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Christine Parker
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The Open Corporation

Effective Self-regulation and Democracy

The Open Corporation sets out an innovative and realistic blueprint for effective corporate self-regulation, offering practical strategies for managers, stakeholders and regulators to build successful self-regulation management systems. Christine Parker examines the conditions under which corporate self-regulation of social and legal responsibilities are likely to be effective, covering a wide range of areas – from consumer protection to sexual harassment to environmental compliance. Focusing on the features that make self-regulation or compliance management systems effective, Parker argues that law and regulators need to focus much more on 'meta-regulating' corporate self-regulation if democratic control over corporate action is to be established.

Christine Parker is Senior Lecturer in Law at the University of Melbourne. She is the author of *Just Lawyers* (1999) and a contributor to *The Survival Guide for Compliance Professionals* (2001).

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To Joyce Ethel Parker (1941–2000)

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Frontmatter
More information

Contents

List of tables and figures *page* vi
Preface vii
Acknowledgements xii

1 Introduction: Corporate self-regulation in the new regulatory state 1
2 The potential for self-regulation 31
3 Motivating top-management commitment to self-regulation 62
4 Cultivating self-regulation leadership 84
5 Self-regulation methodology and social harmony 112
6 The pathologies of self-regulation 135
7 Model corporate citizens: The role of self-regulation professionals 168
8 The three strategies of 'permeability' in the open corporation 197
9 Meta-regulation: The regulation of self-regulation 245
10 Conclusion 292

Appendix: Methodology 302
Notes 312
References 323
Index 347

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978-0-521-81890-2 - The Open Corporation: Effective Self-regulation and Democracy
Christine Parker
Frontmatter
More information

Tables and figures

Tables

1.1 Summary of studies on extent of implementation of corporate compliance programs *page* 23
2.1 Summary of empirical studies of self-regulatory/compliance initiatives 44
2.2 Factors most commonly identified in studies 51
8.1 Strategies of permeable self-management 199
9.1 Principles for meta-regulation 248

Figures

2.1 The dominating business organization 41
2.2 The permeable business organization 42
2.3 Institutionalization of social and legal responsibilities 60
4.1 Modelling of self-regulation leaders 89
5.1 Harmonizing role of self-regulation units 131
9.1 Acquisition of self-regulation skills 264
9.2 'Triple-loop' evaluation of self-regulation 278

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Christine Parker
Frontmatter
More information

Preface

Acting on a tip-off, Japanese Ministry of Transport officials conducted a raid at Mitsubishi Motors in mid-2000.[1] They found thousands of reports of customer complaints about potentially serious vehicle defects hidden in an employee locker room. They should have been reported to the Ministry of Transport which is responsible for coordinating and supervising recalls and free repairs. A few weeks later, Mitsubishi announced that its internal investigation showed that the practice of not reporting serious customer complaints to the Ministry of Transport had been occurring since 1969 and senior Mitsubishi executives had been aware of it, but done nothing to stop it. Apparently, Mitsubishi staff wanted to avoid the embarrassment and cost of recalls.

Mitsubishi's legal responsibility was clear. So was their social responsibility. Faults and serious complaints about their vehicles from individual consumers should have been reported to the Ministry of Transport. They should then have been stored in the company's quality guarantee section, where Ministry of Transport officials could annually inspect the complaints register. Instead, according to newspaper reports, Mitsubishi repair workshops would make covert repairs for individual complainants, before there was a chance to conduct an investigation as to whether there should be a recall. The complaints were then hidden or 'misplaced' in codenamed files, so that Ministry of Transport inspections of Mitsubishi's complaints handling procedures would not find them. By the end of August, Mitsubishi had had to recall more than a million vehicles that should have been recalled earlier.

No regulator or motorist advocacy group could have discovered the paperwork hidden away in employee lockers and codenamed files. It

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Frontmatter
More information

seems that employees did not question what was a standard company practice for thirty years. The regulators and Mitsubishi's customers had to rely on Mitsubishi's internal complaints and fault handling systems to collect, categorize and determine how to treat different faults. It would be preposterous to expect the regulator to be able to keep track of every fault and complaint itself. But once the story came out, the results were dramatic. Sales fell by almost 20 per cent in Japan. All executives took pay cuts of between 20 and 35 per cent in order to demonstrate their responsibility for the cover-up. The president and the general manager of quality both resigned. The recall itself cost many millions of dollars. Most seriously, Mitsubishi's controlling shareholder, Daimler Chrysler (which acquired a stake in Mitsubishi only shortly before the scandal) was able to secure a 10 per cent price cut on its shareholding. Daimler Chrysler also changed its 'hands off' policy in the wake of the scandal and was able to install one of its own executives as chief operating officer for Mitsubishi.

The Mitsubishi case illustrates some of the problems and potential for corporate social and legal responsibility in contemporary democracies. On the one hand, both legal responsibilities and motorist concerns for vehicle safety and reliability failed to improve the internal handling of complaints and faults for thirty years. The capacity of law to regulate corporations is limited by the opacity and complexity of corporate structures, the desire to avoid over-regulation, and the fact that corporate management has such a great capacity to control employee workplace behaviour. On the other hand, once the cover-up was eventually exposed, it was not merely state regulatory agencies that sought to enforce responsibility on the company. A combination of an internal whistleblower (who tipped off the Ministry of Transport), government inspections, media scrutiny, customer reaction, stockholder action, and internal feelings of shame and responsibility motivated Mitsubishi management to conduct an internal investigation that brought out the full story (the Ministry of Transport inspection had only discovered part of the story), to redress the problems identified (through recalls) and to make internal changes that might improve Mitsubishi's handling of complaints and potential recalls for the future.

As this chain of events illustrates, the possibilities for democratic influence over corporate behaviour are not restricted to the capacity of state agencies to regulate them. Democracy, ideally, requires corporate permeability to a range of external values and voices. At the same time,

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Frontmatter
More information

responsible corporations must self-regulate themselves to prevent, detect and/or correct irresponsibility. Neither corporate legal obligations nor corporate social responsibility will have any impact if corporate decision-makers fail to take them on board as a part of everyday management. Corporate responsibility requires corporate responsibility management. This book examines how the open corporation – the company that democratically self-regulates – can be made a reality.

The empirical findings in this book are based largely on my own qualitative fieldwork (interviews and participant observation) with corporate 'compliance' or self-regulation practitioners in Australia, Europe and the USA. (The Appendix sets out the methodology used.) The purpose is to examine the regulatory and social conditions in which self-regulation systems have been adopted by large companies with some modest successes. In particular, I focus on the way that best practice self-regulation practitioners understand the methodology and challenges of accomplishing corporate self-regulation. Mine is a 'pragmatic' approach (Selznick 1992: 23). I use *empirical* evidence on the nature and success of regulatory innovations and implementation of corporate self-regulation systems to build a conception of how corporate responsibility management *ought* to be understood.

The 'open corporation' is a marriage between management and democracy and law. Figure 2.3 diagrammatically represents the relationship: formal government regulation, democratic and stakeholder action, and internal corporate self-regulation all inter-relate through a dynamic of three phases of corporate management of social and legal responsibility:

1. the commitment to respond via self-regulation;
2. the acquisition of specialized skills and knowledge for self-regulation; and
3. the institutionalization of purpose in self-regulation.

Corporate management responds to issues that external regulators and stakeholders manage to put on the table; and regulators and stakeholders can only put matters on the table to the extent that corporate management comes out to invite them in (through appropriate management systems and approaches). Each of the three phases of self-regulation management represents a decision point at which external influences can transform corporate practice and decision-making; but continuing interaction with external stakeholders and regulators at the

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next decision point must help to ensure the management response is appropriate. Ultimately, external stakeholders and regulators must prompt self-critique and continuous improvement through accountability and meta-evaluation, which keep the cycle of engagement moving forwards.

Corporate self-regulation professionals are key agents of the active engagement between management and stakeholders in the open corporation. They will both bear and exert pressures at all the phases of self-regulation management. Indeed, in the marriage of democracy and management, self-regulation professionals play match-maker and crisis counsellor. However, their ability to institutionalize responsibility through both the harmonizing and conflict-handling aspects of their role is only robust when: (a) the broader democracy reaches in to make management democratically responsible for how the company governs itself; and (b) corporate management opens out, by affording the self-regulation function respect and integrity by making legal and social responsibility an integral part of management.

Effective corporate self-regulation therefore means putting 'stakeholders' in a position where they can influence corporate management. It also means that law and regulatory enforcement should be designed to move companies through each of the three phases of self-regulation management. Thus, regulation aimed at companies who have not yet reached Phase One should attempt to create crises of conscience in those who can do something to change corporate culture and self-governance. It prompts commitment to respond to responsibility issues via self-regulation. Regulation aimed at Phase Two fosters and harnesses industry dynamics of innovation and modelling in self-regulation skills and knowledge. Regulation aimed at Phase Three ensures that companies report on the standard of self-regulation process they have introduced, its outcomes and effects. This means that stakeholders and regulators can check that self-regulation is robustly institutionalized. This is done through reporting and verification, using regulatory requirements (such as licence conditions, liability, and so on) as an opportunity for meta-evaluation of corporate self-evaluation.

Meta-evaluation in Phase Three enables meta-learning: corporations that learn to improve their self-regulation and regulators that learn to improve their regulatory strategies to reinforce leaders and move along laggards. The ultimate test of corporate management's self-regulation is the extent to which they evaluate and learn from their own self-regulation performance and failures (double-loop learning). The ultimate test

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of regulatory success is the extent to which regulators and law test companies' self-evaluations, and learn from them how to improve law and regulatory practice – a 'triple loop' of regulation, self-regulation and meta-regulation (see Figure 9.2).

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