changes through the so-called
“Amazon.com tax” method. As described above, California has been a leader in formulating the
structure that is influencing action in other states. The key ingredient being developed is in
conceptualizing the idea of “affiliates” as a doctrine meeting standards of minimal contacts
between/among the states. Generally, affiliates are local businesses linking to a large Internet
vendor, such as Amazon.com, where a visitor to said affiliate site clicks on the link and makes a
purchase and the affiliate receives a percentage of the sale. Controversy among the factions has
been fierce, but 18 states are in various phases of negotiating with Internet vendors in reaching agreements (Maede, 2013).

Another short-term approach is the formation of a public/private alliance, the Streamlined Sales and Use Tax Agreement (SSUTA), of 44 states working independently with local governments and the business community to simply sales and use tax collection through minimizing administrative and cost burdens of retailers. 22 states are in substantial compliance through their own laws, regulations, rules, guides, and policies. These Streamline states are working together addressing use tax collection issues and implementing the process. SSUTA membership and its streamlining concepts are suggested for inclusion in the proposed Marketplace Fairness Act (MFA). This short-term change “stop-gap” method has the potential of becoming part of a long-term change under the MFA(Maguire, 2011; Maeda., 2013).

Politics will continue to be an ongoing powerful force within the myriad off actions and interests related to the multitude of actions addressed above. One significant factor of the underlying political process is to understand the dynamism of lobbyist and lobbying forums potentially influencing government action, a highly controversial phenomenon but specifically protected under the First Amendment of the U.S. Constitution relating to the right to “petition the Government for redress of grievances.” There are formal and informal lobbying activities at every level of government with varying degrees of assistance, influence, and impact on outcomes.

Taxes and their underlying issues are a primary area of lobbying activities and are integrated into the system through a number of public interest groups, including Public Action Committees (PACs), Super PACs, Hybrid PACs, and a myriad of other formal and informal interest groups and individuals. There are over 12,600 registered lobbyists in Washington, D.C., with 6,503 actively involved in tax oriented issues servicing 2,000 client organizations. Lobbyists’ power, influence, and success many times are proportional to the resources of time, money, and support granted by their clients in pursuing their legislative goals and agenda. Amazon.com spent $1.2 million the first three months of 2013 and $1.7 by the middle of the year lobbying tax issues, including promoting interstate sales tax through the passage of the Marketplace Fairness Act (MFA), a change of position from previous years (Byrnes, 2013; McCardle, 2013; Yeager & Leonig, 2013, Drutman & Furnas, 2013; Mapes, 2013; Lobbying Database, 2013).

There is an abundant assortment of interests, positions and opinions as to collecting use tax from remote out of state Internet vendors. The many points of view are diverse: coalitions within primary and secondary group and industry categories, such as intrastate and interstate brick and mortar retailers, intrastate and interstate large and small business retailers, state and local jurisdictions, Internet vendors, consumers, and tax groups.

**Framework of the Traditional Gradual Long-Term Changes of Law**

Aside from the few short-term changes of law alluded to above, the general observation of law is that it is extremely slow to respond, some believe reactionary, and does not adapt well
to a fast changing society and technological innovation. It is one of the quintessential gradual long-term change factors in the U.S. today (Toffler & Toffler, 2006). The so-called “living law” struggles in meeting challenges of keeping up with government and society actions, bureaucracies, and regulatory agencies, let alone the faster paced short-term change orientation of business and commercial interests that may reflect needed changes of effective and efficient approaches favoring competitiveness of new products in the marketplace.

The traditional long-term change issues include the following: (i) the dispute resolution system in U.S. is designed with a degree of predictability through the principle of *stare decisis*, where old decisions stand as precedent for the present and future, giving society some stability, but also promoting a long-term change cycle; (ii) the U.S. Common Law and Constitution, for the most part, originated in an agrarian economy prior to 1850 and at times is slow to adapt to technology changes; (iii) 1850 law, even 1950 law, may be inappropriate for today’s accelerated technological innovations and societal changes for solving problems and promoting opportunities; (iv) in the overall prospective law evolved over a period of hundreds of years and present day commercialization of technological innovations within a few years, complicating the balance between short-term changes and long-term changes, and (v) society is now in the process of rapid change in transitioning from an industrial manufacturing age to an information/digital age (Cross & Miller, 2012).

In addressing the collection of remote Internet use taxes for customer states, the challenge is integrating the needed short-term punctuated equilibrium changes discussed above into the traditional gradual long-term change process of law. Again, there is a de-synchronization problem between the two in calibrating and coordinating a finalized system that may resolve this public policy dispute (Toffler & Toffler, 2006).

At this juncture there is no federal law providing a state authority to collect use taxes directly from remote Internet retail/sellers located outside the boundaries/jurisdiction of the customer/buyer/destination state for Internet sales of tangible personal property.

**Brief Up-Date from the Short-Term Punctuated Equilibrium Side of Business**

The business community may be able to provide a constituent ingredient that is essential in addressing the Supreme Court’s concerns of burdening interstate commerce with the complexity of vendors administering use tax collections for approximately 9600 tax jurisdiction. Commerce Clearing House (CCH), a Wolters Kluwer Business, has recently introduced the “Sales Tax RADAR” software and integrated workflow tool for tracking and decision administration reporting of sales tax and use tax rates and taxability details of 10,000 jurisdictions in the U.S. and Canada. It is a cloud-based tool powered by CCH IntelliConnect, the company’s tax research platform. This technology may be the source of simplifying the collection of *use taxes* from remote vendors/retailers and distributing same to customer states, meeting standards and legal principles for the U.S. Congress in regulating Interstate Commerce (CCH, 2013)
SUMMARY

The amazing journey in the progression of developing approaches for collecting use tax for Internet purchases from remote state Internet vendors is “a work in progress.” The U.S. Supreme Court has been officially silent on the primary issues since 1992. The U.S. Congress has been inactive in passing legislation, though the Senate approved a bill this year, the Marketplace Fairness Act (MFA), of 2013, which is waiting for House approval. Supreme Court and Congressional action in this instance is in the traditional gradual long-term evolutionary change category.

The punctuated equilibrium short-term evolutionary change system has been extremely active in pursuing substitute approaches to the more inactive traditional gradual long-term evolutionary change of federal government actions. A cooperative private/public alliance, the Streamlined Tax Governing Board, Inc., is administering and promoting projects aimed at simplification of use tax collection processes among state members. From this activity the Streamlined Sales and Use Tax Agreement (SSUTA) among 44 states and the District of Columbia are working together. 22 of the states, through their laws, regulations, rules, and policies, are in substantial compliance establishing their own approach for a fair and competitive environment. Note that SSUTA has been included in the MFA as an option.

Another short-term fix is that of the so-called Amazon.com Tax. In 2011 California established a sales/use tax law defining very broad and relaxed nexus requirements for remote Internet vendors. Amazon.com and others similar retailers objected vigorously on various grounds including Constitutional. Through a negotiated settlement with California, Amazon.com soon reversed its position and agreed to the law’s provisions. Amazon and several other Internet retailers are completing similar agreements with eight additional states. Amazon.com spent $1.4 million the first three months of 2013 lobbying tax issues, including promoting interstate sales tax through the passage of the Marketplace Fairness Act (MFA), including the SSUTA approach, a change of position from previous years.

CONCLUSION

Change has started. Solutions are being developed. The evolutionary cycle of short-term change is working overtime to develop substitutes as stop-gaps or work-arounds because of lack of federal actions in addressing interstate commerce Internet use tax issues. Stakeholders from all sides of the controversy are actively devoted in representing and influencing interests of their constituencies as the process continues. Transformation of interstate sales use tax concepts is progressing during this transition. There is even interaction between short-term change features, such as SSUTA, being integrated into MFA, a potential long-term change solution when and if passed by Congress. A software tool simplifying the complexities of monitoring, tracking, and
allocating use tax rate collections for remote Internet vendors possibly meets the Constitutional standard of not being a burden on interstate commerce.

There will continue to be adjustments, modifications, revisions, and refinements in accommodating finalization the use tax system. The authors believe it inevitable that the momentum of the process will continue and changes discussed will soon evolve into comprehensive practices as an alliance, negotiated agreements, federal law, or some combination. There will be some form of interstate Internet tax collection by remote Internet vendors. Change is happening. “. . . the only certainty in life is change . . . .” (Henry Wallace, 33rd Vice-President of the United States).

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FINDING A PERSONAL FIT IN LAW, MORALITY, AND ETHICS

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Stephanie Newport, Austin Peay State University

ABSTRACT

From Socrates’ admonition to “Know Thyself” to the observation of Warren Bennis “...letting the self emerge is the essential task of leaders,” (Cashman, 2008, p. 115), the importance of understanding one’s personal approach to recognizing and solving ethical dilemmas has persisted through the centuries. The purpose of this discourse is to show that morality and ethics are complementary, but mutually exclusive, notions. In combination, they are also, in part, the functional foundations of Business Law, and measures thereof invite scrutiny of their reliability and validity. A matrix juxtaposing morality and ethics is presented as an orderly and informative way for individuals to identify their unique approaches to knowing themselves in the context of an ethical dilemma.

From Socrates’ admonition to “Know Thyself” to the observation of Warren Bennis “…letting the self emerge is the essential task of leaders,” (Cashman, 2008, p. 115), the idea has stood the test of time: individuals who wish to be effective leaders should look within to discover their strengths and weaknesses. Prescriptions as to how to accomplish such a daunting task abound in discourses from religion to philosophy to metaphysics to law. There is little agreement among definitions of either ethics or morality, so charting a path through this maelstrom of advice is part of what makes self-discovery so difficult (Fyfe, 2005). Some sources list five “approaches”: utilitarianism, justice, virtue, rights, and common good (Velasquez, et al 1999), some list two (Brown, 1989) while others classify these concepts as “guidelines” (www.amstat.org) or “principles” (www.apa.org/ethics/code.html). The intent of this paper is to offer a simple way of identifying one’s personal, moral approach to ethical situations and the means one prefers to use to direct one’s selection of “the right thing” to do.

Maxwell (2003) makes a solid case for ethics as the embodiment of the normative prescription for human behavior and morals as the descriptive counterpoint to ethics. Casting ethics as the way humans should act and morals as the way they actually do act establishes them as mutually exclusive concepts. It is postulated that individuals have a dominant initial
interpretation of ethical situations. The way they actually view ethical issues changes little over time, and can be categorized in one of three ways: aretaic, deontologic, or teleologic. People who demonstrate the aretaic approach to ethics will focus on the individual person involved in the ethical situation. The term “aretaic” is derived from Aristotelian word “arête” or “virtue” (Ess) Aretaic, or virtue, ethics is found in most religious interpretations of ethics which primarily encourage building strong character and exhort people to engage in good behavior. When considering an ethical dilemma, an aretaic questioner would focus on what a good or bad person would do to resolve the problem.

The deontologic approach to ethics is found predominant in law. The Greek word “deon” means “duty” (Alexander & Moore, 2012), indicating that people have an obligation to behave ethically. These obligations are often, but not always, codified in law. Indeed, the deontologist will react equally negatively to both a blatant legal violation and a simple broken promise. For example, the American Bar Association, in the early 1980s suggested a code of ethical standard to serve as a model for States to adopt, as they wished (American Bar Association, 2013). Their webpage dedicated to professional responsibility is rife with resources to assist the legal community in identifying ethical solutions to just about any issue they are likely to encounter. In concert with the stated purpose of the Center for Professional Responsibility, members of the legal profession have promised to do their duty: to respect and represent the best interests of their clients. With over 96% of federal and state convictions resulting from plea bargains (Davies, 2013), giving clients complete and accurate information regarding the plea specifics is imperative.

Teleological adherents base their moral choices on the consequences of the behavior or decision. Because decisions made by medical personnel can bear life or death consequences, this approach is often found in medical treatises. Teleological arguments are also the most persuasive of the three moral positions. The first two moral approaches could possibly be challenged successfully. Not everyone thinks drinking alcoholic drinks is wrong; the legal blood alcohol level and the legal age for such behavior can be debated. What cannot be denied are the results of drinking alcoholic beverages, from occasional verbal malfunctions to causing a highway accident.

The study of ethics as normative guidelines for human behavior is presented here as complementary to that of descriptive morality. From hedonism to the Golden Rule, all sorts of possible human behavior can be identified as appropriate or inappropriate. The hedonist likely will do whatever supplies the most self-gratification. Kant’s Categorical Imperative considers whether a chosen behavior is appropriate if everyone did it, such as padding expense accounts or starting rumors. Utilitarians will try to make decisions or choose behaviors such that everyone affected is at least a little bit better off. Justice proponents, both procedural and distributive, make decisions based on equity. The process by which the decision was made and/or decision
itself must be fair to all parties. The Disclosure Principle addresses how comfortable one would be in explaining a decision or action to an interested outsider. The outsider can be a relative whose regard is important to a person, such as a parent or grandparent. The outsider can also be plural: a jury of one’s peers or a national television audience. By “comfortable” it is not meant that one can rationalize a bad decision or think of a plausible cover story. Rather, it connotes one’s comfort level when looking in a mirror. The Golden Rule stipulates that others are treated the way one would wish to be treated.

The following matrix depicts all three moral approaches and how each is compatible with any of the guidelines. The hypothetical layoff situation and possible personal thought processes are offered as a guide to discovering one’s own dominant actual (descriptive) approach to ethical situations and one’s preferred prescriptive guideline.

<table>
<thead>
<tr>
<th>Ethical perspective</th>
<th>Moral description</th>
<th>Aesthetic</th>
<th>Deontological</th>
<th>Teleological</th>
</tr>
</thead>
<tbody>
<tr>
<td>Golden rule</td>
<td>A good manager could avoid a layoff</td>
<td>If the manager faced being laid off, how would he have conducted himself better?</td>
<td>Layoffs will lead to //-------------------</td>
<td></td>
</tr>
<tr>
<td>Kant’s Categorical Imperative</td>
<td>Layoffs would be even more likely if a manager cared only about the other employees</td>
<td>If managers knew what they say they knew were layoffs wouldn’t be their only way of fixing their poor planning</td>
<td>It’s every firm’s reality; layoffs are a way of life.</td>
<td></td>
</tr>
</tbody>
</table>
| Utilitarianism      | A manager who cares about workers would not want all of them to be made off because of a layoff. | A layoff is a breach of the trust a worker has in the company’s managers to run it profitably. The better alternative would be to make some workers.
| Justice             | A bad person would not allow anyone else’s opportunity for a layoff and would protect only friends’ jobs. | A manager who will not run a personal company as it runs a company may beucky creating a hostile environment, which may be illegal. |
| Procedural          | A bad person would not allow anyone else’s opportunity for a layoff and would protect only friends’ jobs. | If, because of the management’s failure, a business is in dire straits, layoffs must be made. |
| Distributive        | Only a dishonest manager in a poor performance led to a layoff would try to explain the resulting layoffs. | A manager whose lack of management skills actually caused a layoff, should not be allowed to explain it, it makes the business. |

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Table 1
Identifying personal fit in ethics and morality

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Since the State of Washington adopted the American Bar Association’s Model Rules of Professional Conduct in 1985 (www.americanbar.org) every State and the District of Columbia has followed suit. The issue of layoffs is only one of a myriad of business decision scenarios that could likely entail legal allegations made by unions against companies, their managers, and their Boards of Directors as well as by companies against unions. The matrix is presented as a vehicle to demonstrate an orderly and informative way of identifying one’s dominant views and reactions to ethical questions. It is an invitation to individuals to identify their thought processes as they seek to know themselves, their motivations, and how they perceive their interpretation of ethical situations.

Clearly a deontological approach to ethics predominates in professional mandates to practitioners of law. In the opinion written for SEC v. Capital Gains Research Bureau, 375 U. S. 180, 186 (1963), it is said that establishing a high standard of business ethics for the securities industry is the fundamental purpose of at least six different securities acts, which advocate replacing the philosophy of caveat emptor with a philosophy of full disclosure. Standards of commercial ethics, such as good faith and fair dealing, that encourage and support creativity and invention are the broadly stated policies behind trade secret law (3 Ohio C.C. (n.s.) 459). In addition, the topic of personal ethical perspectives has global and governmental implications, as recognized by the chairman of the Angola Bar Association in a recent speech. Hermenegildo Cachimombo (2013) stated, “[The] legal profession, exercised with ethics and professional deontology, essentially contributes to the consolidation of a law-abiding state.”

It is believed that the prescriptive use of the matrix is rich in its promise of increasing self-knowledge and ethical effectiveness among members of the legal profession in both private practice and at the highest levels of public service.

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DO VALUES CHANGE OVER TIME? AN EXPLORATORY STUDY OF BUSINESS MAJORS

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ABSTRACT

Value can be defined in a variety of different ways, but can be summarized as the attitudes, beliefs, and principles which guide an individual in making decisions based on how the ultimate outcome effects themselves. Research has found that values and ethical behavior can be changed through experiences and education. Ethics and values have become important issues in recent years due to the exposure created from accounting misconduct and misrepresented financial statements from some of the United States’ largest companies. At the center of this are the managers who prepare and approve the financial statements and the accountants who audit the financial statements. Mean-level changes and rank-order changes in values were obtained from business majors in 2004 and in 2010 using the Schwartz (1992) Value Survey. Our results show that both mean-level changes and rank-order changes occurred for individual values of business majors over time. Furthermore, higher-order values also changed, especially for male business majors.

INTRODUCTION

Ethics and values have become important issues in recent years due to the exposure created from accounting misconduct and misrepresented financial statements from some of the United States’ largest companies. The best publicized of these was the Enron/Arthur Anderson case, which in the end lead to the demise of both companies, with Enron filing for bankruptcy and Arthur Anderson ceasing to exist. Other cases of improper accounting include WorldCom, Waste Management, Sunbeam, Tyco, Adelphia, and Global Crossing. At the center of these cases are the managers who prepare and approve the financial statements and the accountants who audit the financial statements.

Value can be defined in a variety of different ways, but can be summarized as the attitudes, beliefs, and principles which guide an individual in making decisions based on how the ultimate outcome effects themselves. Schwartz (1992) defines values as "desirable goals varying in importance that serve as guiding principles in peoples' lives." It stands to reason that if values guide and/or influence behaviors then values are an important variable in ethical behavior and decision making.
In addition, some research has found that ethical behavior can change over time (see Akers & Giacomino 2000, Clikeman & Henning 2000, Earley & Kelly 2004) with education or experience. Giacomino & Akers (1998) explain, “to provide meaningful guidance regarding values, educators and administrators, in addition to having an understanding of values, should have an awareness of social influences and the importance of values in business. Society can influence the students’ values prior to and during college, while businesses can influence employees’ values throughout their professional careers.” The question arises whether today’s students have adjusted or changed their values in lieu of the recent exposure to the numerous accounting scandals.

The purpose of this paper is to examine the values and value types of business majors using the Schwartz (1992) Value Survey that measures the importance of specific values. The Schwartz (1992) Value Survey is one of the most widely used instrument for measuring personal values (see Lan et al., 2013; Lan et al., 2008; Boer & Fisher, 2013; Nistor & Ilut, 2011; Verkasalo et al., 2009; Myyry, 2008; Lindeman & Verkasalo, 2005; Davidov et al., 2008; Schwartz & Sagiv, 1995). While there have been numerous studies using the Survey, an understanding of whether values change over time is still not clear.

The inclusion of ethical topics within the business curriculum has increased within the last decade following the Enron/Anderson scandal. Many universities have developed separate courses on business ethics and textbooks typically include ethical issues within the chapters. The objective of this study is to explore whether this heighten awareness of ethical issues has altered business majors values between the period of 2004 and 2010.

The next section of this paper will review relevant research on the Schwartz Value Survey (1992), changing values, and gender. Research methodology is the subject of the third section, and the fourth presents the results of the survey. The final section will discuss the results, limitations of the survey, and suggestions for future research.

REVIEW OF LITERATURE

The Schwartz (1992) Value Survey

Schwartz (1992) studies a set of 56 human values across different cultures. The outcome of the study provides a two-dimensional model that classifies values according to their motivational types and explains the compatibilities and tensions between these values. Using samples of undergraduate university students and school teachers across 20 different countries, Schwartz (1992) finds that human values result from ten motivational needs (also called motivational types or value types): self-direction, stimulation, hedonism, achievement, power, security, conformity, tradition, benevolence, and universalism. Furthermore, the author finds that these motivational types could be defined along two categories. There are motivational types that promote individualism (self-direction, stimulation, hedonism, achievement and power) and those
that promote collectivism (benevolence, tradition, and conformity). Meanwhile, universalism and security are motivational types that serve both purposes. The presence of compatibilities between motivational types within each category and conflicts between motivational types across the two categories confirm that humans – to a certain extent – are guided by either individualistic or collective interests.

Schwartz (1992) presents an alternate view of his model based on the conflict between the motivational types. Motivational types could be rearranged to form four high-order value types drawn along two bipolar dimensions. The first dimension represents the continuum between openness (a combination of stimulation and self-direction) versus conservation (security, conformity, and tradition). This continuum measures the extent to which individuals embrace an environment endorsing the fulfillment of emotional and intellectual interests versus an environment promoting the certainty provided by the status quo. The second dimension is the continuum between self-enhancement (power, achievement, and hedonism) versus self-transcendence (universalism and benevolence). This dimension represents the conflict between individuals’ aggressiveness in pursuing their self-interests in contrast to their willingness to dispense with their selfish demands in return for others’ welfare.

The Schwartz (1992) Value Survey has enabled a string of research to study the determinants of these human values, understand their impact on personal behaviors and attitudes, or to draw value profiles for certain populations (see Lan et al., 2013; Lan et al., 2008; Boer & Fisher, 2013; Nistor & Ilut, 2011; Verkasalo et al., 2009; Myyry, 2008; Lindeman & Verkasalo, 2005; Davidov et al., 2008; Schwartz & Sagiv, 1995). For example, Boer & Fischer (2013) study the impact of personal values on attitudes. They find that values promoting self-transcendence are associated with traits like care, and fairness. While self-enhancement values are negatively associated with fairness; they are positively associated with individuals’ attitudes towards authority and political membership. Values of conservation are also associated with positive views towards authority; in addition, they promote attitudes of purity and religiosity.

Other studies attempt to understand the importance of values at the work place. Lan et al. (2013) examine the relation between Chinese accounting practitioners’ values and their work orientation. Employees may view their work as Jobs (way to acquire material benefits), Careers (mean to acquire power and climb social rankings), or Callings (an appreciative view to the value of work in one’s life). The authors find that values associated with self-enhancement (in this case hedonism and achievement) are associated with employees’ view of their work as Career. In contrast, self-transcendence values (benevolence) are associated with employees viewing their work as Callings.

Alternatively, Nistor & Ilut (2011) use the Schwartz (1992) proposition to draw a value profile of individuals in Hungary and Romania. By comparing values at the national level, they find that security (a conservation type of value) is the highest ranked value in both countries. They also suggest that self-transcendence values are the most important in both countries as they find that benevolence and universalism rank highly in both Hungary and Romania. Though there
are similarities between value systems in both countries, the author find that the level of self-transcendence is higher in Hungary than in Romania; thus, providing further evidence that cultural factors may impact values.

VALUE CHANGE

Whether value can change over time or not and what the determinants of this change are is still a question that remains largely unanswered. Rokeach (1973) proposed that personal experiences can impact values both at the individual socialite level. An event experienced by the individual alone may change his values, while an event experience by all of society (such as war) would change an entire society’s values (Rokeach, 1973). Haydon (2004) questions the quality and sustainability of the ethical environments we live in and presumes that they are subject to change. Haydon (2004) believes that education plays an important role in preserving the ethical environment from degradation; therefore, he proposes that the ethical environment should be continuously evaluated. The paper highlights the role of governments in providing educational programs that promote the ethical environment and emphasizes the important role of teacher in conveying values to the younger generations.

Bardi et al. (2009) examine value change over time. They argue that the conflicting natures of individualistic and collective values imply that humans might assign different weights to these values prior to making choices. Therefore, albeit prior research suggests that values are stable over time, these weights could change over time to accommodate situational changes. Using a sample of German school students, the authors measure the change in their values using the Schwartz (1992) Value Survey across two different points in time at the start and end of a school year. Their main findings show that students experience an escalation of self-enhancement values (power and achievement) and a decline in self-transcendence values (universalism and benevolence) over time. Similar results are also found with slightly older subjects tested in a different country. Further tests with adult subjects could not provide evidence of value change at older ages; the author only finds a positive change in hedonism values over time. Further examination reveals that subjects who experienced life-changing events were more prone to undergo changes in values.

Wu (2003) examine the change in student values, ethical recognition, ethical decision-making, and ethical tendencies following education in business ethics. Using a sample of business students from two universities across Taiwan Strait, the author finds that scores of students’ values such as “dedication and respect”, open-mindedness and originality”, and “coziness and fellowship” have improved following the receipt of education in business ethics. Wu (2003) also observed that education has a positive impact on students’ abilities of recognizing ethical situations, and their behaviors concerning ethical decision-making. The study provides evidence that education in business ethics improves student abilities to recognize ethical values and to act according to these values.
Emerson & Conroy (2004) examine the cyclical change in ethical attitudes between 1985 and 2001 by studying responses of university students to 15 ethically questionable situations. They find a positive change in ethical attitudes in the form of “less acceptance” to ethical situations causing moral dilemma in the 2001 sample (in comparison to the 1985 sample). Conroy & Emerson (2006) also find a positive change of ethical attitudes following the Enron/Arthur Anderson scandal. They examine the responses US universities students before and after the scandals in regards to two situations creating ethical breaches: “insider trading” and “reporting tricks”. They find that students were less accepting to these ethical situations following the scandal. They also find that ethical education – as in attending the church or taking ethics course - is positively associated with students’ disapproval of insider trading and accounting tricks. The authors highlight the role of the media following the scandal in creating awareness about these ethical situations which may have contributed to the positive change in attitudes.

Previous research implies that drastic value changes are only possible on the long-run (Bardi et al., 2009). However, we can still witness cyclical changes where the weight and rank of the different values could experience slight changes. Research also suggests that creating a state of awareness (through education or media) is a major contributor to short-term changes in value.

VALUE AND GENDER DIFFERENCES

Research on gender differences and values lend controversial results. Early studies provide no evidence of differences in values or ethical judgment between males and females (see McNichols & Zimmerer, 1985; McCuddy & Peery, 1996; Stanga & Turpen, 1991; Tsalikis & Ortiz-Buonafina, 1990; Jones & Kavanagh, 1996; and Hoffman, 1998). However, recent research suggests that men and women are more likely to adopt different and – potentially – conflicting sets of values. They suggest that men are more inclined to adopt more individualistic values that promote personal success while women are more likely to adopt values that embrace social welfare. For one thing, examining an international sample across 25 countries, Schwartz & Rubel-Lifschitz (2009) find that women embrace values of self-transcendence (i.e. benevolence) while men are more inclined to adopt values promoting self-enhancement (i.e. power). They also find that in cultures promoting gender equality these gender differences vis-à-vis the value system decrease due to the fact that women adopt more self-enhancement values. Another study by Nistor & Ilut (2011) also finds that females have significantly more self-transcendence values than males. Meanwhile, Lan et al. (2013) find a significant difference between the achievement values of male and female (male were higher at p=0.01).

Furthermore, recent research also suggests that women are more likely to hold to their ethical values when faced with situations that create a moral dilemma. Using a survey to measure the likelihood of adopting ethical behaviors across eight countries, Roxas & Stoneback (2004) find that males are more likely to accept or get engaged in less ethical behavior than their female counterparts. Also using a sample of university students, Emerson & Conroy (2004) find that
women are less accepting to situations creating non-ethical behaviors than their male counterparts. Following the Enron scandal, Conroy & Emerson (2006) also find that female students were less accepting to negative business practices – such as insider trading and accounting tricks – in comparison to their male counterparts. Finally, in their study of factors affecting ethical attitudes in China, Lam & Shi (2008) find that there are significant differences between male and female subjects. They find that women are more sensitive than men to issues that violates the rule of the law or ethical issues that violates the social welfare. The authors could not find similar results for their sample of male and female subjects examined in mainland China.

Nguyen et al. (2008) use the social role theory to explain these gender differences in ethical judgment. They claim that woman’s role in the society shape their attributes to become more socially oriented while men are assessed based on their aggressiveness in seeking success which promotes a different set of attributes such as self-reliance. Presented by different business scenarios, they find that women are more inclined to refute unethical situations in comparison to men. Similar results were found by Lund (2008).

**Methodology**

**Test Instrument and Subjects**

The Schwartz Value Survey (1992) was administered to upper division business majors in 2004 and 2010. The Schwartz Value Survey has 56 values which are grouped into 10 value types (see Appendix I). For each value, the student was asked to rate the importance of the value as a guiding principle in his or her life, on a scale of -1 to 7. A “-1” response means the value is opposed to the respondent’s values, a “0” means the value is of no importance, and a “7” means the value is of supreme importance. Scores between “0” and “7” reflect degrees of importance becoming more important as the number increases.

In 2004, 116 business majors completed the survey. Nine surveys were incomplete and therefore eliminated from the study, leaving 107 surveys for 2004 sample. There were 56 females and 51 males in sample with an average age of 28 years old. In 2010, 168 business majors completed the survey. Five surveys were incomplete and were eliminated, leaving 163 surveys for the 2010 sample. There were 87 females and 76 males in the sample with an average age of 24 years old. Both samples were from state universities. The sample from 2004 was from a state university in western United States with an average enrollment of 14,000. The sample from 2010 was from a state university in southern United States with an average enrollment of 11,000. Participation in the survey was voluntary and students were asked to complete the questionnaire during class time.

Mean-level changes on value are used to determine the change in the importance of a value for a group of subjects. As Rokeach (1973) suggests, changes in the mean-level of values
may result from an event experienced by all society. However, changes in rank-order may indicate that individual have experienced different events that cause a change in values. Therefore, both mean-level changes and rank-order changes are analyzed in this study.

The mean for each individual value was calculated. The individual value means were grouped into 10 value types developed by Schwartz & Sagiv (1995) and then further groups into 4 higher order values developed by Schwartz (1992). An analysis of variance, ANOVA, was performed to determine if significant differences existed between the years for each value and value type. The individual values, value types, and higher order values were ranked by their means to determine the most important to least important.

### RESEARCH QUESTIONS

Based upon the results of the literature review and using Schwartz's (1992) definition of values and value types (Schwartz & Sagiv, 1995), we form the following two research questions

- **RQ2**  Do business majors’ values, value types and higher order values change over time?
- **RQ2**  Are there differences in the importance of values between females and male business majors?

### Results

#### Research Question 1: Do business majors’ values, value types and higher order values change over time?

The top ten individual values, value types, and higher order values for business majors for each year are shown in Table 1. For individual values, Family Security is ranked the highest for both years. Of the top ten individual values, eight values are the same between the two years. Business majors in 2004 also include True Friendship and Intelligent among their top ten values. Loyal and Meaning in Life are ranked in the top ten for business majors in 2010.

Of the ten value types, only the last four are ranked similarly between 2004 and 2010. Hedonism is ranked the highest in 2004 and Benevolence is ranked the highest in 2010.

The higher order values show that Self-Transcendence is ranked highest for both years. Business majors in 2004 ranked Openness to Change higher than Conservation, however, the reserve is true for business majors in 2010, indicating that business majors place more importance on Conservation values.


<table>
<thead>
<tr>
<th>Table 1</th>
</tr>
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<tbody>
<tr>
<td>Top Ten Ranking of Individual Values: All Business Majors</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>RANK</th>
<th>VALUE</th>
<th>MEAN</th>
<th>RANK</th>
<th>VALUE</th>
<th>MEAN</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2</td>
<td>Healthy</td>
<td>5.9626</td>
<td>2</td>
<td>Freedom</td>
<td>6.1902</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Self-Respect</td>
<td>5.7850</td>
<td>3</td>
<td>Healthy</td>
<td>6.1840</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Enjoying Life</td>
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Of the 56 individual values in the survey, 41 values have significant differences (See Table 2). Within the top ten individual values of both groups (12 different values), eight were significantly different; Freedom, Self-Respect, Loyal, Family Security, Meaning in Life, Honest, Successful, and Ambitious. The means for all significant values have increased when 2004 is compared to 2010, indicating that business majors place greater importance in these values than they did in the past.

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Business Majors 2004 vs. 2010

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Nine out of ten value types are significantly different for business majors when 2004 is compared to 2010. Only Hedonism is not significant.

To further understand value changes, we compare within gender between 2004 and 2010 (i.e. females to females and males to males).

The top ten individual values for female business majors in 2004 and 2010 are listed in Table 3. Females from both years list Family Security, Healthy and Self-Respect as their top three values. Three other values are ranked in the top ten for both 2004 and 2010; Freedom, Honest, and Successful. Enjoying Life, True Friendship, Ambitious and Responsible are included in the top ten for female business majors in 2004 but not in 2010. While Meaning in Life, Choosing Own goals, A spiritual Life and Loyal are included in the top ten for female business majors in 2010 but not in 2004.
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### Ranking of Value Types: Female Business Majors

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### Ranking of Higher Order Values: Female Business Majors

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<td>5.8966</td>
<td>17.01</td>
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<tr>
<td>Choosing Own Goals</td>
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<td>7.82</td>
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</tr>
<tr>
<td>Healthy</td>
<td>5.8929</td>
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<td>0.0267</td>
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<tr>
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<tr>
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<td>6.1869</td>
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<tr>
<td>Obedient</td>
<td>3.9464</td>
<td>5.2529</td>
<td>21.06</td>
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</tr>
<tr>
<td>Helpful</td>
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<td>58.72</td>
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<tr>
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<td>0.0145</td>
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<td>VALUE TYPES</td>
<td>2004 MEAN</td>
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<td>F-Value</td>
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<tr>
<td>-----------------</td>
<td>-----------</td>
<td>-----------</td>
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<td>--------</td>
<td></td>
</tr>
<tr>
<td>Achievement</td>
<td>5.0670</td>
<td>5.6552</td>
<td>15.32</td>
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</tr>
<tr>
<td>Benevolence</td>
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<td>5.8161</td>
<td>16.89</td>
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<tr>
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<td>4.6161</td>
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<td>31.83</td>
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</tr>
<tr>
<td>Power</td>
<td>2.8333</td>
<td>3.6169</td>
<td>9.56</td>
<td>0.0024</td>
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<tr>
<td>Security</td>
<td>4.7571</td>
<td>5.2747</td>
<td>9.20</td>
<td>0.0029</td>
<td></td>
</tr>
<tr>
<td>Self-Direction</td>
<td>4.9893</td>
<td>5.4897</td>
<td>12.54</td>
<td>0.0005</td>
<td></td>
</tr>
<tr>
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<td>4.4904</td>
<td>7.78</td>
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</tr>
<tr>
<td>Tradition</td>
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<td>4.7241</td>
<td>29.94</td>
<td>&lt;.0001</td>
<td></td>
</tr>
</tbody>
</table>

Three value types are ranked the same for both years. Benevolence is ranked first, Self-Direction is ranked seventh, and Power is ranked last.

Female business majors in 2004 and 2010 rank Self-Transcendence higher than Self-Enhancement. However, female business majors in 2004 rank Openness to Change higher than Conservation, while the reverse is true for female majors in 2010. This indicates that values related to Conservation are more important to female business majors in 2010 than in 2004.

Thirty-one of the 56 individual values have significant differences (See Table 4). Within the top ten individual values for both groups (14 different values), seven values are significantly different; Healthy, Honest, Successful, Meaning in Life, Choosing Own Life, Loyal, and A Spiritual Life. Female business majors in 2010 rate these values as more important than female business majors in 2004.

Of the ten values types only Hedonism and University are not significant. The remaining eight value types are significantly different for female business majors in 2004 compared to female business majors in 2010.

Table 5 shows the ranking of the top ten individual values for male business majors by year. Family Security is ranked first in both years. In addition, seven other values are included in the top ten by both 2004 and 2010 male business majors; Healthy, Honest, Enjoying Life, Successful, Self-Respect, Freedom, and Loyal. Male business majors in 2004 also include Intelligent and Choosing Own Goals in their top ten values, while male business majors in 2010 include A Meaningful Life and Ambitious in their top ten values.

For value types, Hedonism is ranked first for 2004 and Benevolence is ranked first in 2010. Only Stimulation and Universal are ranked the same for 2004 and 2010, seventh and eighth, respectively.

Male business majors in 2004 compared to 2010 did not rank any higher order values similarly. While male business majors in 2004 place more importance to values related to Self-Enhancement and Openness to Change, business majors in 2010 place more importance to values related to Self-Transcendence and Conservation.
Table 5
Top Ten Ranking of Individual Values: Male Business Majors

<table>
<thead>
<tr>
<th>RANK</th>
<th>VALUE</th>
<th>2004</th>
<th>RANK</th>
<th>VALUE</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Healthy</td>
<td>6.0392</td>
<td>2</td>
<td>Freedom</td>
<td>6.2735</td>
</tr>
<tr>
<td>3</td>
<td>Honest</td>
<td>5.7451</td>
<td>3</td>
<td>Healthy</td>
<td>6.2222</td>
</tr>
<tr>
<td>4</td>
<td>Enjoying Life</td>
<td>5.7451</td>
<td>4</td>
<td>Honest</td>
<td>6.1026</td>
</tr>
<tr>
<td>5</td>
<td>Successful</td>
<td>5.7255</td>
<td>5</td>
<td>Enjoying Life</td>
<td>6.1026</td>
</tr>
<tr>
<td>6</td>
<td>Self-Respect</td>
<td>5.7059</td>
<td>6</td>
<td>Successful</td>
<td>6.0769</td>
</tr>
<tr>
<td>7</td>
<td>Intelligent</td>
<td>5.7059</td>
<td>7</td>
<td>Self-Respect</td>
<td>6.0256</td>
</tr>
<tr>
<td>8</td>
<td>Freedom</td>
<td>5.6471</td>
<td>8</td>
<td>Loyal</td>
<td>6.0085</td>
</tr>
<tr>
<td>9</td>
<td>Loyal</td>
<td>5.4902</td>
<td>9</td>
<td>Ambitious</td>
<td>5.8889</td>
</tr>
<tr>
<td>10</td>
<td>Choosing Own Goals</td>
<td>5.4706</td>
<td>10</td>
<td>Meaning in Life</td>
<td>5.8632</td>
</tr>
</tbody>
</table>

Ranking of Value Types: Male Business Majors

<table>
<thead>
<tr>
<th>RANK</th>
<th>VALUE TYPE</th>
<th>2004</th>
<th>RANK</th>
<th>VALUE TYPE</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hedonism</td>
<td>5.3824</td>
<td>1</td>
<td>Benevolence</td>
<td>5.6632</td>
</tr>
<tr>
<td>2</td>
<td>Self-Direction</td>
<td>5.0824</td>
<td>2</td>
<td>Achievement</td>
<td>5.6453</td>
</tr>
<tr>
<td>3</td>
<td>Benevolence</td>
<td>5.0667</td>
<td>3</td>
<td>Hedonism</td>
<td>5.6325</td>
</tr>
<tr>
<td>4</td>
<td>Achievement</td>
<td>5.0343</td>
<td>4</td>
<td>Conformity</td>
<td>5.4786</td>
</tr>
<tr>
<td>5</td>
<td>Security</td>
<td>4.7490</td>
<td>5</td>
<td>Self-Direction</td>
<td>5.4274</td>
</tr>
<tr>
<td>6</td>
<td>Conformity</td>
<td>4.7206</td>
<td>6</td>
<td>Security</td>
<td>5.3128</td>
</tr>
<tr>
<td>7</td>
<td>Stimulation</td>
<td>4.6536</td>
<td>7</td>
<td>Stimulation</td>
<td>4.7151</td>
</tr>
<tr>
<td>8</td>
<td>Universal</td>
<td>4.1569</td>
<td>8</td>
<td>Universal</td>
<td>4.5406</td>
</tr>
<tr>
<td>9</td>
<td>Power</td>
<td>3.7778</td>
<td>9</td>
<td>Tradition</td>
<td>4.5060</td>
</tr>
<tr>
<td>10</td>
<td>Tradition</td>
<td>3.5490</td>
<td>10</td>
<td>Power</td>
<td>3.8960</td>
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</table>

Ranking of Higher Order Values: Male Business Majors

<table>
<thead>
<tr>
<th>RANK</th>
<th>HIGHER ORDER VALUE</th>
<th>2004</th>
<th>RANK</th>
<th>HIGHER ORDER VALUE</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Openness to Change</td>
<td>4.8680</td>
<td>1</td>
<td>Self-Transcendence</td>
<td>5.1019</td>
</tr>
<tr>
<td>2</td>
<td>Self-Enhancement</td>
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<td>2</td>
<td>Conservation</td>
<td>5.0991</td>
</tr>
<tr>
<td>3</td>
<td>Self-Transcendence</td>
<td>4.6118</td>
<td>3</td>
<td>Openness to Change</td>
<td>5.0712</td>
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<tr>
<td>4</td>
<td>Conservation</td>
<td>4.3395</td>
<td>4</td>
<td>Self-Enhancement</td>
<td>5.0579</td>
</tr>
</tbody>
</table>

Of the 56 individual values, 15 are significantly different for male business majors in 2004 compared to male business majors in 2010 (See Table 6). Two values ranked in the top ten
individual values are significant; Freedom and Loyal. Male business majors in 2010 rank 14 values significantly higher than male business majors in 2004. One value, A Varied Life, is ranked significantly lower by male business majors in 2010 than in 2004.

Five value types are significantly different; Achievement, Benevolence, Conformity, Security, and Tradition.

<p>| Table 6 |
| Male Business Majors 2004 vs. 2010 |</p>
<table>
<thead>
<tr>
<th>VALUE</th>
<th>2004 MEAN</th>
<th>2010 MEAN</th>
<th>F-Value</th>
<th>PR &gt; F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freedom</td>
<td>5.6471</td>
<td>6.2500</td>
<td>5.93</td>
<td>0.0163</td>
</tr>
<tr>
<td>A Spiritual Life</td>
<td>3.2745</td>
<td>4.4079</td>
<td>9.17</td>
<td>0.0030</td>
</tr>
<tr>
<td>Social Order</td>
<td>3.9020</td>
<td>4.7368</td>
<td>7.53</td>
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<tr>
<td>Politeness</td>
<td>4.7255</td>
<td>5.6316</td>
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<td>0.0003</td>
</tr>
<tr>
<td>Reciprocation of Favors</td>
<td>3.9412</td>
<td>4.7500</td>
<td>7.82</td>
<td>0.0060</td>
</tr>
<tr>
<td>A World at Peace</td>
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<td>4.4473</td>
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<td>4.7451</td>
<td>4.0789</td>
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</tr>
<tr>
<td>Loyal</td>
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<td>5.9605</td>
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</tr>
<tr>
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<td>5.29</td>
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</tr>
<tr>
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<td>4.7632</td>
<td>13.91</td>
<td>0.0003</td>
</tr>
<tr>
<td>Accepting My Portion in Life</td>
<td>3.0980</td>
<td>4.0526</td>
<td>5.53</td>
<td>0.0202</td>
</tr>
<tr>
<td>Preserving My Public Image</td>
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<td>4.7632</td>
<td>13.72</td>
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<th>PR &gt; F</th>
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</table>

**Research Question 2: Are there differences in the importance of values between females and males business majors?**

The top ten individual values for females and males are ranked in Table 7. Family Security and Healthy are ranked first and second, respectively, by both females and males. Females and males share 6 other values in their top ten; Self-Respect, Freedom, Honest,
Enjoying Life, Successful, and Ambitious. Females include True Friendship and Choosing Own Goals in their top ten values, while males include Intelligent and Loyal in their top ten values.

<table>
<thead>
<tr>
<th>RANK</th>
<th>VALUE</th>
<th>MEAN</th>
<th>RANK</th>
<th>VALUE</th>
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<tr>
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<td>5.9718</td>
<td>5</td>
<td>Enjoying Life</td>
<td>5.9134</td>
</tr>
<tr>
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<td>6</td>
<td>Self-Respect</td>
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<td>7</td>
<td>Successful</td>
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<td>Successful</td>
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<td>8</td>
<td>True Friendship</td>
<td>5.7676</td>
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<td>Intelligent</td>
<td>5.7795</td>
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<tr>
<td>9</td>
<td>Ambitious</td>
<td>5.7394</td>
<td>9</td>
<td>Loyal</td>
<td>5.7717</td>
</tr>
<tr>
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</table>

<table>
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<th>RANK</th>
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<td>Benevolence</td>
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<td>Tradition</td>
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<td>Stimulation</td>
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<td>Tradition</td>
<td>3.9953</td>
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<td>Power</td>
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<td>Power</td>
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<table>
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<th>MEAN</th>
<th>RANK</th>
<th>HIGHER ORDER VALUE</th>
<th>MEAN</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Self-Transcendence</td>
<td>5.1186</td>
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<td>Openness to Change</td>
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<td>Conservation</td>
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<td>Self-Enhancement</td>
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<td>Openness to Change</td>
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<td>Self-Transcendence</td>
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<td>4.6797</td>
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<td>Conservation</td>
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</tr>
</tbody>
</table>
For value types, Benevolence and Hedonism is ranked first for females and males, respectively. Achievement, Self-Direction, Conformity, Security and Power are ranked the same by both females and males.

The higher order values show that Self-Transcendence is ranked higher than Self-Enhancement for female business majors while male business majors rank Self-Enhancement higher than Self-Transcendence. Conservation is ranked higher than Openness to Change for female business majors. Openness to Change is ranked the higher than Conservation for male business majors.

Of the 56 individual values, 16 are significantly different for female and male business majors (See Table 8). None of the significant differences are included in the top ten individual values for either females or males. The ten values ranked as more important by female business majors are Equality, Inner Harmony, A Spiritual Life, Sense of Belonging, A world at Peace, Social Justice, Protecting the Environment, Accepting My Portion in Life, Helpful, and Forgiving. In contrast, males rank these 6 values as more important; Social Power, Pleasure, An Exciting Life, Wealth, Authority, and Daring.

Four value types were significantly different for females and males; Benevolence, Power, Stimulating, and Universal.

<table>
<thead>
<tr>
<th>VALUE</th>
<th>FEMALE MEAN</th>
<th>MALE MEAN</th>
<th>F VALUE</th>
<th>PR &gt; F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equality</td>
<td>5.6923</td>
<td>5.0315</td>
<td>15.13</td>
<td>0.0001</td>
</tr>
<tr>
<td>Inner Harmony</td>
<td>5.6224</td>
<td>5.1102</td>
<td>7.88</td>
<td>0.0054</td>
</tr>
<tr>
<td>Social Power</td>
<td>2.2517</td>
<td>3.0394</td>
<td>9.43</td>
<td>0.0024</td>
</tr>
<tr>
<td>Pleasure</td>
<td>4.7413</td>
<td>5.0945</td>
<td>4.42</td>
<td>0.0363</td>
</tr>
<tr>
<td>A Spiritual Life</td>
<td>4.9720</td>
<td>3.9526</td>
<td>5.33</td>
<td>0.0217</td>
</tr>
<tr>
<td>Sense of Belonging</td>
<td>4.8671</td>
<td>4.4331</td>
<td>4.58</td>
<td>0.0333</td>
</tr>
<tr>
<td>An Exciting Life</td>
<td>4.8767</td>
<td>5.3465</td>
<td>6.73</td>
<td>0.0100</td>
</tr>
<tr>
<td>Wealth</td>
<td>4.1608</td>
<td>4.6417</td>
<td>4.87</td>
<td>0.0282</td>
</tr>
<tr>
<td>A World at Peace</td>
<td>4.7343</td>
<td>4.0787</td>
<td>8.21</td>
<td>0.0045</td>
</tr>
<tr>
<td>Authority</td>
<td>3.5175</td>
<td>4.0157</td>
<td>4.31</td>
<td>0.0388</td>
</tr>
<tr>
<td>Social Justice</td>
<td>5.0000</td>
<td>4.4094</td>
<td>8.80</td>
<td>0.0033</td>
</tr>
<tr>
<td>Daring</td>
<td>3.6084</td>
<td>4.3858</td>
<td>12.91</td>
<td>0.0004</td>
</tr>
<tr>
<td>Protecting the Environment</td>
<td>4.1469</td>
<td>3.6850</td>
<td>4.43</td>
<td>0.0362</td>
</tr>
<tr>
<td>Accepting My Portion in Life</td>
<td>4.2308</td>
<td>3.6693</td>
<td>4.40</td>
<td>0.0369</td>
</tr>
<tr>
<td>Helpful</td>
<td>5.3007</td>
<td>4.8346</td>
<td>6.30</td>
<td>0.0127</td>
</tr>
<tr>
<td>Forgiving</td>
<td>5.1049</td>
<td>4.6457</td>
<td>5.84</td>
<td>0.0163</td>
</tr>
</tbody>
</table>
### Discussion of Results, Limitations and Conclusions

Research question 1 explores whether changes in values occur for business majors between 2004 and 2010. The analysis shows business majors place increased importance in values over time. This increase in importance is also reflected in the rank-order of values. These findings are in accord with Hayden (2004), who claims that education creates an awareness of the ethical environment, which may contribute to changes in values. In addition, these results are consistent with Bardi et al. (2009). They find that student values changed over the course of one academic year.

Because both value type and higher order values are comprised of the individual values, we see similar changes in these two groupings. Our findings for the higher order values are inconsistent with that of other research. While Bardi et al. (2009) report that self-enhancement values increases while self-transcendence values decreases over time, our results show an increase in both higher order values.

The higher order value of Openness to Change includes the value types of stimulation and self-direction. These value types emphasize independent thought and embrace of new and exciting challenges. Education is thought to foster these values, especially since exposure to ethical issues can be found in today’s business curriculum. The higher order value of Conservation includes the values types of security, tradition and conformity. These value types promote stability of the society and tighter links to the existing organizations and structures. While our results show that business majors in 2010 increased the importance of both higher order values compared to 2004 business majors, the higher order values of Openness to Change and Conservation were reversed between the years. These findings imply that factors other than education may have altered the ranking by business majors. Potential increase in media awareness about negative events such as financial scandals, wars, or the decline in the economy might have shifted the importance of the values promoting conservation to a higher ranking in comparison to Openness to Change. This provides an opportunity for future research to understand whether these changes are cyclical in nature or whether they represent a permanent shift in social values.

The convergence of higher order values of females and males in 2010 is an interesting observation. The results in Tables 3 and 5 show that both females and males in 2010 have identical rankings of the higher order values (Self-Transcendence, Conservation, Openness to Change, Self-Enhancement).

<table>
<thead>
<tr>
<th>VALUE TYPE</th>
<th>FEMALE MEAN</th>
<th>MALE MEAN</th>
<th>F VALUE</th>
<th>PR &gt; F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benevolence</td>
<td>5.5650</td>
<td>5.3244</td>
<td>3.99</td>
<td>0.0468</td>
</tr>
<tr>
<td>Power</td>
<td>3.3100</td>
<td>3.8900</td>
<td>9.64</td>
<td>0.0021</td>
</tr>
<tr>
<td>Stimulating</td>
<td>4.2378</td>
<td>4.6929</td>
<td>7.78</td>
<td>0.0057</td>
</tr>
<tr>
<td>Universal</td>
<td>4.6722</td>
<td>4.3140</td>
<td>7.10</td>
<td>0.0082</td>
</tr>
</tbody>
</table>
The analysis of only males between 2004 and 2010 show some controversial results. Typically males are more inclined to adopt Self-enhancement values (Lan et al., 2013), which is confirmed when we compared females to males. However, this finding included all males from 2004 and 2010. When we examine the change in male values over time, we see a shift in ranking with male views of self-transcendence values becoming higher than self-enhancement values for the 2010 sample in contrast with our findings for the 2004 sample. A reason for this shift may be that the average age of males in 2004 is 35 years old while the average age of males in 2010 is 23 years old. Our interpretation of the 2010 results suggests that the younger sample of male business majors may not possess all the motivational interests that promote self-enhancement (such as career, social recognition, seeking power etc...) until a later stage of life. Our findings show that male students seek Achievement and Hedonism but not Power value types at this early stage of life. Future research is needed to examine these results to better determine the stage where males start seeking power and other values that constitute self-enhancement. These findings may also provide support for previous proposition that changes such as personal experience or the development of new opportunities may alter personal values (Schwartz and Bardi, 1997; Bardi et al., 2009; Rokeach, 1973).

Research question 2 explores the differences in values across gender. Our results confirm findings of previous research that value differences by gender exist at the individual value level and for value types. The major contribution of these findings is in regards to the higher order values. While female business majors adopted Self-Transcendence and Conservation values, we find that male business majors tend to embrace Openness to Change and Self-Enhancement. These findings are in accord with other studies (Nguyen et al., 2008; Schwartz & Rubel-Lifschitz, 2009; Lan et al., 2013). These findings confirm the natural orientation of females towards moral values that are linked with social welfare. They also confirm that males are more oriented towards values that promote individual success.

There are a couple limitations to this study. First, the 2004 and 2010 subjects come from different locations. This is not a critical limitation since the Schwartz Value Survey has shown an acceptable level of consistency when applied to different cultures. Second, we were unable to employ a longitudinal analysis of value changes while using the same subjects over time because we wanted to provide a reasonable time separation between the two samples. Additional confounding factors may have been introduced if we examined the same sample in 2010 as in 2004 due to the change in the status of the 2004 subjects from students to professionals.

To conclude, our findings provide further evidence that changes in values can occur over time and that awareness of ethical issues and life experiences may act as a catalyst for change. Second, while ethical differences across gender exist, they may also imply that we are witnessing a convergence of higher order values between males and females in the 2010 samples. This leads us to refute the previous paradigm that males place higher emphasis on values promoting self-interest. Additional research is needed to explore some of these findings and better understand the determinants of value change over time.
REFERENCES


Appendix I

Year of Birth: ________________
Sex: Male: _______ Female: _______
Major: ________________

In the space before each value, write the number (-1,0,1,2,3,4,5,6,7) that indicates the importance of that value for YOU, personally. *Try to distinguish as much as possible between the values by using all the numbers.* You will, of course, need to use numbers more than once.

AS A GUIDING PRINCIPLE IN MY LIFE, this value is:

<table>
<thead>
<tr>
<th>Opposed to my values of importance</th>
<th>Not important</th>
<th>Important</th>
<th>Very important</th>
<th>Of supreme importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>-1</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>

Before you begin, read the values listed below. Choose the one that is most important to you and rate its importance. Next, choose the value that is most opposed to your values and rate it -1. If there is no such value, choose the value least important to you and rate it 0 or 1. Then rate the rest of the values.

1. _______ EQUALITY (equal opportunity for all)
2. _______ INNER HARMONY (at peace with myself)
3. _______ SOCIAL POWER (control over others, dominance)
4. _______ PLEASURE (gratification of desires)
5. _______ FREEDOM (freedom of action and thought)
6. _______ A SPIRITUAL LIFE (emphasis on spiritual not material matters)
7. _______ SENSE OF BELONGING (feeling that others care about me)
8. _______ SOCIAL ORDER (stability of society)
9. _______ AN EXCITING LIFE (stimulating experiences)
10. _______ MEANING IN LIFE (a purpose in life)
11. _______ POLITENESS (courtesy, good manners)
12. _______ WEALTH (material possessions, money)
13. _______ NATIONAL SECURITY (protection of my nation from enemies)
14. _______ SELF-RESPECT (belief in one’s own worth)
15. _______ RECIPROCATION OF FAVORS (avoidance of indebtedness)
16. _______ CREATIVITY (uniqueness, imagination)
17. _______ A WORLD AT PEACE (free of war and conflict)
18. ______ RESPECT FOR TRADITION (preservation of time-honored customs)
19. ______ MATURE LOVE (deep emotional and spiritual intimacy)
20. ______ SELF-DISCIPLINE (self-restraint, resistance to temptation)
21. ______ DETACHMENT (from worldly concerns)
22. ______ FAMILY SECURITY (safety for loved ones)
23. ______ SOCIAL RECOGNITION (respect, approval by others)
24. ______ UNITY WITH NATURE (fitting into nature)
25. ______ A VARIED LIFE (filled with challenge, novelty and change)
26. ______ WISDOM (a mature understanding of life)
27. ______ AUTHORITY (the right to lead or command)
28. ______ TRUE FRIENDSHIP (close, supportive friends)
29. ______ A WORLD OF BEAUTY (beauty of nature and the arts)
30. ______ SOCIAL JUSTICE (correcting injustice, care for the weak)
31. ______ INDEPENDENT (self-reliance, self-sufficient)
32. ______ MODERATE (avoiding extremes of feeling and action)
33. ______ LOYAL (faithful to my friends, group)
34. ______ AMBITIOUS (hard-working, aspiring)
35. ______ BROADMINDED (tolerant of different ideas and beliefs)
36. ______ HUMBLE (modest, self-effacing)
37. ______ DARING (seeking adventure, risk)
38. ______ PROTECTING THE ENVIRONMENT (preserving nature)
39. ______ INFLUENTIAL (having an impact on people and events)
40. ______ HONORING OF PARENTS AND ELDERS (showing respect)
41. ______ CHOOSING OWN GOALS (selecting own purposes)
42. ______ HEALTHY (not being sick physically or mentally)
43. ______ CAPABLE (competent, effective, efficient)
44. ______ ACCEPTING MY PORTION IN LIFE (submitting to life’s circumstances)
45. ______ HONEST (genuine, sincere)
46. ______ PRESERVING MY PUBLIC IMAGE (protecting my ”face”)
47. ______ OBEDIENT (dutiful, meeting obligations)
48. ______ INTELLIGENT (logical, thinking)
49. ______ HELPFUL (working for the welfare of others)
50. ______ ENJOYING LIFE (enjoying food, sex, leisure, etc.)
51. ______ DEVOUT (holding to religious faith and belief)
52. ______ RESPONSIBLE (dependable, reliable)
53. ______ CURIOUS (interested in everything, exploring)
54. ______ FORGIVING (willing to pardon others)
55. ______ SUCCESSFUL (achieving goals)
56. ______ CLEAN (neat, tidy)
Value Types
(Schwartz & Sagiv 1995)
Values for Each Type Shown in Parentheses

Achievement: Personal success through demonstrating competence according to social standards. (Successful, Capable, Ambitious, Influential)

Benevolence: Presentation and enhancement of the welfare of people with whom one is in frequent personal contact (Helpful, Honest, Forgiving, Loyal, Responsible)

Conformity: Restraint of actions, inclinations, and impulses likely to upset or harm others and violate social expectations or norms. (Politeness, Obedient, Self-Discipline, Honoring Parents and Elders)

Hedonism: Pleasure and sensuous gratification for oneself. (Pleasure, Enjoying Life)

Power: Social status and prestige, control or dominance over people and resources. (Social Power, Authority, Wealth)


Self-Direction: Independent thought and action-choosing, creating, exploring. (Creativity, Freedom, Independent, Curious, Choosing Own Goals).

Stimulation: Excitement, novelty and challenge of life. (Daring, A Varied Life, An Exciting Life)

Tradition: Respect, commitment, and acceptance of the customs and ideas that traditional culture or religion impose of the self. (Humble, Accepting My Part in Life, Devout, Respect for Tradition, Moderate)

DEPOSIT INSURANCE, CONSOLIDATION AND THE BANKER’S OMBUDSMAN IN THE MODERN LAW OF BANKING IN NIGERIA: A CRITICAL PERSPECTIVE

Ayuba O. Giwa, Delta State University, Abraka, Nigeria
Peter A. Aghimien, Indiana University South Bend

ABSTRACT

The Nigeria Deposit Insurance Corporation Act brought about a sweeping revolution into the banking industry in Nigeria. It marked a watershed in the law and practice of banking in Nigeria. It redefined a banker customer relationship from its primordial bi-lateral contact of uberimae fidei between the banker and the customer, to something else. It has in a unique way, driven a coach and horses through the traditional and otherwise settled privity of contract doctrine with the establishment of a bankers’ Ombudsman or Commission. This paper sets out to ascertain the law’s sphere of influence including what the insurance is all about, the consolidation that followed, and the challenges still subsisting. It takes a critical look at the idea of the law vis a vis its practical purposes and achievements and constraints. The paper is an essay into an emerging banking global best practice of insuring monies deposited in banks from the perspective of a developing economy. Additionally, it is essentially a dissection and analysis of the mainstream statute in the area with a tilt of censorial jurisprudence aimed at properly positioning the all-important phenomenon of deposit insurance and the challenges of consolidation and Banking Supervision. The paper will be of use to legislators, legal draftsmen, professional and occupational bankers, lawyers, academicians, and people interested in the Nigerian banking enterprise. It is aimed at surer and greater investor protection, more certainty in the rules of engagement of operators in the banking industry, and invariably an improved economy.

Keywords: Banking, Financial institutions, Insurance, Deposit Insurance

INTRODUCTION

The internationalization of the concept of Deposit Insurance in banks came in the wake of the formation of the International Association of Deposit Insurance (IADI) in Basle, Switzerland in May 2002. Nigeria was one of the foundation members. Since then, the concept has grown worldwide with the participation of nearly 69 Deposit Insurers out of the nearly 210 countries and territories in the world¹ Nigeria has recorded quite some appreciable successes since the
constitution of its own Deposit Insurance Corporation known as and called the Nigeria Deposit Insurance Corporation with the acronym of NDIC. These successes are mainly in the areas of the eradication of the collection of deposits by non-bank institutions and unlicensed ventures known in the local parlance as “Wonder-Banks,” improved Disciplinary and Penal provisions in the emerging Regulations, consolidation and improved capitalization of banks, a remarkable reduction in the number of participating corporate bodies in the banking business, and of course the payment of some dividends to depositors of some of the failed banks. Notwithstanding these apparent successes, it is clear that challenges still exist in the continued efforts at protecting depositors’ funds in banks worldwide. This work is a Nigeria perspective of new safety net device and its continued challenges. The work briefly examines the antecedents to this new era and the consolidation of banks that took place with the emergence of the new legal regime. Its actual and potential problems are analyzed with recommendations for possible improvement.

**Brief Antecedents to the Banking Innovation Brought About By the Emergent Law on Deposit Insurance in Nigerian Banks**

Prior to 1990, banking business in Nigeria did not involve any form of insurance of funds placed in banks. This was because the two main stream statutes that regulated the industry at the time did not provide for any such insurance. The Central Bank of Nigeria Act apart from governing the operations of the Central Bank and empowering the institution to generally supervise and oversee the activities of the commercial banks, did not require that deposits in banks be insured in any form and to any degree or extent whatsoever. Of course, the Banking Act of 1969 was a relic of the Civil War that took place in the country and was principally aimed at converting the nomenclature of the Nigerian currency or legal tender from “Pounds” to a new name coined from the Country’s name i.e. “Naira”. The Nigerian Currency or legal tender notes still bear that name till date.

Apart from the existing laws at the time not requiring deposits placed in banks to be insured, they did not also have the provisions and mandate to impose limits in the number of corporate bodies that went into the banking business. Such limitation being achievable by statutory requirements pegging minimum cash deposits to secure payments of some dividends to depositors in the event of liquidation, and the outright rejection of applications for participation in the industry on grounds of inadequate safety net requirements to prevent failures or bankruptcy. The point must also be made that the Bills of Exchange Act did not and could not have provided for any such structural regulation of participating institutions in the money market as the law dealt solely with operational instruments in the market, i.e. bills of exchange and negotiable instruments as the title depicts.
THE ABUSES

Now, banking business is statutorily defined as follows in Nigeria12;

“Banking business” means the business of receiving deposits on current account, savings account or other similar account, paying or collecting checks drawn by or paid in by customers, provision of finance or such other business as the Government may, by order published in the Gazette designate as banking business.

The net result of all of the above legal provisions before the enactment of the law on deposit insurance is that banking or banking business became nearly an all comer’s affair. Every corporation that could manage to own a fairly sizeable safe box or strong room or vault went into the banking business. Indeed some individuals even without any corporate veils went into the business. The scenarios as painted in one of Nigeria’s leading newspaper13 at the time were bizarre and frightening.

Naturally following on the mass entrants of participants largely ill equipped and profit driven without safety net guarantees, was the equivalent mass failure of such participating ventures. This failure was bi focal. First, the regular operators who were not properly supervised mismanaged or out rightly embezzled to naught, the deposits placed with them, which led their operations to fail.

Secondly, new participants came into the arena with diverse, dubious and devious techniques that crystallized in their eventual nomenclature of “wonder banks.”14 No doubt this created doctrinal distortions to the hitherto settled notions of banking and or banking business.

Arising from the above bi focal points of view, it became imperative that the legal regime for the industry be reviewed, revised, and enhanced. The aims of such review being essentially to prevent the unsuspecting investing public from the eventual loss of their funds when these banks fail. Progressively, therefore, the mainstream laws were amended and the new law of deposit insurance came into being. It is an aspect of it that is the main focus of this work. That is to say, the aspect requiring the insurance of institutions participating in the business, and the actual and potential challenges ensuing.

The focus of the new

The Nigerian Deposit Insurance Corporation Act15 was one of the foremost innovations introduced into the banking industry in Nigeria in the wake of the problems and doctrinal distortions mentioned above. The main focus of the law as already noted was to key into the emergent global best practices in the banking industry of deposit insurance and other safety net requirements such as more detailed supervision of participating corporations/companies.
Primarily the Act establishes a body that is more or less an ombudsman\textsuperscript{16} for the industry. It makes mandatory the insurance of funds deposited in banks with the said ombudsman and confers extensive powers of supervision both structural and operational on it. Powers ample and plenary enough to include withdrawal of operators from the money market, winding up and liquidation of companies hitherto licensed to so participate. That is the Act or law in substance.

In outline, the last amendment as contained in the Federal Republic of Nigeria Official Gazette\textsuperscript{17} is divided into twelve parts. It has 60 sections and a number of subsections. Parts I to III of the Act essentially establish the Deposit Insurance Corporation\textsuperscript{18} and enact provisions for the composition of its board as well as corporate governance. Part IV deals with the main theme of the Act, going by its nomenclature, although that nomenclature is deceptive as it tells only half of what the Corporation is. This part i.e. IV makes provision for the “Deposit Insurance Scheme”. Parts V to IX elaborate extensively on the regulatory and supervisory powers of the corporation or ombudsman. This is why the point was muted a while ago that the nomenclature of the corporation is deceptive\textsuperscript{19}. Whereas only one part (Part IV) of the law is devoted to “deposit insurance scheme,” five parts are devoted to supervision. Part X of the Act is a tool put in the hands of the ombudsman to enable it not just to bark but also to bite. This part creates a whole new code of criminal law in this specialized area aimed at penalizing transgressors of the Act or any regulations made pursuant to the Act. Part XI appears to set up accounting templates in a special way for the insured institutions while part XII the last part deals with provisions that are prohibitory in nature while others are empowering. Prohibitory such as forbidding advertisement of sorts specified in the law and empowering such as engenders synergy and cooperation amongst other regulatory bodies such as the Central Bank of Nigeria.

**Re-Positioning and Consolidation of the Banks**

In this regard, the law provides that all licensed banks and other financial institutions must insure their deposits with the corporation. Incidentally, there are no unlicensed banks operating in Nigeria. Even where there are, they do not operate in the open. After the clamp down on pyramid investment schemes or wonder banks in the early 90s in the country, it is doubtful if any other body corporate or individual has tried it again. Except now that outfits hitherto known as community banks are called micro finance institutions, it would have been difficult to imagine what other bodies would be required to insure their deposits if not banks. As community banks, they were not covered by the deposit insurance scheme until recently. Basically, it is mandatory for all licensed banks to insure their deposits with the corporation. Failure to do so amounts to carrying on banking business in an unsafe manner for which the bank’s operating license can be withdrawn.

Granted that the powers to withdraw the operating license of a bank can be exercised on grounds of carrying on the business of banking in an unsafe manner, it is still pertinent to observe that the penalty stipulated in section 15(1) (b) of the Act is grossly inadequate. What is
meant here is that the stipulated penalty of N1, 000.00 (One Thousand Naira) less than seven US dollars per day for failing to insure deposits, is not sufficiently deterrent.

At that rate, the operator will pay only N366, 000.00 or less than USD2, 600 in a year of operating without insurance. During the days of the “Wonder banks”, three months or 90 days was sufficient for them to rake millions of Naira or dollars into their coffers. If the penalty were to be as stipulated above, and alone, they would have remained in business till date.

It is therefore humbly submitted that the penalty of N1, 000.00 per day for failing to insure deposits by a participating institution is grossly unrealistic and should be revised upwards. Such revision should state a ratio of the deposits so accumulated as the penalty. For example 50% or more to serve as severe and effective deterrence.

It is arguable that such an unsafe practice bearing next to nothing as penalty is responsible for the sheer number of participating banks turnover in the country. The enforcement of this provision led to the mergers and consolidation that significantly reduced the number of participating institutions or banks in the industry as demonstrated below.

Insured Banks/Institutions

After all efforts and at the last count, they came to 89. From that 89, they came to 25. They are now 24. The table below shows the present participating institutions in the exercise after the sweeping consolidation and falling aside of some of them.

Note that it was only recently, (2012) that Oceanic Bank was consolidated with Ecobank following the withdrawal of the license of Oceanic Bank due to its failure to comply with this Deposit Insurance Requirement of its insurable deposits.

Section 20 of the Act provides for the insurable deposits covered by the scheme. The most outstanding feature of this definition or description is that insider deposits and double accounts with a right of counter claim on each against the other by holders thereof are exempted from coverage. Participating banks or institutions would cease to be so under the provisions of section 22 of the Act as hereinafter discussed.

Grounds for the above shrinkage (mergers/consolidations)

It is obvious from the provisions of section 22 of the Act, that is the only authority for the shrinkage tabulated above. Whenever it appears to the Corporation that an insured bank or its directors or trustees have committed a grievous violation of its obligations arising from the Act, or have continued to conduct the business of the bank in an unsound manner; or intentionally or negligently permitting any of the officers or agents of the insured bank to violate any provisions of any law or regulation to which an insured bank is subject, such as the Central Bank of Nigeria Act or the BOFIA or any other law, the Corporation shall serve on the board of the insured bank a warning notice. The notice shall state that where the unsound practice continues, the
name of the bank shall be removed from the register of insured banks. The corporation shall forward a copy of such warning notice to the Central Bank of Nigeria and the Minister.

<table>
<thead>
<tr>
<th>THE OLD BANKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Access Bank</td>
</tr>
<tr>
<td>3. Afribank Nig. Plc.</td>
</tr>
<tr>
<td>4. ACB Int. Bank</td>
</tr>
<tr>
<td>13. Center Point Bank</td>
</tr>
<tr>
<td>14. Chartered Bank</td>
</tr>
<tr>
<td>16. City Express Bank</td>
</tr>
<tr>
<td>17. Continental Trust Bank</td>
</tr>
<tr>
<td>22. Eagle bank</td>
</tr>
<tr>
<td>24. EIB Int.</td>
</tr>
<tr>
<td>26. Equity Bank</td>
</tr>
<tr>
<td>27. FBN (Merchant Banker)</td>
</tr>
<tr>
<td>29. First Atlantic Bank</td>
</tr>
<tr>
<td>30. First Bank of Nigeria</td>
</tr>
</tbody>
</table>

Examples of such grievous violation of obligations under the Act include
a) Where an insured bank persistently suffers liquidity deficiency in a sustained manner.
b) Where an insured bank persistently contravenes the provisions of the Banks and other Financial Institutions Act, and any rules and regulations made thereunder, the monetary policy guidelines and the provisions of the Nigeria Deposit Insurance Act.  

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c) Making incomplete or incorrect statements to the Nigeria Deposit Insurance Corporation also amount to a violation of obligations on the part of an insured bank.
d) Where an insured bank is in default with the payment of its insurance with the corporation and its contract of insurance is terminated by the NDIC.
e) It continues to hold itself out as an insured bank after its insurance with the corporation has been terminated for default as above.
f) If an insured bank habitually fails to render returns to the corporation or does not submit upon request, such other information for the efficient performance of the functions of the insurance corporation it will amount to unsafe practice.
g) Making incorrect statements to the Corporation as regards customer’s deposits it has insured, amounts to an unsafe practice.
h) Where it fails to write adequate provisions for bad and doubtful debts up to the amount recommended by the Corporation or pays dividends in defiance of this provision: it would have breached its obligations.
i) Failure to write off bad debts as may be recommended by the corporation, amounts to a breach of obligation.

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Steps towards Removal

Where the insured bank fails within a reasonable time to make amends sequel to the above breach of obligation, the board of the NDIC shall:

a) Give to the bank not less than thirty days written notice of its intention to terminate the status of the bank as an insured bank; and

b) Fix a time and place of hearing before a person designated by the board to conduct the hearing at which evidence may be produced and upon such evidence, the board of the NDIC shall make its findings, which shall be final on the question of the removal of a bank from the list of insured banks.
Where the bank is not duly represented at the hearing by an authorized representative of
the accused bank, it shall be deemed to have consented to the termination of its status as an
insured bank and the corporation shall inform the Central Bank of Nigeria and the Minister of
Finance of the decision34.

The corporation shall cause a notice of such termination to be published in the national
newspapers35.

Where the participation of a bank in the Corporation’s insurance scheme is terminated,
the bank shall immediately cause a notice of such termination to be published in the national
newspapers to the creditors to whom liabilities are owed and in furtherance thereto, bring the
consequences36 of such termination to their notice34.

After the termination of the status of an insured bank under subsection (3) of section 22,
the insured deposit of each depositor in the bank on the date of its termination, less all
subsequent withdrawals from the deposits of such depositor, shall continue to be covered for
another period of two years, and thereafter such depositor shall cease to be covered where the net
assets are sufficient to meet the insured deposit38.

The corporation shall not insure any sums in addition to any deposits specified in
subsection (7) of above or any new deposits in the bank made after the date of determination of
its status as an insured bank and shall not advertise or hold itself out as having insured deposits36.

Where an insured bank is closed on account of its inability to meet the demands of its
deposits, the corporation shall have the powers and rights to recover any debts owed to the
closed bank or any assets (including properties belonging to the closed bank) but which are in
possession of any other person or institution, whether depositors of the bank or not37.

Where the insured status of a bank is terminated by reason of its inability to meet the
demand of its depositors, the Minister shall appoint the Corporation as the receiver for the bank
apparently pending ratification of the court38.

Removing from List of Insured

This is a very dangerous provision. Dangerous in many senses
a) Such a notice of intention to remove from the list of insured banks if leaked or known
to the public will be sufficient to ground the bank in question. This is because most
depositors will go there to withdraw their deposits and the bank would collapse.
b) The notice of removal from the list of insured banks is as good as a withdrawal of a
bank’s license though the law requires that the “cease and desist” or warning be
served three consecutive times before the notice is served on the bank. It does not
state or spell out what rights if any a bank or banker has by way of a challenge of the
issuance of such notice.
c) For such a serious procedural requirement, the mode of service of the notice on the insured bank ought also to be spelt out in the law to avoid the possibility of what is suggested above. For example, by delivery to either the Managing Director personally or by registered post or courier post addressed to that office. This will also ensure a safeguard on the possibility of the notice leaking out to the public through an irresponsible junior officer or employee.

The inherent dangers highlighted above stem from the fact that the notice of intention is not the same as the subsequent enactments in section 22 of the law\(^4\) which spell out in details the steps towards such removal, the antecedents and consequences.

The question therefore is whether the provisions of section 4(h)\(^4\) should exist side by side with the provisions of section 22\(^4\). Certainly section 22\(^4\) being later in time and more comprehensive will be deemed to have over taken or to supersede section 4(h)\(^4\). It is therefore submitted that section 4(h)\(^4\) is superfluous and unnecessary to the extent that it provides for the notice of intention to remove from the list of insured banks. In other respects, i.e. the provisions relating to the “cease and desist” order, the sub section makes sense particularly with the suggested amendment to make it easier and clearer to understand and comply with.

**Getting Back To the List And Out Of “A Death Sentence”**

This is provided for in section 23 of the Act\(^5\). As a matter of fact section 23(i) a, b & c and the other provisions of section 23 i.e. 23(2) and (3) appear to be medicine after death. They ought not to be part of section 23(i) or lumped together. 23(i) presupposes that the bank is seeking to resurrect. 23(2) and (3) appear to be calling on the Deposit Insurance Corporation to take steps and measures to resurrect it. What if it is unable to stand? Why would the provisions of 23(2) and (3) not come before 23 stating the grounds for removal? Why should a bank whose name has been withdrawn from the list of insured banks remain in business for the purpose of sections 23 to apply to it? Which members of the public would leave their funds or deposits voluntarily in banks that have been visited with section 22 orders and decisions to await section 23? In any event and for whatever they stand for, the provisions of section 23 are set out below: -

23(i) A bank whose status as an insured bank is terminated in accordance with section 22 of this Act, may re-apply to participate in the Corporation after the terminated bank has satisfied all the conditions required of it by the Board, particularly after the Board has given consideration to the following, that is: -

a) The financial position and its general operational practice since the termination order became effective;

b) That the grounds for which the bank’s participation in the corporation was terminated have been satisfied; and
c) The future earnings prospects and general character of its management are satisfactory.

2) Pursuant to paragraph (b) of section 5 of this Act, the corporation shall at the request of an insured bank and under such conditions as may be specified by the corporation, assist the bank if it-
   a) Has difficulty in meeting its obligation to its depositors and other creditors; or
   b) Persistently suffers liquidity deficiency; and
   c) Has accumulated losses which have nearly or completely eroded the shareholders fund.

3) The corporation may take one or a combination of actions or any of the following to assist a failing bank, that is-
   a) Grant loans on such terms as may be agreed upon by the Corporation and the failing bank;
   b) Give guarantee for a loan taken by the insured bank;
   c) Accept an accommodation bill with interest, for a period not exceeding ninety days maturity, exclusive of days of grace and subject to renewals of not more than four times.
   d) Subject to the approval of the Minister on the recommendation of the Central Bank of Nigeria.

i) Take over the management of the bank until its financial position has substantially improved or
ii) Arrange a merger with another bank or management of the bank within such time as the corporation may specify; or
iii) Arrange a merger with another bank or contract to have the deposit liabilities assumed by another insured bank; in which case, the receiving banks shall assume all the recorded deposit liabilities of the failing banks.

4) The receiving bank shall receive those assets of the failing bank that are acceptable and an amount equal to the difference between the assumed deposit liabilities and acceptable assets shall be advanced to the receiving bank or purchase the unacceptable assets from the failing bank.

5) The corporation shall receive unacceptable assets of the failing bank and regard such assets as collateral of the advance to the receiving bank or purchase the unacceptable assets from the failing bank.
The provisions enable the NDIC to take over the management of the failing bank in the first instance and where it is unable to survive, take over its assets. It also has the powers to make specific changes in the management structure of the bank and within a specific time too. Where necessary and possible, it can also arrange a merger of the ailing bank with another bank. The recent consolidations and mergers by banks in Nigeria that were caught by the N25 billion minimum capital requirement aptly demonstrates the role mergers can play in saving banks that would otherwise be liquidated. This was largely responsible for sustaining the number of banks up to the 24 that they are now from nearly 90. Practical examples include the U.B.A. (United Bank for Africa) merger with Standard Trust Bank, retaining the name of UBA as a mega bank. The Platinum Bank merger with Habib Bank and forming an acronym from their two names as Platinum Habib Bank, or Bank PHB. Unity Bank came out of a merger of nearly seven banks including New Nigeria Bank, Bank of the North and others. The end point is that the key to viable banking and a stable money market in the economy is regulation. That is to say, regulation by law such as this Nigeria Deposit Insurance Act.

Subsisting/Potential Problems/Challenges

Unfortunately and as will be seen presently, actual and potential challenges subsist in the industry notwithstanding the above. Some of these challenges may be extrinsic to the legal framework itself but others are not. They are quite intrinsic.

The new legal regime being novel and experimental and ever changing, it will be very pertinent to highlight dangers ahead even if it is not conceded that they are flip sides of the advancements or achievements. These dangers range from the present ownership structure, management problems, legislative shortcomings, judicial constraints, political and policy inconsistencies and the ever consuming and or swallowing effect of internationalization or globalization in an ever shrinking global village theatre where third world countries must play the second or third fiddle. It is proposed to succinctly comment on these shortcomings or challenges in the succeeding part of this work.

1. The Negative Effective of the Present Ownership Structure arising From Re-Capitalization and Consolidation Exercise

We have seen the ownership of banks move from individuals to families; families and few friends, State Governments and now the public at large. At the inception of the N25 billion minimum share capital requirements for banks, it was common knowledge that the erstwhile owners, try as they could, were not able to personally raise the capital. They were forced by circumstances of the law, to resort to the capital market to raise the differences, which were substantial. By means of mind catching and highly imaginative and tempting press campaigns through advertisements in the print and electronic media**, they successfully cornered and
acquired huge amounts from the public. Those who could not make it that way sought umbrage under those who could and either gave up their names or their identities in lieu thereof. The others fell bringing the number at the end of the day to 24.

The net result of this highly expensive experiment is the virtual transfer of ownership of the surviving banks from individuals and arrowheads\textsuperscript{47} to the fluid public\textsuperscript{48}. The further result of this result is that those who would hitherto have been held squarely responsible for the activities of the companies – nay banks when the need to lift their veils of incorporation\textsuperscript{49} arose have now successfully melted into mere directors and or shareholders. It is dangerous for an imperfect and embryonic bureaucracy and system like Nigeria’s. Under so called perfect or developed systems like the United States of America and Asia, Mega corporations under the full glare of regulatory “police” and “super police” institutions\textsuperscript{50} have been seen to fail and fail woefully, and be wiped out of the surface of the business earth\textsuperscript{51}. Two good examples in recent times are the ENRON Corporation in the U.S, whose chief executive was found due for a 30 years jail term\textsuperscript{52}. Investments, pensions, hopes, aspirations \textit{et al} perished with the Enron collapse. Who knows whether the death of some of the investors, employees and pensioners, directly or indirectly would not have followed between 2004 and 2006 when the trial of the officers commenced and concluded? Particularly that of Kenneth Lay the Chief Executive Officer (CEO) and founder.

Again, in respect of Daewoo Corporation of Korea, the Guardian Newspaper\textsuperscript{43} reported that Kim Woo-Chong the founder of Daewoo Corporation worldwide, was;

a) Sentenced to 10 years in jail after running from the law or justice for 6 years for embezzling the company’s funds. And that

b) The 69 years old was also to hand over the sum of 12 billion pounds and fined the same.

The Mega Corporation collapsed in 1999 with a debt of 80 billion USD\textsuperscript{54} At its peak, it employed 320,000 people in 110 countries. The Company the Guardian reported started encountering problems after it borrowed money in the 1990s to finance expansion.

The point being made and the illustration being drawn is that size or large size by itself is not a guarantee to prevent failure. Huge and massive recapitalization if not properly managed can spell doom for a company and nay a nation’s economy. One man is alleged to have stolen 12 billion pounds. One billion pounds is more than about 200 billion naira. Two hundred billion naira equals the capitalization of 8 banks at N25 billion each. It would therefore take less than a quarter of what was stolen in Daewoo to collapse all the banks in Nigeria. Needless to say that Nigerians from history may even be more heartless than Koreans when dealing with their fellow Nigerians. Many Nigerians exist who will not flinch at stealing 3 or 4 billion pounds even if it would mean the entire national economy collapsing, provided they have it to enjoy with members of their families in other people’s countries. The final word here therefore is that: Vigilance and not size should be the watchword for the banking industry in Nigeria. This is one
of the flip side of the much touted re-capitalization and increased capitalization and consolidation. We must move on nonetheless.

2. Management Problems as a Factor in Bank Distress and Failures

It is very tempting to ask if any other problem can be responsible for bank distress and failures other than arising from management. The simple response to such enquiry would be that factors such as adverse political\textsuperscript{58} and economic\textsuperscript{56} climates, uncertain legislative terrain\textsuperscript{57} and inclination to fraud\textsuperscript{58} though capable of breeding poor management are not themselves rooted in poor management. Again cultural and attitudinal disposition of the borrowing public and customers resulting in horrible debt profiles cannot be rested squarely on the shoulders of management. Turpsy turvidious legislations and imprecise and shifting supervisory policies are equally not direct management oriented problems although they aggravate and in some cases cripple the situation. An ill equipped and corrupt judiciary charged with the interpretation (or misinterpretation) of banking laws is certainly a problem extrinsic to management.

The above notwithstanding the question remains very pertinent that it is difficult if not unrealistic to seek to explain away bank failure/distress in contemporary times without reference to management\textsuperscript{59}. This problem can arise as a result of any or many of several aspects. The point remains that howsoever arising, the belief is strong that prudent, ardent, efficient proficient, articulate, purposeful and professional management can have and surely has the effect of bringing into play, what in the law of tort is regarded as the last opportunity rule in the tracing of the cause of an accident. That is, who had the last opportunity to avoid the debacle or disaster or failure? Can it be the politician, the legislator or lawmaker, the supervisory authorities, the interpreting authorities, the customer or lending public or the manager. It seems that it must be the manager.

Management problems can arise from any of the causes already observed\textsuperscript{60}. Apparently, these would include

(i) Poor training of management personnel.
(ii) Inherent ineptitude of even those trained.
(iii) Non professionalism of management personnel.
(iv) Endemic corruption or ill motivation.\textsuperscript{61}

The end result of the application of any of the above defects to management is the making or taking of wrong or fatal decisions or in some cases inexplicable decisions. When management decisions are patently wrong or otherwise inexplicable or fatal, the institution on behalf of whom or which such decisions are taken is usually the one that bears the brunt. The brunt of such decisions to banks, dovetails in all cases to loss of capital or customers which amounts to the same thing either in the short run or in the long run. Sometimes this can result in sudden distress or death or failure of the bank in question.
Empirical observation will show that in Nigeria today, no less than 80% of the employees of most of the banks had no previous training in banking and the running of financial institutions before they got employed as such employees. They were mostly recruited into the services after their secondary school education particularly where they had credits or distinctions in mathematics or other arithmetical courses at the ordinary level. Thereafter, they are put through or shown routine jobs or transactions by persons like themselves but employed earlier in time. In due course they are with luck elevated into supervisory positions and thence into management positions to make professional decisions for the continued existence of the banks or perhaps their demise.

It is true that prior to the establishment of a professional training institution/body for bankers in Nigeria, the London based Institute of Bankers assisted in the professional training of Nigeria bankers and thereafter the Nigeria Institute of Bankers$^2$ followed. Both institutes render largely in service training for bankers with the award of the Associateships or Fellowships after the taking and passing of the requisite qualifying examinations.

Apart from such in-service training, most Nigerian Universities nowadays offer courses leading to the award of bachelor degrees in banking. The curriculum of such courses drawn up by the National Universities Commission and not the Bankers Institute however leaves much to be desired. What is significant is that bachelor’s degrees are awarded by such Universities without any form of internships or practical training. Granted that the possession of such degrees does not make professionals of their holders, a more practical approach ought to have been adopted in the training or courses leading to the award of such degrees.

The most significant point that must be made in this regard is that there is yet no law that forbids the employment of non-professionals into the management cadre of banks and banking institutions. It is even submitted with the greatest respect that were such a law to exist, it was bound to be observed more in the breach than otherwise.

This has to be so because it would amount to a half way course as there has to be a law first that non-professionals should not own banks before there can be one that they should not manage same. To the extent therefore that the ownership structure of banks is laissez faire under the law, subject to the other statutory conditions particularly capitalization, the employment of personnel into banks cannot be regulated by reference to academic or paper qualification. In more practical language, nothing stops an illiterate billionaire from owning a bank or banks in Nigeria and ipso facto from employing his illiterate or semi-literate or non-professional son or spouse or sibling as the managing director or chief executive officer (CEO).

In the legal profession for example legislation now exist to eliminate the non-professional practice of law in almost all-important aspects. Even then it has to be under serious check/supervision and control. Right from the training threshold, the law now insists that only professionals and not mere theorists and ideologues train members of the legal profession. With the relevant degree, it is now compulsory for any entrants into the Nigerian Universities to lecture law courses leading to the award of bachelor or so degrees in law to have themselves
been called to the Nigerian Bar. That is to say capable of and licensed to practice the law in a professional capacity before being employed to teach it. That way the emphasis will be “do as I say and do or can do” and not “do as I say but have never done or cannot do”. Again at the Law School i.e. the school run by the Council of Legal education for the practical training of qualified persons for call to the Nigerian Bar, professionals are engaged. It is common knowledge that nobody can be appointed to act as a legal practitioner unless he is called to the Bar. Where non-lawyers preside over inferior courts or tribunals, their decisions, before execution, are liable to review by way of appeals to higher or superior courts presided over by lawyers, the above ensures that the professional sting pervades salient aspects of the practice of law.

It is arguable that this analogy is too remote to be brought into banking practice. That cannot be. This is because banking has been elevated from a vocation or mere employment to a profession by practice. Recent indication about reference of certain applications for loans to the Central Bank of Nigeria for vetting or clearance having regard to quantum and profiles of applicants may indeed be aimed at professionalizing or controlling the grant of loans and advances. This is more so when management decisions on loans determine to a large extent, the survival of banks.

The present legal regime for the training of professionals in banking and for the acquisition of banking etiquette and morals cannot be found in the standard legislations on the area. That is to say the Central Bank Act\(^63\) the Banks and Other Financial Institution Act\(^64\) and the NDIC Act\(^65\). There is nowhere in these codes where prior training is made a pre-requisite for the employment to personnel or management personnel in the banks. Again, and to draw analogy from the legal and medical professions, a member of the Bar can be debarred and prevented from practicing the profession if he was found wanting in matters of serious professional discipline. Similarly, the medical license to practice given to a medical doctor can be revoked for similar reasons. In banking, experience has shown that managers who contributed to the adversities in their banks to the knowledge of their colleagues have been able to successfully re-locate from such distressed banks to viable ones. In some cases they even set up banks of their own and appear to flourish.

The law establishing the Nigerian Institute of Bankers\(^66\), show that the institute in the main, carries on the non-institutionalized grade assessment of persons practicing banking. This assessment takes the form of written examinations without any viva voce appraisal of the candidate. There also appear to be no provision in the law for the practical and confidential reports on candidates for the purpose of determining their on the job suitability. Practical and confidential reports on candidates writing the Institute of Bankers examinations by superior officers in their hierarchy can complement the written examinations before successful candidates are admitted as associates or fellows of the institute (of bankers). The advantage of professionalizing a discipline such as banking at managerial level is that \textit{inter alia} the professional body would assist the other regulatory or statutory bodies such as the Central Bank
and the NDIC which more elaborately discussed in this work, in the maintenance of standards and best practices in the industry.

3. Legislative Shortcomings/Deficiencies

This has been the focus. They take the form of loopholes, inadequate and non-existent provisions, and incomprehensible ones. An example here is the terminal aspect of the law, which determines what happens in the event of bank failure. It is proposed to borrow from the words of the NDIC to ramify these problems as still being there. Said the Corporation under inadequate legal provisions:

10.2. “A deposit insurer, while acting as a liquidator of closed bank, should be vested with special powers. The special powers are to expedite the liquidation process in order to maintain confidence and stability of the banking system as well as ensure cost effectiveness of the liquidation process. Furthermore, the special powers will help to facilitate higher levels of asset realization, which could minimize losses to depositors.

Consequently, in many jurisdictions including the Federal Deposit Insurance Corporation (FDIC) of USA, the Deposit insurer is granted special powers.

Liquidations undertaken by FDIC, for instance, are not subject to court supervision. There is also limitation on court action against FDIC, which is intended either to restrain or affect its powers or functions as liquidator. In addition, no attachment or garnishee order can be enforced against FDIC without its consent. Furthermore, FDIC does not require any court order to be appointed as liquidator by a Chartering Authority. Generally, bank liquidation is not expected to be subjected to the general insolvency proceedings instead, bank-specific insolvency laws are enacted.

Contrary to best practices, NDIC has to apply to the Federal High Court (FHC) to be appointed as a liquidator, NDIC is also subject to the general Companies Winding up Rules, which among others, require notice to be issued and advertised before appointment. The legal process is thus protracted. This inhibits thus the payment of insured deposits as illustrated by the case of Savannah Bank of Nigeria PLC.

4. Judicial Constraints

This is mainly as regards jurisdictional and threshold problems. A judge of the Court of Appeal as she then was, had this to say about the role of the judiciary in the banking industry.
It is the judicial powers vested in it by the constitution that makes the judiciary an active participant in the banking industry. Before the enactment of the Failed Banks Decree, banking cases that came to the courts were mostly in the areas of employer/employee/relationships, dishonored cheques, breach of contract, customer/bank relationship as in Jammal Steel Structures v. ACB Ltd (1973) ANLR 208 and Bronik Motors v. Wema Bank (1983) 6 SC 158.

It is very doubtful if any court worth its name will “intentionally” as perceived by Mr. Tilije, provide cover for bad debtors. It is a high time people understood that judges are not law makers or law enforcement agents. They are to interpret the laws. Even Lord Denin warned in his book, The Family Story, London. “My root belief is that the proper role of a judge is to do justice between the parties before him. If there is any rule of law, which impairs the doing of justice, then it is the province of the judge to do as he legitimately can to avoid that rule or even to change it so as to do justice in the instant case before, him.

From this statement, it is obvious that the constraints of the judiciary in playing its constitutional role in the development, administration and realization of the objectives of banking laws are both extrinsic and intrinsic. They are related to each other and indeed interwoven. The most regrettable of the extrinsic constraints is that of perception and public confidence. The general notion of the public is that the judiciary is a sanctuary for fraudsters who defraud banks and bank debtors who do not want to pay their bad debts. It is only the judiciary, through good and clear examples by way of sound and just judgments that can correct this perception. It has to be corrected because it is very necessary for the survival of the industry and its goals. A correct view of the role of the judiciary as an impartial arbiter will serve as both an encouragement to investors and a chilling reminder to the industry’s fraudsters and decimators that a painful nemesis awaits them as the sentinel of their successful activities in short changing and killing the system.

The intrinsic constraints as mentioned by His Lordship include

(i) Inadequate training and continuing education for the judiciary in such emergent and fast developing areas of the law as banking.
(ii) Obsolete methodology in the administration of the machinery of justice.
(iii) Unwarranted jurisdictional constraints.

Such jurisdictional constraints as restrict adjudication on such regulatory banking matters to the Federal High Courts only. This is notwithstanding that they have no special training to qualify them for same and more so are few and far between in the country.

There is no point in taking all the enhanced and extraordinary measures being taken to regulate the banking industry only to leave a gaping hole in it from the judicial hold. Any such
holes can sink the entire ship. Since the Failed Banks Tribunal is disbanded, special divisions of the Federal High Courts or State High Courts should be created if possible with contributory funds from stakeholders like the Central Bank and the NDIC to expertly and expeditiously deal with banking matters.

5. Internationalization, Regionalization, Globalization and the disadvantaged Position of Nigerian banks in this Regard

The brief point being made with this sub-head is that having gone through Nigeria’s legal regime for banking and other financial institutions, there is no letter to be found in the laws that contemplates Nigerian banks operating outside Nigeria with such laws for now. Again, there are no letters in the laws or dominant laws such as BOFIA and the rest, which contemplate foreign banks participating in the industry in Nigeria. Yet they operate the country’s foreign reserves which run into billions of dollars for now. One is not unmindful of the fact that certain indications from the sector administratively insinuate that heavy capitalization beyond the present twenty five billion could earn Nigerian banks this privilege. The question that still remains is under which section of BOFIA or the NDIC ACT or the Failed Banks Act etc. will this be done? We must bring Nigerian Laws in line with globalization before the albatross called globalization consumes them in the name of international arbitration of global players and the principle of choice of laws.

It will only take one curious arbitration clause in a contract between a Nigerian bank and a foreign one to remove the application of all the country’s much commended laws and render them inapplicable to banking transactions involving foreign banks. This can cost the country’s poor depositors great loss and pains. Such a clause can make the laws of a sub State like Texas to be the applicable laws and exclude any regulatory powers of the CBN and NDIC. It is as bad as that.

Admiralty matters were nearly spared this booby trap called globalization when the enabling laws governing admiralty jurisdiction specifically states that notwithstanding the provisions of any other law to the contrary, only the Federal High Court has jurisdiction in admiralty matters. Yet in the case of Baker Hughes Process Systems Ltd. (A division of Baker Hughes Inc. of Delaware USA) v. ABNL Ltd, the contention that the foreign company was not incorporated in Nigeria or granted exception under CAMA to do business in Nigeria was dismissed by the American and Canadian Arbitrators as uncivilized law and therefore not of universal application in the face of the arbitration clause by the parties to exclude Nigerian laws from their oil drilling production barge business. Though the Nigerian Arbitrator gave a dissenting opinion, it was a minority opinion, which was at best mere literature.

A sensitive area of the national economy and existence such as banking should watch against this bug called globalization. It is beyond our systems and so our systems should be
legally insulated from it. It is anti-nationalism and neo colonialism. It is worse than bad governance if anything can be worse than bad governance.

Safety provisions such as in the Admiralty Jurisdiction Act⁵ should be built into our banking laws so that they cannot be swept away or discounted by non-existent entities such as Baker Hughes Process System alleged to be incorporated in Bermuda but which Mr. Strachan who signed the contract in question on its behalf could not remember exists in his oral testimony. The majority opinion of the arbitrators should serve as a warning in Nigeria to our lawmakers.

One or two sour ventures of the nature of the above arbitration case by any of the banks operating in Nigeria will drive a coach and horse through the otherwise beautiful laws adumbrated in this work. Vigilance again is therefore the watchword. Clear and express provisions should he made enabling the Central Bank of Nigeria and or the Nigerian Deposit Insurance Corporation to be a party and or signatory to any joint venture contracts that any insured bank dares to enter with any foreign bank or firm.

PART V
SPECIFIC RECOMMENDATIONS FOR CHANGES IN THE LAW AND EXPECTED IMPROVEMENTS

The recommendations specifically made for changes in the new legal regime and the improvements expected therefrom are laced with the analysis and reviews of the relevant portions of the law above for convenience and ease of reference and tagging. A summary of same notwithstanding can be beneficially recapitulating and reflective as itemized hereunder.

(i) The insured amount or expected dividends from the insurance or so called insurance scheme has been found wanting and inadequate. This is in the sense that whereas the notion of “insurance” imports or connotes “indemnity”, an insurance situation whereby the dividend payable upon the anticipated event is for less than indemnifying, amounts to a non-starter or at best a platonic situation as already emphasized. It as a result of this that this work recommends that this aspect be amended so that either the whole or a substantial percentage of the whole of the insured amount is recoverable.

(ii) The paper commends the consolidation that emerged from the scheme and the resultant larger capitalization or capital base of the emergent banks. It however notes and cautions that experience worldwide has shown that size per se cannot guarantee survival as corporations far larger and more capitalized have been seen to go down. Hence the recommendation that more detailed, purposeful and robust supervision and discipline is a better panacea to bank failures and distress.
(iii) The paper observes the possibility of a heavily discounted notion of professionalism in the personnel makeup of the industry and consequently recommends changes in this direction and a push towards greater professionalism.

(iv) A Legislative lacunae such as the inability of the Ombudsman to proceed straight to liquidation of ailing, failing and failed banks is identified as an extrinsic factor to the extant law. It is nonetheless proffered that provisions to this effect be written into it to enhance the ombudsman’s realization of its mission.

(v) A further extrinsic problem of judicial and international alternate dispute resolution is equally penciled down in the work. In this regard, the putting into place of necessary adjectival laws is indicated as imperatives.

PART VI
EXPECTED RESULTS

It is hoped and believed that the recommendations towards improvements in the legal regime in question will bring forth the basic and fundamental objectives of the law. These fundamental and desirable objectives are virtually universal. Though they appear self-evident yet they are never found to be self-executing*.

(i) Greater and surer investor protection
(ii) Certainty of rules of engagement of operators and
(iii) An improved economy.

SUMMARY AND CONCLUSIONS

Matters of security of monies deposited in banks and the stability of the banks themselves are very germane to the banking industry and business generally, in the world and in Nigeria. Prior to the enactment of the law establishing the deposit insurance scheme, the Central Bank of Nigeria tried to supervise the industry. However, no clear provisions or any existed in its statute spelling out such detailed steps and requirements for the management of ailing or failing banks. The net result was that such “corpses” of banks remained open for a very long period after becoming “corpses” and members of the public went ahead and deposited their monies with them and never got them back. This paper has thus critically appraised one of the most crucial aspects of modern day banking regulation in Nigeria and the emerging global emphasis on safety nets in banking business. That is to say the powers and functions of the Deposit Insurance Corporation with regard to the insurance of bank deposits, the institutions or banks that are required to do so and the consequences of so doing or failing to do. It is brought out that criminal sanctions attend any failure in this regard though the amount of penalty is criticized.
The necessary stringed supervision and control that follow the listing of a bank as an insured institution are examined, including removal or change of management, and the mergers and consolidation that followed as the need arise. The final question of bank liquidation and refunds/payments of deposits and dividends is mentioned. Throughout, certain aspects of the law manifesting inelegance and imprecision are highlighted and suggestions for amendments or possible amendments are made intrinsic and extrinsic challenges both actual and potential are discussed. In the end, it is appreciated that the enhanced regulations brought about by the new laws can go a long way in stabilizing the banking sector and instilling confidence in the investing members of the public whether from within or outside Nigeria.

ENDNOTES

1 See http: // www.iadi.org (20th July 2013)
3 Giwa, Ayuba O. The emergent International/global phenomena of Deposit Insurance and Banking Regulation-A critical Appraisal of its modest successes in Nigeria, being part of a research thesis for the award of Doctor of philosophy Degree in law of the Edo State University, Ekpoma, Nigeria, 2010.
4 The Central Bank of Nigeria Act, now Cap C4 Laws of the Federation of Nigeria 2004 and the Banking Act 1969. These were the mainstream statutes that regulated the Industry before the Enactment of others like the Failed Banks Act which was Decree no 18 of 1994. The Banks and other Financial Institutions Act 1991 and subsequently the Nigeria Deposit Insurance Corporation Act now Cap. N102 Laws of the Federation of Nigeria 2004. We say the mainstream statutes because others like the Bills of Exchange Act 1882, a colonial legislation applicable to the country, and Finance (control and Management Act) Cap. 144 LFN 1990 equally governed the banking business but as said, none of them required any statutory guarantees, Limited or comprehensive of any deposits placed in Banks in Nigeria.
5 Cap C 4 supra
6 The equivalent of the Federal Reserve Bank in the United States of America
7 Supra footnote 4
8 There is no question that banks are corporations or incorporated companies or entities whose articles of association contain clauses enabling them to carry out the business of Banking i.e. receiving deposits from members of the public. Thus they were and are still subject to the operations of the companies and Allied Matters Act Cap. C 10 laws of the Federation of Nigeria 2004 which again merely deals with incorporation of business to confer juristic personality on them and enable them exist independently of those natural persons or individuals that subscribed to their memoranda and articles of association see the locus classicus of Salomon v. Salomon (1897) AC 22
9 Bills of Exchange Act 1882 which forms part of Nigerian law, though a colonial relic, by virtue of it being enacted in the United Kingdom, the Country’s Colonial master, and being enacted before 1st January 1900 when laws made in England ceased to be automatically applicable to Nigeria. Those before 1900 were regarded as statutes of General Application to virtually all the countries of the Commonwealth until legislative bodies were individually set up in those Countries.
10 The money market as distinguished from the capital market, both of which combine to form the financial system.
11 These are essentially the tools with which banking business is carried out and not the corporation or institutions (structures) that carryout the banking business.
13 The Nigerian Observer, Wednesday, January 27th 1993 page 11
They were essentially pyramid investments schemes that collected deposits from members of the public with promises of jumbo interests running into hundreds of percentages of the amounts deposited just to attract more deposits. In the end the required pay outs became overwhelming and crashed the ventures which could not meet the promised percentages that where indeed commercially impossible such as promising a thousand percent of deposits within 30 days or less. It must be noted that these are different for example from the Trivestopedia definition of “Investment Pyramid” which is a portfolio strategy that allocates assets according to the relative safety and soundness of investments (see www. Investopedia.com/terms/investment pyramid consulted 10/8/2013) in the latter cases, the bottom pyramid comprises of low risk investments whilst the top is the opposite. Here we are talking about cash collected and not invested at all.

It is now Cap N102, Laws of the Federation of Nigeria 2004, in 2006, it was amended but it remains Cap N102 laws of the Federation of Nigeria 2004.

An ombudsman is usually appointed by the government or by parliament but with a significant degree of independence, who is charged with representing the interest of the public by investigating and addressing complaints of maladministration violation or rights: "etc. (Wikipedia – en.wikipedia.org/wiki/ombudsman last consulted 1/8/2013

Official Gazette no 73, Lagos, 29th December 2006 (Nigerian Deposit Insurance Corporation web site http://www.ndic.org.ng; last consulted 20/7/2013)

http://www.ndic.org.ng supra.

It is indeed a banking or Bankers Ombudsman or Commission.

Cap N102 LFN 2004, in its last amendment in 2006, this amount is now N500, 000.00 (about 3, 125USD which is still not enough.


CAP N102 Supra s. 22(1)

Ibid

CAP C 4 LFN 2004 for example deals extensively in Ss 26 to 29 and 36 to 42 with the Powers of the Central Bank and its relationship with other Bankers.

CAP B3 LFN 2004.

CAB B3 LFN 2004 which is a mainstream legislation on banking practice

CAP N 102 supra.

Such bad and doubtful debts or credits will certainly mislead the public as to the actual worth of a bank.


S. 22(3)(b) Ibid

S. 22 (4)

S. 22 (5)

The absence of safety in their deposits and the imminent withdrawal of the banks license.

S. 22(6) CAP N102 op.cit

S. 22(7) Ibid.

S. 22(8) Ibid.

S. (9) Ibid

S. 22(10) Ibid but by the 2006 amendment of the Act however, the approval or ratification of the court is no longer necessary

The NDIC Act CAP N102 LFN 2004

Ibid.

Ibid.

Ibid

Ibid

Ibid

CAP N 102 supra

Newspapers, as well as radio and television.
These arrowhead were often the ones involved in serious insider dealings.

Thus diluting the responsibility hitherto on the alter egos of the various banks who though still controlled the affairs of the banks, nonetheless had their responsibilities for failures heavily discounted.


Like the FIDIC op.cit at foot note 2.

With such failures, millions of invested funds in, the companies are lost and may even result in stock market collapse.

Kenneth Lay was convicted of corporate fraud in the Enron scandal but died of a heart attack a few days before he was sentenced as reported by the cable News Network (CNN).*For a detailed treatise on the Enron imbroglio see the 274 page book on “Enron and world Finance –A case study in Ethics” Dembinski, Paul H et al Palgrave McMillan www.strongwindpress.com.


United States Dollars

Where governments change capriciously and without any fixed duration such as happen in coup de tat prone countries, there would certainly result inconsistencies in government policies with each group of coupists presenting different policies.

Adverse economic climates would arise where the poverty level is so high that the citizens or the majority of them virtually live from hand to mouth leaving nothing to be invested.

An uncertain legislative terrain where laws relating to banking or any other business are amended too frequently, particularly through administrative regulations empowered by such laws would render the rules of engagement in such businesses highly uncertain, shifting, and at the whims and caprices of regulators.

No doubt corruption brings to naught, all progressive efforts in financial stability as it usually involve very few depriving very many of what they are legitimately entitled to.

Indeed the new thinking in corporation law is that there is a shift from the management of companies to their actual governance. Manage connotes patching and fixing of faults whereas governance entails total control and direction of affairs. That is, being on the driver’s seat and governing companies just as Municipal Councils, Local Government Areas and States are governed. For this shift paradigm see Pound J. “The promise of the governed corporation”. Harvard Business Review-Corporate governance. Harvard Business School Press Boston Massachusetts 2000, pp. 79 -104.

Improper motivation is the surest indices of corruption and embezzlement of other people’s funds. Devious and dubious persons abound who are easily motivated by either greed, nepotism, concupiscence, avarice, cupididity, covetousness and all other forms of negative tendencies. Often times, they roller-coast and wave-ride into highly sensitive positions of responsibilities and execute their nefarious inner most objectives before they are detected. In Nigeria, for example, names of hitherto great bankers such as Cecilia Ibru of Oceanic Bank, Erastus Akingbola of Intercontinental Bank and many other who were arrested, tried and convicted publicly of embezzlement of billions of customers/investors monies, now live bile in the mouth. The web is agog with Cecilia Ibru including-www.greenlight.com.ng/business with a caption “steal Billions of Dollars & Then Become an Evangelist. For the of assets forfeited by her see www.procurementmonitor.org for Akingbola, see-“Rogue Banker Erastus Akingbola – “saharareporters.com all web sites here last consulted 12/7/2013.

Chartered Institute of Bankers of Nigeria-www.cibng.org established vide the Chartered Institute of Bankers Act now Act no. 55 of 2007 commencing 11th April 2007. Even the late enactment of the law regulating one of the oldest professions in Nigeria nay the world is telling taling. Banking started in Nigeria more than a century ago about 1897.

CAP. C LFN 2004.

Bofia. Ibid. At footnote 26


Chartered Institute of Bankers Act. Op cit at footnote 46

The Guardian Newspaper (Nigeria) Sept. 20, 2005
Savannah Bank of Nigeria Plc. was closed by the Central Bank of Nigeria and for more than 5 years, the liquidation process has not ended and no depositor is yet paid, eventually their appeal to the Supreme Court succeeded yet the depositors are still gasping for breath while the bank itself remains in limbo (see www.businessdayonline.com) see Savannah Bank Plc v. Central Bank of Nigeria & 2 ors (2009) 6 NWLR (pt 1137) p. 237

Justice Mary Odili-paper presented at the 2004 seminar on Banking & Allied Matters for judges organized by the Chartered Institute of Bankers (CIBN) on the need for continued legal education for judges. The paper itself titled “How judiciary can impact positively on the Nigerian Banking Industry” was published at page 78 of the Guardian Newspaper of 18/1/05. She is now a justice on the Supreme Court of Nigeria Bench.

Banks and other Financial Institutions Act Ibid

Nigeria Deposit Insurance Act Ibid

CAP F 2 LEN 2004


Who incidentally became an Att. General and Minister of Justice in Nigeria (Chief Bayo Ojo SAN). The arbitration case itself is unreported. It is case no AAA50T1980051001 award dated 26th July 2004.

Op cit. footnote 73

They have to be pursued and pursued deliberately too. That is to borrow the language of the current American President, Barrack Obama during his inaugural speech on his second term in office when he was referring to the country’s declaration of fundamental human rights believed by that declaration to be truths that are “self-evident”. http://www.whitehouse.gov/the../inaugural-address-president-barrack-obama (last opened 3/3/13)