

# A Case Study of Siemens' Violation of Business Ethics in Argentine Based On Stakeholder Theory

Dr. Zhu Wenzhong<sup>1</sup>

<sup>1</sup> Guangdong University of Foreign Studies (GDUFS)

*Received: 20 May 2012 Accepted: 12 June 2012 Published: 24 June 2012*

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## Abstract

Hand in hand with prosper of International business brought by globalization, many ethical problems have been surfacing in the past decades: bribery, corruption, human rights issues, etc. Business ethics, as an academic discipline as well as a business practice, is becoming the focal point of waged and animated debate. The increasing attention on it generates many relative theories, among which Freeman's stakeholder theory stands out. This paper, backed by Freeman's stakeholder theory, conducts a case study of Siemens' violation of business ethics by analyzing its recent bribery scandal in Argentina. After a detailed analysis of the interests of Siemens' stakeholders, it draws a conclusion of Siemens' severe violation of business ethics, and thus suggests some solutions.

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**Index terms**— Simens Telecommunication; Business Bribery; Stakeholder Analysis.

## 1 Introduction

Business ethics is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. To put it in a simple way, business ethics involves the application of standards of moral behavior to business situations.

Despite the fact that the concept "business ethics" was firstly proposed in 1970s and hailed as oxymoron, it witnessed a waged and animated debate as well as increased public awareness ever since. On one hand, there is a huge growth of number of businessmen who realize that pure profit-oriented corporate operation can not stand permanently in a global market where customers' ethic awareness is increasing; on the other hand, more and more companies find themselves time and again stuck in ethic dilemmas. For instance, bribery, as one of the notorious business ethical problems, has surfaced as important issues in an increasingly interdependent world economy.

The increasing attention on business ethics not only takes place in business practices, but also in academic fields. Scholars' study on business ethics also gave birth to a famous theory: stakeholder theory, put forward by R. Edward Freeman, which in turn serves as the theoretical foundation of business ethics study. The theory attempts to address the "Principle of Who or What Really Counts" by identifying the stakeholders in business ethics practices.

Based on business ethics and stakeholder theory, this paper proposes to conduct a case study by analyzing Siemens' latest business ethics violation-the Bribery Scandal in Argentina. Following the analysis, suggestions pertinent to this issue are also put forward. What is a stakeholder?

## 2 II.

## 3 Literary Review

The earliest definition offered by an internal report of Stanford Research Institute in 1963, they define it as those groups that directly influence the organization's existence. Freeman continues to employ this term

by further defining it as those groups that are so vital to the organization that they dominantly affect the organization's survival and success and can also be affected by the actions of the business (Freeman, 1984). The term "stakeholder" is a variant of the familiar and traditional idea of stockholders-the investors in or the owners of business. It has experienced an evolution and progress in its scope and range.

In the traditional view, the stockholders or the shareholders are the owners of the firm, therefore, a firm has binding fiduciary duty to give the top priority to stockholders by satisfying their needs in the first place and increasing their output. It is based on the input-output model in which firms have to only address wishes and benefits of parties closely pertinent to its operation: investors, employees, suppliers, and customers ??Donaldson and Preston, 1995). is typically presented in Freeman's stakeholder theory.

### 4 b) Freeman's Stakeholder Theory

As in Freeman's Strategic Management: A Stakeholder Approach, the stakeholder theory is a theory of organizational management and business ethics that addresses morals and values in managing an organization. It identifies and models the groups which are stakeholders of a corporation, and both describes and recommends methods by which management can give due regard to the interests of those groups. In short, it attempts to address the "Principle of Who or What Really Counts.

In Freeman's stakeholder theory, stakeholder are not only those people who have direct stakes in the firm but also those who are equivalently influential as well, especially in affecting reputation and public image, but their stake is more representational of public than direct. Stakeholder theory argues that every legitimate person or group participating in the activities of a firm do so to obtain benefits and that the priority of the interests of all legitimate stakeholders is not self-evident. From this perspective, the groups of stakeholders expand to government and social institutions etc.

In his book Strategic Management: A Stakeholder Approach, Freeman outlines groups of stakeholder in both internal and external environment.

Internal stakeholders are as follows: employees, managers, and owners.

External stakeholders are: suppliers, customers, society, government, creditor, shareholders, competitors, communities, academics, NGOs or activists, environmentalists, media, etc.

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In his Strategic Management-Analytical Methods for Stakeholder Management, Freeman (1984) clearly comes out with the stakeholder management theory which refers to the management activities management of an enterprise carries out to balance the stake requirements of stakeholders. Compared to the traditional shareholders supremacists, this theory holds that the development of any enterprise is closely related to the investment and participation of each stakeholder and the pursuit of an enterprise is the entire stake of all stakeholders instead of some major stakes.

Stakeholders not only include the shareholders, creditors, employees, consumers, suppliers etc. of the enterprise, but also pressure groups such as government, local residents, local communities, medias, environmentalists etc. even the natural environment, future generations etc. who may be directly or indirectly affected by the operation of the enterprise. These stakeholders are closely related to the development of the enterprise, they share the operation risk of the enterprise, some pay a cost for the operation of the enterprise, some supervise and constrain the enterprise, and the decisions of the enterprise must take their stakes into consideration and accept their constraints. In this sense an enterprise is the institutional arrangement of intelligence and management professionalization investment, the development of an enterprise relies on the quality of responses to the requirements of each stakeholder instead of only shareholders. This corporate management idea explains the corporate performance appraisal and the core of management, which lies foundation for the later theory of performance appraisal c) Stakeholder Theory and CSR

## 5 The Effect of Stakeholder Theory in the Study of CSR

There are many common grounds between CSR and stakeholder theory as both are concerned about the relationship between the enterprises and their shareholders and the enterprises and individuals and social group apart from their shareholders; however the two are different concepts. What they study and care are problems of different levels and categories. CSR considers the influence of enterprises on society from the perspective of the whole society and care the relationship between enterprises and the society; while stakeholder theory care more about

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the relationship between enterprises and stakeholders from the perspective of the enterprises. Ever since the establishment of CSR its supporters spread from various institutions, scholars and ordinary people, which helps in the development of CSR. However this theory encountered lots of problems in practice, and needs further study and improvement. In the process of seeking solution to these problems, we usually introduce stakeholder theory to help to resolve those problems.

## 6 Y i. Modification of Shareholder Primacy Theory by Stakeholder Theory

The biggest barrier to the implementation of CSR is the Shareholder Primacy rule to some extent, Friedman et. holds that the only purpose for the existence of enterprises is to maximize the profit and shareholder benefits. Their three interrelated propositions are a. shareholders should reserve the right to control the enterprise; b. managers are entrusted the responsibility to singly serve the interest of shareholders; c. the object of enterprises is to maximize the wealth of shareholders; while stakeholder theory holds that i, stakeholders who are affected by the enterprise have the right to participate enterprise decision-making; ii, managers are entrusted with the responsibility to serve the interests of all stakeholders; iii, the object of enterprises is to enhance the interests of all stakeholder not just shareholders'. Stakeholder theory holds that enterprises are 'contract unities' consisted of many a stakeholders and the investment comes not just shareholders but also employees, suppliers and creditors of the enterprise.

Shareholders provide the material capital and other stakeholders provide not only material capital but also human capital which is equivalent to material capital in term of significance particularly in today's knowledge economy. And in some aspects the significance human capital exceeds the significance of material capital. Enterprises are not simply the 'aggregation' of material capital any more but a kind of 'institutional arrangement of governance and management of professional investment' and in essence they are the aggregations of various contracts. The risks of enterprises should not just be bore by shareholders and other stakeholders should also share the risks, as a result the owners of enterprises should not be confined to shareholders and all the stakeholders are the owners of enterprises. The rights of stakeholders are equal and independent, they jointly own the enterprises. While challenging the shareholder primacy principle, stakeholder theory clears the way for the development of CSR theory in that CSR theory has long been holding that the only mission of enterprises to increase shareholder interests should be changed and thinks that enterprises should view problems from a higher ground and consider their relations with all the stakeholders, the entire society and shoulder some social responsibility.

### ii. Indentification of Subjects for Shouldering Social Responsibility and Defining Responsibilities

Viewing from the various definitions of CSR, it is easy to conclude that the beneficiaries of enterprises' shouldering social responsibilities are people of the society including investors, employees, clients, creditors and beneficiaries of environment and resources, social security and welfare etc. Through shouldering corresponding social responsibilities and taking social benefits as target range, enterprises can maximize their contributions to the sustainable development. And the responsibilities they take are legal, economic, moral, cultural aspects, however today there still lots of people stand against CSR. They start from the point where the subjects and contents of obligations of corporate social responsibility are vague and think that enterprises should not shoulder social responsibilities. Some business and law scholars even think there is not subjects for corporate social responsibility in that there are no satisfactory answers for questions such as the whom should enterprises responsible for, whom can be the subjects that urges enterprises to shoulder responsibilities? To vaguely say that customers, ordinary people and the social communities these enterprises belong to is not enough because the groups can hardly be obligees to exist meanwhile they also hold that the content of social responsibilities is also vague.

## 7 World

Currently the understanding of stakeholders generally include the first class stakeholders that affect the existence of enterprises, and the secondary stakeholders who do not affect the existence of enterprises or are affected by the enterprises. Though the definition is extensive, it indentifies stakeholders as shown in the following basic framework: investors, employees, customers, suppliers, creditors, trade associations, local communities, political groups etc. Many foreign scholars studying CSR and stakeholder theory holds that stakeholder theory can be introduced to the study of CSR, ??arroll (1991) thinks that stakeholder theory should be applied to the study of CSR and it can be used to identify the orientation of CSR, and by the identification of each relevant stakeholder group the range of CSR can be identified. Clarkson (1995) stakeholder theory can provide a 'theoretical framework', in which CSR can be identified as the relations between enterprises and stakeholders, for the study of CSR. Just as Evan and ??reeman (1993) had it that 'though it cannot replace CSR, stakeholder theory can be regarded as an important condition for the study of CSR and it can specify the subjects the enterprises should be responsible for'. In this stage when the theoretical research of CSR still needs to be carried further, we can adopt stakeholder theory to define the range of responsibilities enterprises should carry. This is both possible and necessary and enterprises can be responsible for each stakeholders in the framework of stakeholder theory.

### iii.

## 8 Case Description

Siemens AG is a German multinational conglomerate company headquartered in Munich, Germany. Siemens and its subsidiaries employ approximately 420,800 people across nearly 190 countries. On Dec. 13, 2011, The Securities and Exchange Commission charged seven former Siemens executives with violating the Foreign Corrupt Practices Act (FCPA) for their involvement in the company's decade-long bribery scheme in Argentina to retain a \$1 billion government contract to produce national identity cards for Argentine citizens.

## 9 Communities

According to the SEC's complaint filed in U.S. District Court in Manhattan, the scheme lasted from approximately 1996 to early 2007. Initially, in the 1990s, the Menem government planned to implement all national electronic ID cards, known as Documentos Nacionales de Identidad (DNI) for every Argentine citizen. In order to obtain the contract which is total of 1.26 billion U.S. dollars, Siemens bribed Argentine government officials with 70 million U.S. dollars through intermediary. Menem government finally signed the contract with Siemens in 1998.

But a change in Argentine political administrations foiled the contract: after the next President Fernando De La Rúa came into office, some officials questioned the contract on the ground that the cost of each electronic ID reported by Siemens was twice what the government estimated. Therefore, the government announced the suspension and cancellation of the contract. In a political change and economic crisis, Duhalde succeeded De La Rúa as the president. During his term of office, Siemens was told by the intermediary that a 27 million U.S. dollars bribery could "resurrect the contract". In order to revive the contract, Siemens paid additional bribes in a failed effort to Kirchner government until 2004. When the company later instituted an arbitration proceeding to recover its costs and expected profits from the canceled contract, Siemens paid additional bribes to suppress evidence that the contract originally had been obtained through corruption.

iv.

## 10 Case Analysis a) Stakeholders of Siemens

Bribery has been defined as "the offering, giving, receiving, or soliciting of something of value for the purpose of influencing the action of an official in the discharge of his or her public or legal duties." (Fritzsche, 1998). The bribe is the gift bestowed to influence the recipient's conduct and the outcomes of decisions wherein the nature and extent of the influence are not made public. The item of value may be direct payments of money or property. It may also be in the form of a kickback after a deal has been completed. It may be any money, good, right in action, property, preferment, privilege, emolument, object of value, advantage, or merely a promise or undertaking to induce or influence the action, vote, or influence of a person in an official or public capacity.

Based on Freeman's stakeholder theory, the first step in the analysis of this case is to identify the relevant stakeholders and determine the positive and negative impacts on the stakeholders. The stakeholders affected by Siemens' bribery in this case include Siemens' stockholders; Siemens' employees; Siemens' supplier; Local community; the Argentine government; Argentine community; Siemens' competitor; Siemens' competitors' employees and stockholders. b) Impact on stakeholders For Siemens' stockholders, the contract with the Argentine government would increase profit and gain market share for them. Even though bribery was needed to win the contract, the profit yielded in the contract can not only cover the bribery but also trigger more.

For Siemens' employees, the profit yielded from the contract would also benefit themselves a lot. It is likely that their pay got increase, bonus and allowance met a growth, working environment had much improvement etc.

For Siemens' suppliers, the growth of Siemens means the growth of themselves as long as they are in a cooperative business relationship. The increase of Siemens' business would lead to more orders to Siemens and more profit for them.

For the local community, the contract would bring cascade effect: it would create more jobs for local people. The local community would benefit from the employment of its citizens which would bring money into the community and provide additional tax revenues. The prosper of Siemens' business can also cast a positive influence to relative industries.

For government, Firstly, the bribery would reduce freedom of choice by altering the conditions under which a decision is made. Its appeal of additional gains for some government officials would lure them to select the less attractive alternative which provides less total satisfaction. By doing so, it adversely would disrupt the official's decision and undermined fair competition among the industry. If the De La Rúa administration's doubt that the cost of each electronic ID reported by Siemens was twice what the government estimated is true, then the government has to pay the price for the hidden payment with more governmental expenditure, which leads to a greater loss of money of the government.

Secondly, it would damage the authority, prestige and force of laws and regulations. The bribery circumvented the legal system and obtained illegal For Argentine community, From the perspective of whole economy system and environment, it would: 1. hinder fair and just competition and disrupt the order of the whole economic system. Instead of gain market share with quality, businesses would turn to shortcuts like relationship with government officials 2. Result in allocating more resources to a less desirable alternative. The failure of the allocation system would lead to stagnation of technology, service and the whole industry structure. 3. Increase

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the cost of transaction, and do harm to public's interest. The higher cost would result in higher prices or even monopoly.

From the whole society, it would: 1. Cast damage to social credit and rot the social conduct. On one hand, the prevalence of bribery destroys the mutual trust and equity of businesses; on the other hand, businesses with good compliance to laws are suppressed and discouraged. 2. Violate code of ethics. 3. Breed more and more relative crimes. Bribery is always accompanied with business secret theft, deception and evasion of taxes.

For Argentine people, the greater expense on the ID project would result in more outflow of taxpayers' money from their pocket in that the misconduct and wrongdoings of officials would be shared by all the community. The bribery would harm taxpayers as well as undermine public support for governments.

For Siemens' competitors, Siemens' bribery would deprive them of fair competition in this project, and further distort trade. The loss of the competitors is invisible, though, but solid.

For Siemens' stockholders, employees and local community, the loss of the contract would provide lower profits for the stockholders, fewer jobs for the employees and less money in the competitors' local community.

Taking the interest of all stakeholders into account, Siemens violated business ethics seriously, even though it brought some illegal benefits to its own stockholders.

V. Suggestion a) Internally: shaping organizational ethical environment. Siemens' bribery scandal is by no means the first violation of business ethics. Back to 2008, its decades-long bribery scheme with 1.3 billion U.S. dollars shocked the world. Subsequently, it was accused of posting business secret of competitors. Its continuous scandal is an indication that Siemens fails to form an ethical corporate culture and ethical environment. To make a change of the current scandal and prevent any further ones, shaping organizational ethical environment should be Siemens' top priority.

Shaping organizational ethical environment goes through four stages, each of which demands different actions of organization. The four stages are: ethical awareness, ethical reasoning, ethical action, and ethical leadership.

i. Ethical awareness. Ethical Awareness is the foundation of an ethical climate. Through ethical awareness, employees learn how to identify problems and how to resolve them. In this stage, code of conduct must be established to support ethical awareness. Formal statement that defines how the organization expects and requires employees to resolve ethical questions must be delivered. A code of conduct typically addresses issues pertaining to: preferred style of dress, avoiding illegal drugs, following instructions of superiors, being reliable and prompt, maintaining confidentiality, not accepting personal gifts from stakeholders as a result of company role, avoiding racial or sexual discrimination, avoiding conflict of interest.

ii. Ethical reasoning. Since codes of conduct cannot detail a solution for every ethical situation, so corporations provide training in ethical reasoning.

Courses in Ethical Reasoning teach employees to reason in a principled way about moral and political beliefs and practices, and to deliberate and assess claims for themselves about ethical issues. Students examine the competing conceptions and theories of ethical concepts such as the good life, obligation, rights, justice, and liberty with a focus on developing the ability to assess and weigh the reasons for and against adopting them to address concrete ethical dilemmas. Employees in these courses may encounter a value system very different from their own that calls attention to their own ethical assumptions.

iii. Ethical action. Ethical action involves helping employees recognize and reason through ethical problems and turning them into ethical actions. It takes preparing, assessing, deciding, implementing, and reflecting. Whenever employees encounter ethical dilemmas or problems, Siemens should help them out by applying their code of conduct to practice: identifying the issues, assessing them, deciding solutions, implementing solutions and reflecting them. The current Siemens' bribery scandal is good example for its employees to review and retrospect the ethical problems concerning

## 11 iv. Ethical leadership

In this stage, executives must demonstrate ethical behavior in their actions. Leaders are first and foremost members of their organizations and stakeholder groups. Since they hold most of the senior positions and are decision makers, their values, vision and ethical standard case great impact on subordinates and thus impact the whole organization. To shape ethical conduct in an organization, leaders' behavior, actions are needed to demonstrate their support and determination.

In Siemens' bribery scandal, most of the unethical behaviors were conducted by senior executives, which attribute the frequent news of its violation of business ethics. Thus, in Siemens, to shape ethical conduct and maintain ethical culture, leaders must firstly own their ethical criteria and behave ethically accordingly. To counter bribery, wider cooperation must be conducted between countries and these conventions and organizations. Under the globally accepted guidance and principles, Signatories countries must adopt national legislation to fight against bribery. Government should take regular review of business' and officials' compliance to these laws by establishing stricter supervision system.

Secondly, external supervision involves power of media. Media is the oral power of reining any unethical behavior. Thus, media should pay more close attention on business ethical issues, track and make more exposure of unethical firms, and encourage those ethical ones.

Thirdly, the whole society should also participate in this campaign. When the whole society establish a common principle of "zero tolerance" to bribery, and monitor it ceaselessly, businesses dare not commit bribery

because of their consideration of corporate image. The more and more serious social attitude towards bribery would make businesses think twice before they leap.

## 12 VI.

## 13 Conclusion

This paper conducts a case study of Siemens' violation of business ethics by employing Freeman's stakeholder theory. Based on Freeman's theory, stakeholders of a firm should not only include its stockholders, instead, it covers a wide range from its internal employees to external suppliers, government, society, and even competitors. In the case of Siemens' bribery scandal in Argentina, the present author outlines its stakeholders and conducts a detailed analysis of the impact of Siemens' bribery on each stakeholder. The conclusion follows the analysis is that Siemens seriously violated business ethics by terribly detrimenting the interest of its stakeholders.

The analysis of Siemens' unethical bribery scandal also triggers the author's further discussion about an international issue: bribery. Bribery, as one of the notorious business ethical problems, has surfaced as important issues in an increasingly interdependent world economy. No longer seen purely as a morality play, the accepted world view of corruption and bribery today is that they hinder competition, distort trade and harm consumers and taxpayers as well as undermine public support for governments. Therefore, to fight against bribery, suggested solutions are also provided. On one hand, internal ethical environment shaping is of urgent need; Siemens should immediately follow the four stages of the structure of ethical environment from ethical awareness to ethical leadership to improve its current ethical predicament. On the other hand, external supervision and cooperation from international and national community to media is also in demand.

Although business ethics is in an actual fact as old as business, however, it didn't get enough attention until 1970s. As the ethical problems keep surfacing and disrupting the business order, business ethics, as an academic discipline as well as a business practice, is on its way of gaining momentum. To probe into it and make this oxymoron a better guide of business code of conduct, more and more efforts are still in much need. <sup>1 2 3</sup>



Figure 1:

<sup>1</sup>Global Journal of Management and Business Research Volume XII Issue XIII Version I

<sup>2</sup>© 2012 Global Journals Inc. (US) Year

<sup>3</sup>© 2012 Global Journals Inc. (US) Year interest, which is a contempt against laws and is detrimental to the implementation of laws. Thirdly, it would undermines attempts by governments to improve the overall wealth of the nation, diminish the image of government and governing party, and further lose people's trust.

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