

IIUM

# Etch-A-Sketch Ethics

Case study

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## Summary

The case describes the decision by Etch-A-Sketch to move its production from Ohio to China. The Ohio Art Company was perhaps well known to be one of the top selling toys company of all time. In the 1990s, Etch-A-Sketch, the maker of the popular drawing board, was faced with a sluggish toy market and strong pressure to keep prices low. Consequently, the company made the unpopular decision to outsource production in December of 2000 to Kin Ki Industrial, a leading Chinese toy maker, laying off 100 U.S workers in the process. The closure of the company was expected by the employees but the thought of it moving was not emotionally easy since the company was the one holding the community together. The small Ohio town of Bryan where the manufacturing took place faced significant effects from the outsourcing. The population declined heavily and the tax base of Bryan, Ohio was severely eroded. Homes were also on auction and there were notices of foreclosures in the local paper.

The rationale behind the decision for outsourcing was mainly cost saving. First and foremost the company wanted to lower their wages. Chinese factory workers made \$75 per month compared to \$1500 per month for U.S factory workers. On top of that, there were also low overhead costs for plants, maintenance, electricity and health benefits. All in all, they had to keep the cost of Etch-A-Sketch under \$10 in order to compete with big retailers such as Wal-Mart and Toy "R" Us.

In December 2003, New York Times published a report stating that there were dismal pictures of working conditions in China. Workers were working from 7:30 am to 10:00 pm everyday whereby they worked for 84 hrs/wk compared to the 40 hrs/wk set by local authorities and also at a rate of 24 cents/hr versus 33 cents/hr minimum wage. They also stated that there were no pensions or medical benefits given to the workers and that the dormitories where the workers lived were in poor condition and the food was very unhealthy.

Meanwhile in Ohio, William Killgallon, Ohio Art Company's CEO responded that senior partners at the Chinese plant acknowledged that the wages were indeed low and that it will be raised. Furthermore, he claimed to have no knowledge of the labour problems and that he will visit China soon to make sure their expectations were met.

## Analysis. Answering the questions

**Question 1. Was it ethical of the Ohio Art Co. to move production to China? What were the economic and social costs and benefits of this decision? What would have happened if production had not been moved?**

The decision on whether or not the company shifting production is ethically wrong is more of a debatable topic. Several factors can influence the company's decision.

First and foremost, in legal terms the company did not break any laws and so its decision to offshore was merely based on other options. If the company did not find ways to lower production costs below \$10, the company would have eventually gone bankrupt. If production had not been moved, the company would be unable to generate enough profits to continue business. Either way, the employees would have suffered job losses. The Company's sole responsibility was to maximize

profit within legal constraints. Furthermore, the company's decision benefited shareholders, which is seen as an ethical decision.

However, Ohio Art Company's obligations to its employees are something that must be considered as well. The company, which is perceived as a family by the community, should not just abandon its employees. They have a moral obligation to look after the community's interest at large. On the other hand we can say that it was unethical to its employee's in China in that, they did not even guarantee minimum working conditions in China.

The economic benefit of Ohio Art Company's decision was that, the company did not go bankrupt, which enabled the company to stay competitive against all the other big retailers and that the owners were still a source of revenue for their home country i.e. the government. The company was also able to provide jobs to the poor Chinese villagers who gained higher paying jobs and were able to move from the countryside to the city. On the other hand, American consumers were able to benefit from the lower prices. As to social costs, the closing of the factory resulted in the collapse of the local community. 100 workers lost their jobs if we take into account that Bryan has only 8,000 inhabitants. Furthermore, the working conditions in China were very bad and workers lived in poor conditions and their wages were very low.

Lastly, if the production had not been moved, Ohio Art Company would have lost competitiveness and go bankrupt. On the other hand, if they were willing to look for other alternative ways to save money like for example reducing operating costs they may still stay competitive.

**Question 2. Is it possible, as Mr. Killgallon claims, that the Ohio Art Company had no knowledge of labor problems at Kin Ki? Do you think company executive had any knowledge of the working conditions?**

In our opinion, Mr. Killgallon knows and aware about the labor problems at Kin Ki. Being one of the biggest companies in toys market, Ohio Art Company is well established since the 1960s. They became so successful that their sales volume has reached more than 100 million units. They have already reached the high standard and are ready to globalize their production as they did with Kin Ki. When they decided to outsource their production of Etch-A-Sketch to China, they should have considered several factors such as the sufficiency of resources, labor rights and working conditions. As a CEO of Ohio Art Company, Mr. Killgallon should know the details and the requirements of going global.

Being a good company executive, he should have knowledge about conditions of the labor in China. From the beginning of the process of going to China, they have studied and taken into consideration all the working conditions there. Then the company executive should also check and supervise their labor working conditions as they might face trial in court if anything happen to the labor later. In this case, we think the company executives knew about the working conditions but they decided to neglect it as they focus more on earning profits. They hoped nobody will know about their suffering labor in China and they will continue to earn more profits.

### Question 3. What steps can executives at the Ohio Art Company take to make sure they do not find the company profiled in The New York Times again as an enterprise that benefits from sweatshop labour?

Sweatshop - business establishment that makes its employees work under harsh and often hazardous conditions, and pays only minimal or survival wages.<sup>1</sup>

First of all, the company simply must follow the rules of the country where it operates. Working for 84 hours a week compared to the 40 hours week set by local authorities in Shenzhen province and also at a rate of 24 cents per hour versus 33 cents per hour minimum wage is an atrocious violation made by Ohio Art Company.

Secondly, on top of complying with the country legislation, Ohio Art Company has to make sure it complies with all contemporary expectations of a business that operates ethically. Business ethics can be interpreted in different ways but that does not allow an Ohio Art Company to operate without any concern for its business mode in various parts of the world, be it China, Poland, Vietnam or US.

There is a common agreed list of criterions on how the international company should lead its business and most of these criterions are well founded, discussed and clarified. Moreover they are very fundamental and therefore easy to understand for a company executive.

To say that the Ohio Art Company should feed the Chinese workers and treat them very well, that is to say nothing. It is already clear that Ohio Art Company should have done something about its Chinese operations. That is not the question. The real question here is how much the company should do and what it should do exactly.

To answer this question in a right and balanced manner, we think the company should set the international standards as a benchmark, i.e. the standards that define how workers should be treated and paid for their job. When it comes to treating workers we should look at how they are treated across the globe focusing on world best practices. It is absurd to follow Chinese labor standards which are rough compared to those of US or European (in fact the Ohio Art Company's Chinese manufacturer did not even follow these official standards for Shenzhen province). At the same time it will be dubious and impractical to follow US labor standards and norms in China. In other words, the company has to clearly define what acceptable treatment of employees is and what is not.

In order to make it workable the Ohio Art Company has to draft a comprehensive checklist of best practices and norms for the operations of its Chinese manufacturer. This checklist eventually has to take a legal form, be finalized, distributed and explained throughout the whole company and finally incorporated into corporate culture of Ohio Art Company as well as Kin Ki. Kin Ki, though being remotely located manufacturer in China, has to go through exactly the same process as Ohio Art Company itself. If the rules are not followed the Ohio Art Company should threaten to work with Kin Ki. Both, Ohio Art Company and Kin Ki, have to be precisely clear on what it means to them fair and proper treatment of employees.

Ohio Art Company should ask questions, demand transparency, and inform Kin Ki Industrial about the labour standards that they must meet.

That is a one time job. The job that has to be done on a regular basis is frequent and random inspections on all premises of Ohio Art Company located in China or any other country where Ohio Art Company decides to outsource its manufacturing activities.

Regular and open visits by all media and special interest groups should be welcomed in order to show that the company is truly striving to do the best to comply with what is considered the best world practices and has nothing to hide or to be afraid of from the public. The company should make annual inspection by employing local managers at Kin Ki to monitor company's activities and the treatment of the labour. At the same time managers at Ohio Art Company should learn the cultural differences between China and US and be aware of the business environment in China.

The document reflecting the world best practices on the employee treatment must be implemented and not left to be put in a frame on the wall or some other purely symbolic purposes.

What is more, the company should not also wait for the world's latest best practices but instead should set them itself. Ohio Art Company should be proactive and should not wait till it will be torn apart by zealous media and human rights groups. The company can redefine its image in the public as a company that pays special interest to how its overseas operation is run, the company that really cares about its employees even in far located China.

Before Ohio Art Company choose their manufacturer they should ask these questions:

Does the business have a code of conduct that protects human rights or checklist of best practice norms on treating workers?

Is the business providing development programs in the communities where your workers live?

Are the business factories monitored by independent, third-party sources?<sup>2</sup>

The Ohio Art Company should try to be something opposite to Nike, which was well known for its child labor use in Pakistan and humiliating labor practices in China.<sup>3</sup>

## Conclusion

One of the biggest ethical problem companies faces nowadays is the outsourcing of production to a low-wage country in order to cut costs. The company usually hires a subcontractor in the country they move production to and let them handle the practical things. Unfortunately in most cases the subcontractor gets involved into unethical activities. The way the subcontractor treats their employees is inhuman and the wages they pay them are below legal minimum wages. Even though Ohio Art Company itself is not then directly treating the production workers poorly, they are still responsible for the actions of their subcontractors. Thus before outsourcing their production, companies should really think through the effects of their actions on everyone who is affected by their decisions.

Ohio Art Company was well aware of its Chinese operations and unethical activities taking place there.

Ohio Art Company needs to change the situation, it should comply with the law of country where it operates, develop a comprehensive checklist or code of conduct, transform it into legal document and enforce it throughout the whole company including Chinese manufacturer Kin Ki. In the case the subcontractor fail to comply the company should threaten to terminate its contract.

The company should also do more than what is expected of it. The regular checks and inspections have to be conducted both by the company and external special interest group. The company should be proactive rather than reactive.

## References

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<sup>1</sup> <http://www.businessdictionary.com/definition/sweatshop.html> (assessed on 26.11.2011, web site "Business dictionary").

<sup>2</sup> Peck, D. (n.d.). Retrieved from Guide to Ending Sweatshops:  
<http://www.greenamerica.org/pdf/endingsweatshops.pdf>

<sup>3</sup> <http://www1.american.edu/ted/nike.htm> (assessed on 24.11.2011, Azam F., *NIKE: Nike Shoes and Child Labor in Pakistan*, web site "TED case studies").