MANAGERISM

The Rise and Fall of Business Ethics

How business managers lost their business ethics and family firms with moral purpose became profit-maximizing shareholder-value corporations

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CADBURY – A QUAKER COMPANY

This is the tale of the business ethics of Cadbury – one of the word's iconic chocolate brands. In 1824, John Cadbury, a Quaker (a pietist Christian denomination) began to sell tea, coffee, cocoa and drinking chocolate from rented premises in Birmingham, England. That was the beginning of the famous Cadbury family-owned business. Following the lead of Swiss companies, Cadbury later introduced its own milk chocolate bars. In 1893, George Cadbury bought 120 acres (49 ha) of land close to the confectionery works, where he planned and built Bournville a community village. This gave Cadbury workers an alternative to the unhealthy inner-city slums.

The Cadbury family were pioneers in industrial relations and employee welfare, setting standards that other enlightened employers followed. Cadbury was one of the first UK firms to introduce the custom of Saturday half-day working and of closing the factory on national public holidays. As keen sportsmen, Richard and George Cadbury encouraged recreational activities and built sports facilities in Bournville including football, hockey and cricket pitches, tennis and squash courts and a bowling green.

By the early twenty-first century, Cadbury brands were sold in 200 countries around the world. The firm employed over 36,000 people, was the third largest soft-drink company, and the fourth largest confectionery business in the world.

TRANSFORMATION INTO A CAPITAL CORPORATION

After being a successful family business for 100 years, Cadbury became a public limited company in 1962 when it offered shares to outsiders. By then, several hundred family members were co-owners – but only ten actively managed the business. Other family members were keen to get their hands on "their" money and so the Cadbury board had decided to allow the sale of shares. For the first time in its history, Cadbury was no longer under direct family control.

One major disadvantage of Cadbury being owned by dispersed public shareholders was potential conflict between those shareholders who focus on the long-term success of the business and those shareholders who want short-term profits – not only profit from dividends but also profit from selling when share prices rise and selling to anyone who will pay a higher price to take over the firm.

At that time, the Swiss competitor Nestlé had a two-tier share system with registered shares limited to Swiss citizens, which protected it from hostile advances, and made a takeover virtually impossible. The story of Hershey, another iconic chocolate maker, was also a different one.

HOSTILE TAKEOVER

In 2010, Kraft Foods, Inc. acquired Cadbury for $18.9 billion in a hostile takeover. That ended Cadbury's close links to its Quaker founding family and its historical social ethos. Instead, it instilled a pure capitalist mindset in management.

One year later, the top managers of the Kraft Foods conglomerate included Cadbury in a newly formed subsidiary Mondelez International, Inc. This was a cunning strategy by Kraft executive managers to make a successful business even more profitable, or so they claimed. Cadbury now had highly incentivized top managers at the helm. However, profit margins declined, so Mondelez management hired Accenture to tell them how to run their global conglomerate. Accenture consultants recommended a $3 billion cost-cutting program for subsidiaries including Cadbury and Nabisco. Taking this advice, Mondelez began closing Cadbury factories in several higher-wage countries including the United States, Canada, Ireland and New Zealand, and shifted manufacturing to lower-wage countries like China, India, Brazil and Mexico. The closure of Cadbury factories in Dublin, Montreal, Chicago, Philadelphia, and Dunedin in New Zealand, generated protests from local communities who were, of course, more interested in the negative impact on their communities than the profit expectations of shareholders or the bonuses of Mondelez International, Inc. managers.

Under UK company law, created essentially to protect the wealth and privileges of shareholders, employees and other stakeholders have no legal right to demand that corporate managers take their interests into account. When Kraft had taken over Cadbury, after promising to keep open Cadbury's manufacturing plant in Somerdale, England, one week later those same executives said they would close the Somerdale plant. As part of a maximum shareholder value strategy, they later announced that some profit-earning brands of Cadbury would be legally transferred to Switzerland where government tax on such corporate earnings is lower.

In 2016, as a final betrayal of the historical Cadbury ethos, the managers silently canceled (no press release) the Cadbury promise to buy Fairtrade cocoa. An ethical British enterprise had been transformed from a force for social good to a shareholder-value entity. Other controversies surrounding the behavior of corporate managers at Mondelez International, Inc. are listed in Wikipedia.[1]

VICTIM OF SPECULATION

How did the family-owned Cadbury firm which once practised strict Quaker moral values fall victim to predatory capitalists? After all, the British press opposed the takeover, unions protested the sell-out, and U.K. government ministers including the Prime Minister debated the issue. The deciding factor was Cadbury's diversified shareholders – and they were for it. There was no ownership party left to prevent a firm with a philanthropic tradition and ethos from being taken over by Kraft Foods, Inc. – a kind of holding corporation with 23 subsidiaries including another 4 holding companies.

When Kraft announced its hostile bid Cadbury's share price soared from £5 to £8. Many so-called 'investors' were keen to sell out and pocket the profit. Hedge funds, for example, moved fast raising their stake from 5 percent to 31 percent. They told Chairman Roger Carr they would gladly trade

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[1] https://en.wikipedia.org/wiki/Mondelez_International Child slavery deforestation, and so on.

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their stock for a gain of 20p per share. Convinced the unwelcomed transaction was a fait accompli, Carr negotiated the best deal possible. He said, "I am paid by the shareholders and I delivered huge value to the shareholders – that was my responsibility."

But Carr also remarked, "Something has happened to the system that appears to tip the playing field to short termism." Later, in a speech at Said Business School, University of Oxford, referring to the role hedge funds played in the Cadbury takeover, he said, "Whilst capitalism is efficient, it may be unreasonable that a few individuals with a few weeks of share ownership can determine the life-time destiny of many."[2] But what Roger Carr was describing about 'capitalism', as he called it, was not a sometime failing – it is a systemic failure.

Prof. Colin Mayer, Said Business School, Oxford University, in his book *Firm Commitment* describes this behavior as a characteristic of Anglo-American corporations "... the corporation is a rent-extraction vehicle for the shortest-term shareholder." And further "The problem is not one of how to define and measure values to which we attach significance, but how these values can be re-established in markets where patterns of ownership are no longer conducive to the promotion of interests other than those of shareholders."

Cadbury was not the only firm with ethical roots. Similar cradle-to-grave models were pursued by other firms in Britain, the U.S. and Europe. "Papa" Suchard introduced workplace insurance, free holidays and a kindergarten at his Swiss factory from the 1870s. Another Swiss chocolate maker, Jean Tobler of the Toblerone brand, built houses for workers and offered vacations for workers and their families. Both brands now belong to Mondelez International, Inc. Many once privately-owned enterprises aimed for Profit with Purpose such as Rowntree's, Lever Brothers, Johnson & Johnson, and so on, but few are now loyal to earlier ethical principles.

They were at that time not capital corporations owned by dispersed international shareholders speculating on higher profits, higher share prices and M&A growth to monopolize customer and supplier markets. They were enterprises that grew through product quality, innovation, trustworthiness, honesty and reputation. Many nineteenth-century U.K. firms were founded by devout Christian entrepreneurs (see Thinkpiece 42 *What is the Purpose of Business Ethics*)

ACQUIRED BY A GLOBAL M&A CONGLOMERATE

It was in 2009 that Cadbury first received the unwanted attention of Kraft Foods. For the two former family chairmen Adrian and Dominic Cadbury the news of the later sale to the American conglomerate was "a tragedy". "One hundred and eighty years of history gone," remarked Dominic. "And, I would argue 180 years of being a beacon of good practice ... all gone and it was so easy."

Cadbury became a subsidiary of a global food conglomerate created by a hundred years of M&A stratagems. Kraft Foods had its roots in the National Dairy Products Corporation formed in 1923, which built an oligopoly by acquiring and merging other firms in the U.S. ice-cream market. By the 1930s, National Dairy Products had acquired over fifty-five competitors to become the largest dairy company in the U.S. and the world. At the same time another dairy products firm, Kraft Cheese

[2] https://www.lehmanns.de/shop/wirtschaft/26131411-9780191611346-corporate-governance-and-chairmanship

Company, was also consolidating the U.S dairy industry. By 1930, Kraft Cheese Company brands had captured forty percent of the cheese market. In 1976, Kraft was acquired by the National Dairy Products Corporation, which adopted the name Kraft, Inc. This Kraft was itself acquired in 1988 by tobacco giant Philip Morris Companies, which had previously purchased General Foods, before buying Nabisco Holdings, and merging both to create Kraft General Foods. Later the firm became Kraft Foods Company and purchased the biscuit division of Groupe Danone, a French company, before readying its hostile pursuit of Cadbury. The acquired Cadbury became part of Kraft spin-off Mondelez International, Inc. While in 2015, Kraft Foods merged with Heinz to become The Kraft Heinz Company.

Corporate growth by M&A transactions instead of operational growth is common among capital corporations. This business model of growing a capital corporation by purchasing brands and market share, and eliminating industry competitors, continues until the present day.

Hershey and the Failed Hostile Takeover by Mondelez. Hershey is America's leading chocolate business with one third of the U.S. confectionery market. The original Hershey business embraced a Christian ethos. The founder, Milton Hershey, was of a Christian Mennonite family. Like the Cadburys he adopted a paternalistic and humane management style (Hershey works councils obviated trade unions). The town of Hershey in Pennsylvania referenced the successful Cadbury Bournville village. Hershey wanted his workers to be able to live self-reliant independent lives with comfortable homes, health care, and schools for their children.

Unlike Cadbury whose family members surrendered family control of the company, during his lifetime Milton Hershey donated a majority shareholding to The Hershey Trust. When Mondelez International, Inc. attempted a hostile takeover in 2016, The Hershey Trust, by then a $12 billion charity and Hershey's controlling shareholder, blocked the takeover attempt, as it had other attempts.

Pennsylvania law now says that a charitable trust, if selling a business enterprise, must consider the economic impact on the community and the special relationship with the community. The town of Hershey (population 14,000) has opposed several attempted takeovers. Many residents extol the "Hershey legacy" that a successful business also takes care of the community.

CAPITAL CORPORATIONS – PROFIT WITHOUT PURPOSE

It is factual and fair to say that the top managers of Mondelez International, Inc. are not interested in the welfare of any stakeholders other than shareholders. Not only are corporate officers often legally obliged, but also their careers depend on satisfying the expectation of shareholders, whose investment strategy is simple: short-term ownership of an overperforming stock. Management theories like Shareholder Value justify this approach. Most business schools still teach that profit is the proper purpose of a corporation and the rightful mission of management.

STAKEHOLDER ENTERPRISES – PROFIT WITH PURPOSE

Today corporate managers serve the interests of shareholders but not stakeholders
The issue is not whether managers **can** make trade-offs between the interests of different stakeholders (including shareholders) because managers do make trade-offs.
The issue is who should decide the corporate ethics and who should implement them.
Stakeholders should decide **what** and the executive managers should decide **how**.

Reform is necessary because, especially in the Anglo-American financial world, corporate managers who follow a balanced public or community purpose instead of pure profits can soon be

fired by shareholders. This is a key difference between a private family-owned enterprise and a public capital corporation. It is exemplified by the many case studies of ethical business enterprises on our Managerism website.

Prof. Colin Mayer, Oxford University, writes in his book *Firm Commitment*, that business and managerial success should be properly measured against fulfillment of declared purpose and not fulfillment of anticipated profit.

WHAT SHOULD BE DONE

Business enterprises have a social responsibility to their stakeholders including the community of which they are an integral part – that is business or corporate ethics. To revive business ethics, it is necessary that company law, regulation and governance be reformed:

- Reform of company law and shareholder rights
- Reform of legal responsibility and monetary incentives of corporate managers
- Reform of corporate governance in the interest of all stakeholders and not only shareholders.

Legal reform is necessary to protect the interests of all stakeholders and to limit the rights of shareholders.
Business ethics are only viable if corporations are also managed for a moral purpose.
Business enterprises should be managed for Profit with Purpose.

FURTHER READING

Prof. Colin Mayer, Firm Commitment – Why the corporation is failing us and how to restore trust in it, Oxford University Press, Oxford, England, 2013

Prof. Colin Mayer, PROSPERITY – better business makes the greater good, Oxford University Press, Oxford, England, 2018

See www.managerism.org:

Thinkpiece 42 - What is the Purpose of Business Ethics

Thinkpiece 20 - The Decline of Moral Behavior in Business

Insight 5 - The Honorable Merchant - A Role Model for Today