“The ethics of outsourcing at Mattel”

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SECTION 3. General issues in management

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The ethics of outsourcing at Mattel

Abstract

This study addresses the ethical issues related to Mattel Corporation. This study presents a chronological dateline highlighting the illegal and unethical activities that took place by suppliers for Mattel as well as Mattel's reaction to the crisis. In addition, this article will address how corporate culture played a role in the decision to outsource the manufacturing process to facilities, which were not following legal standards.

Keywords: Mattel, corporate culture, ethics, Fraud, product safety.
JEL Classificastion: M14.

Introduction

Corporate culture is defined as the shared values and beliefs of individuals within an organization (Stanwick and Stanwick, 2009). Corporate culture is an important concept to examine when researchers attempt to explain unethical behavior within an organization. Previous research in the area has primarily focused on the positive aspects culture that is related to firm performance (Deal and Kennedy, 1982; Peters and Waterman, 1982; Denison, 1990). It is also important to consider that the corporate culture can have negative impact on a firm's operations if the culture supports unethical and illegal activities. This study examines how one company, Mattel, developed a culture which allowed the unethical and illegal actions of its suppliers to negatively affect its operations.

In 2006, 75 percent of all toys manufactured worldwide came from China. Within China, one province, Guangdong, is the location of 5,000 of China's 8,000 toy manufacturing plants. It is estimated that 1.5 million workers are employed in Guangdong toys manufacture (MacLeod, 2006). Mattel makes approximately 65 percent of its toys there. The corporation states that it demands that the toys that are outsourced to other manufacturers must comply with the safety standards established by Mattel. Raw materials that would be used by an outsourced manufacturer are first sent to the Mattel control facility in order to verify they meet all safety standards. Mattel has been manufacturing in China since the first Barbie was made there in 1959. The corporation has developed a number of long standing relationships with China manufacturers, which may have lead to more relaxed monitoring and control of its operations (Story, 2007). Furthermore, Mattel was a major customer for these suppliers, so it should have absolute control over the manufacturing process as it relates to the level of quality and compliance with government regulations and standards. However, Mattel's top level managers appeared to be fixated only on the low price of production of the Chinese suppliers. By allowing the quality standards to drop to potentially dangerous levels, Mattel managers focused only on their own self-interests since their performance was directly linked to the financial performance of Mattel. Therefore, Mattel managers ignored potential safety issues with the production of the toys in China since lower levels of production or higher costs per unit would have a direct impact on their total level of income for the year. As a result, it does not matter whether the lack of quality controls were deliberate or not. Since Mattel's name goes on the final product, its managers were accountable for the actions of their suppliers (Hegarty and Sims, 1979; Singhapakdi and Vitell, 1990; Granitz, 2003).

1. The first recall of toys

On August 1, 2007, Mattel had to recall almost 1.5 million toys that were made in China. Over 80 toys contained potentially dangerous levels of lead in the paint on the toys. A long time supplier of Mattel had used non-approved paint pigment which violated Mattel's and the toy industry's standards (Bogoslaw, 2007). On August 2, 2007, Mattel issued a press release in which it explained its course of action to correct the problem. Mattel worked with the U.S. Consumer Product Safety Commission and other regulatory agencies around the world to pull the toys off the shelves and halt the distribution of any toy that contained the unacceptable levels of lead. Robert Eckert, Chairman and CEO stated that: "We apologize to everyone affected by this recall, especially those who bought the toys in question…We realize that parents trust us with what is most precious to them…their children. And we also recognize that trust is earned. Our goal is to correct this problem, improve our systems and maintain the trust of the families that have allowed us to be part of their lives by acting responsibly and quickly to address their concerns" (Mattel, 2007).

This recall was despite the fact that Mattel was aware of the potential lead hazard at least a month earlier,

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when one of the European retailers that sold Mattel products in early July discovered lead in some of its toys. On July 6, 2007 Mattel stopped production in the factory, which they believe was the origin of the lead paint. Commenting on the supplier using the lead paint, CEO Eckhart stated that this was a supplier which had worked for Mattel for 15 years and: "…this isn't somebody that just started making toys for us…They understand our regulations, they understand our program, and something went wrong. That hurts". It is a requirement established by Mattel that those outsourced factories making Mattel toys must use paint and other material from certified suppliers. As a result, Mattel was not sure whether the manufacturer substituted paint from a supplier who was not certified or whether the lead paint came from a certified supplier. In 2007, 50 percent of Mattel's total revenues were based on the toys that were manufactured in their 11 factories in China which they owned and operated (Story, 2007a).

2. Why lead paint?

Lead is added to paint in order to increase the speed in which the paint dries, to increase the durability of the paint and to enhance the ability of the paint to resist moisture which could cause corrosion (Wikipedia). Lead paint is also easier to apply on hard surfaces and can produce a richer color than paint without lead. The net result is that lead enhances how the paint is used in the production process, but the lead is not allowed to be added to the paints. Therefore, paint in which lead has been added is sold at a "discount" price of one third of the cost of paint that does not include lead (Barboza, 2007).

Mattel had allowed the local suppliers to implement their own safety testing which resulted in the shipping of tainted toys from the factories in China to children around the world. The suppliers had started to use cheaper paint which contained lead to reduce manufacturing costs. The supplier that made the toy Lee Der Industrial Company was investigated by the Chinese Government for its role in the use of tainted paint. The supplier stated that it was cheated by its own paint supplier, who sold Lee Der Industrial the paint which included the lead. Lee Der Industrial claimed that they were not aware that the paint was contaminated with lead (Zamiska and Casey, 2007). The Chinese government banned Lee Der Industrial from exporting any more toys until a full investigation was completed. The net result was that Lee Der Industrial had to stop its operations, which led to the suicide of its founder Zhang Shuhong. Mattel's response in a press release to the suicide was that: "We were troubled to hear about this tragic news…This is a personal misfortune not a corporate event. Any loss of life is a tragedy and we feel for the family during this difficult time" (Cody and Jie, 2007).

3. The second recall

On August 14, 2007, Mattel issued a second major recall of toys manufactured in China. The second recall include additional toys made with paint contaminated with lead as well as millions of other toys which have magnets which could become loose and could be swallowed by children. An estimated 436,000 toys were being recalled due to lead paint. An additional 18.2 million magnetic toys were being recalled after reported injuries and death of children who had swallowed the magnets after they had become loose from the toy. Mattel stated that the magnetic toy recall included 63 different varies of toys including such well known brand names as Polly Pocket, Batman, and Barbie. The lead paint recalled toys included brand names such as the characters of Sesame Street, Dora the Explorer and Disney's Cars (Story and Barboza, 2007). The senior vice-president of worldwide quality assurance at Mattel, Jim Walter, stated that Mattel had "strengthened" its three-point check quality system to ensure that toys with lead would not enter the marketplace. The three point system includes verifying that only certified suppliers of paint will be used to manufacture the toys, a mandatory testing of every batch of toys produced, the tightening of quality controls including random inspections during the manufacturing process and the testing of every production run of completed toys (Barboza and Story, 2007). As was the case with the first recall, a subcontractor was used to supply the paint to Mattel's contractor in China. Hong Li Da supplied the paint to Early Light Industrial which was not aware that the paint had been contaminated with lead. Early Light had been a contractor for Mattel for 20 years. Mattel had used between 30 and 50 contractors in China and many subcontracted out part of the production process to a subcontractor. Lee Der, the contractor of the original Mattel recall lost its license to export and subsequently went out of business (Story and Barboza, 2007). Lee Der had been a Mattel contractor for 15 years.

Mattel executive vice-president for worldwide operations, Thomas Debrowski, stated that Mattel realized that there were continuing rising costs of production in China which was squeezing the profit margins of the Chinese manufacturers. He stated that: "In the last three to five years, you've seen labor prices more than double, raw materials prices double or triple…and I think that there's a lot of pressure on guys that are working at the margin to

try and save money". However, Debrowski stated that Mattel does not take the blame for putting downward pressure on the pricing of the toys despite the rising manufacturing costs. "No, absolutely not…We insist that they continue to use certified paint from certified vendors, and we pay for that, and we're perfectly willing to pay for that" (Story, 2007). It was during this time period that the Consumer Product Safety Commission (CPSC) accused Mattel of not following the mandated requirement to notify the CPSC within 24 hours after the company has made a decision to recall any products. Mattel's CEO, Robert Eckert, admitted that Mattel did not follow the CPSC requirement because they should have the right to discuss the problems on their timetable because the 24 hour time limit is unreasonable. The CPSC had already fined Mattel twice since 2001 for knowingly withholding information regarding products that could create "unreasonable risk of serious injury or death" (Casey and Pasztor, 2007).

4. The third recall

The following day, September 4, 2007, Mattel announced their third major recall. It was recalling approximately 775,000 toys with lead paint which included a number of Barbie accessories. Mattel's CEO, Robert Eckert, stated that: "We apologize again to everyone affected and promise that we will continue to focus on ensuring the safety and quality of our toys" (Casey, 2007). In a letter to *The New York Times*, Eckert commented that: "As a father of four, I am intimately aware of the expectations of parents. They want safe toys, and they want assurances that those toys have been tested to make sure that they're safe. Currently lead paint is topmost on parents' minds. I want parents to be assured that we are taking action…Our toys are overwhelmingly safe. To date, our lead-related recalls of toys produced in the past 12 months represent less than half of 1% of our production. I'd rather the number was zero…when I was a young man growing up in suburban Chicago, my father encouraged me to earn his trust through my actions rather than just talk about what I was going to do. Today, I tell my children '*deeds, not words*'. And it is on this principle that Mattel will move forward. We will earn back your trust with our deeds, not just with our words" (Eckert, 2007).

On September 18, 2007 a subcommittee of the United States Congress announced that some of the toys Mattel had recalled contained 180 times the allowable levels of lead in the paint. Therefore, up to 11 percent of the paint was lead or 110,000 parts per million. The federal law in the United States allows only 0.06% lead or 600 parts per million in paint (O'Donnell, 2007).

On September 21, 2007, Mattel's executive vice-president for worldwide operations, Thomas Debrowski, apologized to China for harming the reputation of the toy manufacturers in China for the 17 million toys Mattel recalled in 2007 not because of lead paint but because of flaws in the design of some of their magnetic toys. Debrowski commented that: "Mattel does not hold Chinese manufacturers responsible for the design in relation to the recalled magnet toys" (Story 2007b). By admitting to a design flaw, Mattel could face numerous product liability lawsuits by publically announcing a product defect. Debrowski's apology included taking full responsibility for the problem with the magnetic toys: "Mattel takes full responsibility for these recalls and apologizes personally to you, the Chinese people, and all of our customers who received the toys…It's important for everyone to understand that the vast majority of those products that we recalled were the result of a design flaw in Mattel's design, not through a manufacturing flaw in Chinese manufacturers" (Casey, Zamiska and Pasztor, 2007). The Chinese product safety chief, Li Changjiang, reminded Mattel that: "…a large part of your annual profit…comes from your factories in China…This shows that our cooperation is in the interests of Mattel, and both parties should value our cooperation. I really hope that Mattel can learn lessons and gain experience from these incidents and that Mattel should improve their control measures" (Olesen, 2007).

5. The consequences of the recall

In October 2007, shareholders filed a lawsuit against Mattel for withholding timely announcements of recalled products. The lawsuit alleged that top management at Mattel produced misleading financial statements since they were privy to potential recall notices and yet did not make them known publically until months later. The lawsuit claimed that this has been a general practice at Mattel for years. In addition, the lawsuit charged Mattel with breaching its fiduciary duties by not abiding by the consumer protection laws including the 24 hour notice statue. In addition, the lawsuit claimed that executives at Mattel were involved in insider trading by selling $33 million of Mattel stock before the announcement of the recalls became public (Taub, 2007). In October 2009, Mattel settled a consumer class action lawsuit for over $50 million to pay to consumers, who had purchased the toys containing the lead paint. The settlement will resolve 22 lawsuits that were filed against Mattel and its subsidiary Fisher Price and major retailers on behalf of the millions of families who had bought Mattel products that had been recalled (Anderson, 2009).

Therefore, it appears that the quality issue was deliberately avoided by many employees within Mattel. This

supports the view of Miller and Thomas (2005), who state that peer pressure of colleagues would support and reinforce unethical behavior even if it is in violation of the individual's own personal code of ethics. The net result of a corporate culture that support unethical actions was that the employees, which developed, maintained and supported this type of culture would not be penalized for their actions. The top level executives at Mattel were only indirectly "caught" for their actions since they continued to assign blame to the suppliers. It was only after extreme pressure from stakeholders such as the United States government, the customers and the media that Mattel finally "admitted" that they would take some responsibility for the unsafe toys. Bass and Steidmeier (1999) propose that top level executives can manipulate the beliefs of their subordinates into believing their own altered state of reality. This could explain, in part, why it took so long for Mattel to react to the claims made by its stakeholders.

Conclusions

This case highlights a number of important concepts related to unethical behavior within corporations. The actions by the top executives at Mattel support the belief that unethical actions influence the corporate culture of the firm. Through, the use of group norms at Mattel, unethical behavior was not discouraged by top level managers and was actually supported by the actions of the managers and their lack of action with their suppliers. As Trevino, Hartman and Brown (2000) state, top level executives must be both a moral person and a moral manager in order to develop an ethical leadership role within the firm. It is through both "*talking the talk*" (moral person) and "*walking the walk*" (moral manager) that top level executives can guide the ethical behavior of the individuals through the firm's corporate culture.

Future course of action. Robert Eckert has been the CEO and Chairman of Mattel since 2000. Before his current position, he had worked for Kraft Foods for 23 years. This case raises a number of ethical dilemmas, which Eckert and his staff must address to ensure the long term ethical commitment of Mattel. These dilemmas include: When does the pressure to reduce costs override the ethical values of the company? How can you change the culture of the company to ensure that this type of crisis will not occur in the future? What should the role of outsourcing be for a global company which focuses on products for children? What type of control and monitoring systems should be implemented in order to ensure the ethical values of Mattel are maintained? And finally, should top management be financially "punished" for the results of this and any future ethical crises?

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