BUSINESS ETHICS

Ethical Decision Making and Cases

8TH EDITION

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Business Ethics: Ethical Decision Making & Cases, 8th Edition

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To Anita and Robert Chandler.

— O.C. Ferrell

To Brett Pierce Nafziger.

— Linda Ferrell

To my parents, Bernice and Gerhard and my grandchildren Emma, Matthew, and Hyrum.

— John Fraedrich

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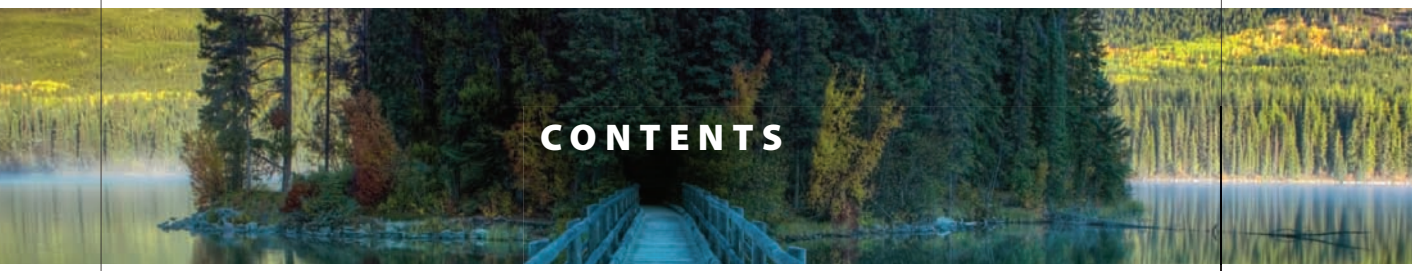

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PREFACE

Twenty years ago, the first edition of *Business Ethics: Ethical Decision Making and Cases* became the first textbook to use a managerial framework to teach business ethics. The Eighth Edition builds on this record of success and provides an enhanced teaching package to help teach the fastest-growing business course in the last two decades. In all higher education institutions there are three times as many courses in business ethics than there were in 1990. This dramatic increase has occurred as a result of stakeholder concerns about ethical conduct and public policy to encourage corporate ethics programs. No longer is ethics considered merely an independent personal decision; rather, managers are held responsible both within and outside their company for building an ethical organizational culture. As the market leader with over 550 institutions using our book, we are working to keep you, the instructor, up to date on the ever-changing issues and research within business ethics.

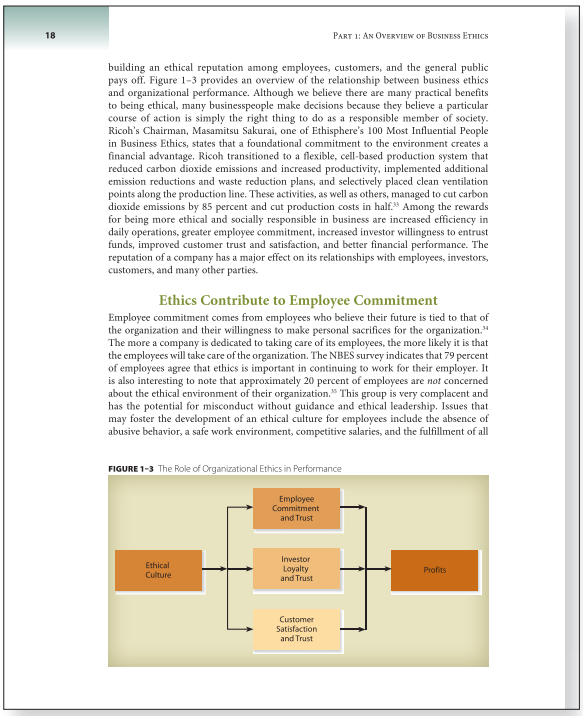
The Eighth Edition continues to change the way business ethics is taught and reflects the issues, challenges, and opportunities students will face in managing ethics in any organization. While we base each chapter on ethical frameworks and research from the academic community, we also include knowledge and best practices from business and public policy decisions from governments and international entities. This real-world approach to business ethics helps prepare students to face ethical challenges in business, and develop an ability to make ethical decisions in our global economy.

The past decade has seen the demise of many corporations, and some industries, that failed to appropriately incorporate ethics into their decision making processes. In

the first few years of the twenty-first century, we saw the failure of Enron, Worldcom, and many other firms that engaged in deception, fraud, and misconduct. The focus was on excessive risk-taking. Public policy in the form of the Sarbanes-Oxley Act and Federal Sentencing Guidelines for Organizations (FSGO) amendments was developed to prevent future misconduct. Only five years after these events, the financial industry pushed the global economy into the deepest recession in 80 years. It was discovered that excessive risk-taking, misconduct, and the failure to address stakeholders' interests were again to blame. These factors contributed to the downfall of many financial institutions, including Lehman Brothers, Bears Stearns, Countrywide Financial, Merrill Lynch, and Washington Mutual. Without a government rescue, many large banks would have failed. All these events increased regulations and laws encouraging organizations to develop programs that improve ethical conduct and prevent misconduct.

Using a managerial framework, we explain how ethics can be integrated into strategic business decisions. This framework provides an *overview of the concepts, processes, mandatory, core, and voluntary business practices* associated with successful business ethics programs. Some approaches to business ethics are excellent as exercises in intellectual reasoning, but they cannot deal with the many actual issues and considerations that people in business organizations face. Our approach prepares students for the real ethical issues and dilemmas that they will face in their business careers.

We have been diligent in this revision to provide the most relevant examples of how the lack of business ethics has challenged our economic viability and entangled countries and companies around the world. This book remains the market leader because it *addresses the complex environment of ethical decision making in organizations and pragmatic, actual business concerns.* Every individual has unique personal principles and values, and every organization has its own set of values, rules, and organizational ethical culture. Business ethics must consider the organizational culture and interdependent relationships between the individual and other significant persons involved in organizational decision making. Without effective guidance, a businessperson cannot make ethical decisions while facing a short-term orientation, feeling organizational pressure to perform well and seeing rewards based on outcomes in a challenging competitive environment.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PART 1: AN OVERVIEW OF BUSINESS ETHICS

building an ethical reputation among employees, customers, and the general public pays off. Figure 1–3 provides an overview of the relationship between business ethics and organizational performance. Although we believe there are many practical benefits to being ethical, many businesspeople make decisions because they believe a particular course of action is simply the right thing to do as a responsible member of society. Ricoh's Chairman, Masamitsu Sakurai, one of Ethisphere's 100 Most Influential People in Business Ethics, states that a foundational commitment to the environment creates a financial advantage. Ricoh transitioned to a flexible, cell-based production system that reduced carbon dioxide emissions and increased productivity, implemented additional emission reductions and waste reduction plans, and selectively placed clean ventilation points along the production line. These activities, as well as others, managed to cut carbon dioxide emissions by 85 percent and cut production costs in half.[53] Among the rewards for being more ethical and socially responsible in business are increased efficiency in daily operations, greater employee commitment, increased investor willingness to entrust funds, improved customer trust and satisfaction, and better financial performance. The reputation of a company has a major effect on its relationships with employees, investors, customers, and many other parties.

Ethics Contribute to Employee Commitment

Employee commitment comes from employees who believe their future is tied to that of the organization and their willingness to make personal sacrifices for the organization.[54] The more a company is dedicated to taking care of its employees, the more likely it is that the employees will take care of the organization. The NBES survey indicates that 79 percent of employees agree that ethics is important in continuing to work for their employer. It is also interesting to note that approximately 20 percent of employees are *not* concerned about the ethical environment of their organization.[55] This group is very complacent and has the potential for misconduct without guidance and ethical leadership. Issues that may foster the development of an ethical culture for employees include the absence of abusive behavior, a safe work environment, competitive salaries, and the fulfillment of all

FIGURE 1–3 The Role of Organizational Ethics in Performance

Employees cannot make the best, most ethical decisions in a vacuum devoid of the influence of organizational codes, policies, and culture. Most employees and all managers are responsible not only for their own ethical conduct, but for the conduct of coworkers and those who they supervise. Therefore, teaching business ethics as an exercise in independent and group decision making helps to acknowledge key influences upon (un)ethical conduct of coworkers and managers. Employees must be taught how to recognize and when to

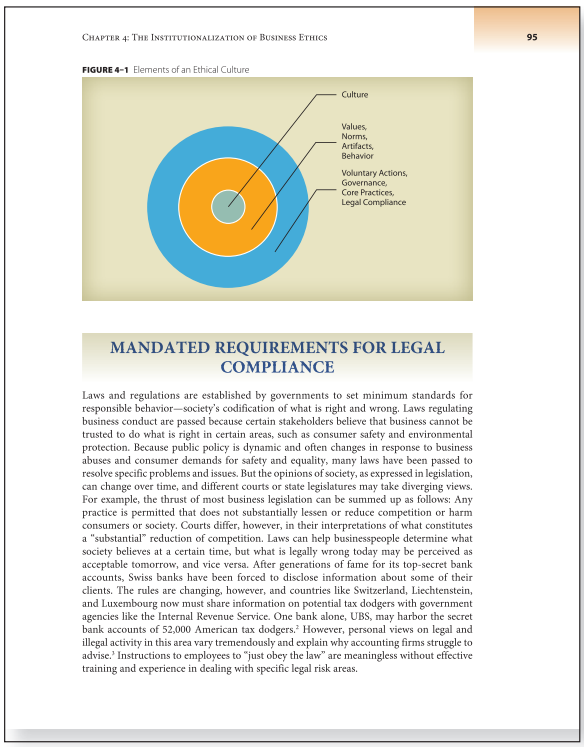
report and address ethical issues in the workplace. Students must also learn how to "fit in" the ethical culture of their organization and be responsible for their own decisions while upholding the ethical standards of the organization. In this edition we help readers understand that in an organizational environment, their values are weighted differently from actions taken outside the business world. Profit is one element that distinguishes business versus nonbusiness decisions.

By focusing on the issues and organizational environments, this book provides students the opportunity to see the roles and responsibilities they will face in business. The past decade has reinforced that business ethics is not a "fad" but a prevailing set of risks that organizations face on an ongoing basis, and organizations are now demanding better, more informed employees. Governments, universities, and colleges now understand that the ethical decision process must be taught.

Our primary goal has always been to enhance the awareness and the ethical decision making skills that students will need to make business ethics decisions that contribute to responsible business conduct. By focusing on these concerns and issues of today's challenging business environment, we demonstrate that the study of business ethics is imperative to the long-term well-being of not only businesses, but also our economic system.

PHILOSOPHY OF THIS TEXT

Business ethics in organizations requires principle-based leadership from top management and purposeful actions that include planning and implementation of standards of appropriate conduct, as well as openness and continuous effort to improve the organization's ethical performance. Although personal values are important in ethical decision making, they are just one of the components that guide the decisions, actions, and policies of organizations. The burden of ethical behavior relates to the organization's values and traditions, not just to the individuals who make the decisions and carry them out. A firm's ability to plan and implement ethical business standards depends in part on structuring resources and activities to achieve ethical objectives in an effective and efficient manner.



CHAPTER 4: THE INSTITUTIONALIZATION OF BUSINESS ETHICS 95

FIGURE 4–1 Elements of an Ethical Culture

MANDATED REQUIREMENTS FOR LEGAL COMPLIANCE

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Laws regulating business conduct are passed because certain stakeholders believe that business cannot be trusted to do what is right in certain areas, such as consumer safety and environmental protection. Because public policy is dynamic and often changes in response to business abuses and consumer demands for safety and equality, many laws have been passed to resolve specific problems and issues. But the opinions of society, as expressed in legislation, can change over time, and different courts or state legislatures may take diverging views. For example, the thrust of most business legislation can be summed up as follows: Any practice is permitted that does not substantially lessen or reduce competition or harm consumers or society. Courts differ, however, in their interpretations of what constitutes a "substantial" reduction of competition. Laws can help businesspeople determine what society believes at a certain time, but what is legally wrong today may be perceived as acceptable tomorrow, and vice versa. After generations of fame for its top-secret bank accounts, Swiss banks have been forced to disclose information about some of their clients. The rules are changing, however, and countries like Switzerland, Liechtenstein, and Luxembourg now must share information on potential tax dodgers with government agencies like the Internal Revenue Service. One bank alone, UBS, may harbor the secret bank accounts of 52,000 American tax dodgers.[2] However, personal views on legal and illegal activity in this area vary tremendously and explain why accounting firms struggle to advise.[3] Instructions to employees to "just obey the law" are meaningless without effective training and experience in dealing with specific legal risk areas.

The purpose of this book is to help students improve their ability to make ethical decisions in business by providing them with a framework that they can use to identify, analyze, and resolve ethical issues in business decision making. Individual values and ethics are important in this process. By studying business ethics, students begin to understand how to cope with conflicts between their personal values and those of the organization.

Many ethical decisions in business are close calls. It often takes years of experience in a particular industry to know what is acceptable. We do not, in this book, provide ethical answers but instead attempt to prepare students to make informed ethical decisions. First, we do not moralize by indicating what to do in a specific situation. Second, although we provide an overview of moral philosophies and decision making processes, we do not prescribe any one philosophy or process as best or most ethical. Third, by itself, this book will not make students more ethical nor will it tell them how to judge the ethical behavior of others. Rather, its goal is to help students understand and use their current values and convictions in making business decisions and to encourage everyone to think about the effects of their decisions on business and society.

Many people believe that business ethics cannot be taught. Although we do not claim to teach ethics, we suggest that by studying business ethics a person can improve ethical decision making by identifying ethical issues and recognizing the approaches available to resolve them. An organization's reward system can reinforce appropriate behavior and help shape attitudes and beliefs about important issues. For example, the success of some campaigns to end racial or gender discrimination in the workplace provides evidence that attitudes and behavior can be changed with new information, awareness, and shared values.

CONTENT AND ORGANIZATION

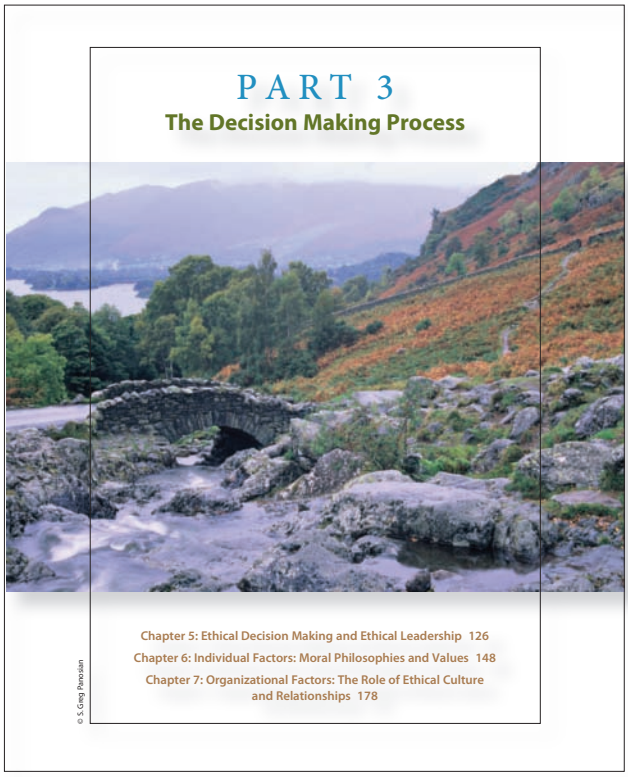
In writing *Business Ethics*, Eighth Edition, we strived to be as informative, complete, accessible, and up to date as possible. Instead of focusing on one area of ethics, such as moral philosophy or social responsibility, we provide balanced coverage of all areas relevant to the current development and practice of ethical decision making. In short, we have tried to keep pace with new developments and current thinking in teaching and practices.

The first half of the text consists of ten chapters, which provide a framework to identify, analyze, and understand how businesspeople make ethical decisions and deal with ethical issues. Several enhancements have been made to chapter content for this edition. Some of the most important are listed in the next paragraphs.

Part One, "An Overview of Business Ethics," includes two chapters that help provide a broader context for the study of business ethics. Chapter 1, "The Importance of Business Ethics," has been revised with many new examples and survey results to describe issues and concerns important to business ethics. Chapter 2, "Stakeholder Relationships, Social Responsibility, and Corporate Governance," has been significantly reorganized and updated with new examples and issues. This chapter was reorganized and expanded to develop an overall framework for the text.

Part Two, "Ethical Issues and the Institutionalization of Business Ethics," consists of two chapters that provide the background that students need to identify ethical issues and understand how society, through the legal system, has attempted to hold organizations responsible for managing these issues. Chapter 3, "Emerging Business Ethics Issues," has been significantly reorganized and updated and provides expanded coverage of business ethics issues. Reviewers requested more detail on key issues that create ethical decisions. Within this edition, we have increased the depth of ethical issues and have updated the following new issues: abusive and intimidating behavior, lying, bribery, corporate

intelligence, environmental issues, intellectual property rights, and privacy. Chapter 4, "The Institutionalization of Business Ethics" examines key elements of core or best practices in corporate America today along with legislation and regulation requirements that support business ethics initiatives. The chapter is divided into three main areas: voluntary, mandated, and core boundaries.



Part Three, "The Decision Making Process" consists of three chapters, which provide a framework to identify, analyze, and understand how businesspeople make ethical decisions and deal with ethical issues. Chapter 5, "Ethical Decision Making and Ethical Leadership," has been revised and updated to reflect current research and understanding of ethical decision making and contains a new section on ethical leadership. Chapter 6, "Individual Factors: Moral Philosophies and Values," has been updated and revised to explore the role of moral philosophies and moral development as individual factors in the ethical decision making process. This chapter now includes a new section on white-collar crime. Chapter 7, "Organizational Factors: The Role of Ethical Culture and Relationships," considers organizational influences on business decisions, such as role relationships, differential association, and other organizational pressures, as well as whistle-blowing.

Part Four, "Implementing Business Ethics in a Global Economy," looks at specific measures that companies can take to build an effective ethics program, as well as how these programs may be affected by global issues. Chapter 8, "Developing an Effective Ethics Program," has been refined and updated with corporate best practices for developing effective ethics programs. Chapter 9, "Implementing and Auditing Ethics Programs," offers a framework for auditing ethics initiatives as well as the importance of doing so. Such audits can help companies pinpoint problem areas, measure their progress in improving conduct, and even provide a "debriefing" opportunity after a crisis. Finally, Chapter 10, "Globalization of Ethical Decision Making" is completely revised to reflect the complex and dynamic events that almost caused a global depression. This chapter will help students understand the major issues involved in making decisions in a global environment.

Part Five consists of eighteen cases that bring reality into the learning process. Nine of these cases are new to the eighth edition, and the remaining nine have been revised and updated. The companies and situations portrayed in these cases are real; names and other facts are not disguised; and all cases include developments up to the end of 2009. By reading and analyzing these cases, students can gain insight into ethical decisions and the realities of making decisions in complex situations.

TEXT FEATURES

Many tools are available in this text to help both students and instructors in the quest to improve students' ability to make ethical business decisions.

- Each chapter opens with an outline and a list of learning objectives.
- Immediately following is "An Ethical Dilemma" that should provoke discussion about ethical issues related to the chapter. The short vignette describes a hypothetical incident involving an ethical conflict. Questions at the end of the "Ethical Dilemma" section focus discussion on how the dilemma could be resolved.
- At the end of each chapter are a chapter summary and an important terms list, both of which are handy tools for review. Also included at the end of each chapter is a "Resolving Ethical Business Challenges" section. The vignette describes a realistic drama that helps students experience the process of ethical decision making. The "Resolving Ethical Business Challenges" minicases presented in this text are hypothetical; any resemblance to real persons, companies, or situations is coincidental. Keep in mind that there are no right or wrong solutions to the minicases. The ethical dilemmas and real-life situations provide an opportunity for students to use concepts in the chapter to resolve ethical issues.
- Each chapter concludes with a series of questions that allow students to test their EQ (Ethics Quotient).
- Cases. In Part Five, following each real-world case are questions to guide students in recognizing and resolving ethical issues. For some cases, students can conduct additional research to determine recent developments because many ethical issues in companies take years to resolve.

CHAPTER OBJECTIVES

- To explore conceptualizations of business ethics from an organizational perspective
- To examine the historical foundations and evolution of business ethics
- To provide evidence that ethical value systems support business performance
- To gain insight into the extent of ethical misconduct in the workplace and the pressures for unethical behavior

CHAPTER OUTLINE

Business Ethics Defined
Why Study Business Ethics?
A Crisis in Business Ethics
The Reasons for Studying Business Ethics
The Development of Business Ethics
Before 1960: Ethics in Business
The 1960s: The Rise of Social Issues in Business
The 1970s: Business Ethics as an Emerging Field
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Developing an Organizational and Global Ethical Culture
The Benefits of Business Ethics
"Ethics Contribute" to Employee Commitment
Ethics Contribute to Investor Loyalty
Ethics Contribute to Customer Satisfaction
Ethics Contribute to Profits
Our Framework for Studying Business Ethics

AN ETHICAL DILEMMA*

John Peters had just arrived at the Memphis branch offices of Bull Steins (BS) brokerage firm. BS is one of the top 50 firms in the industry with a wide range of financial products. Five years prior, John graduated from Midwest State University and went to Marell and Pew Brokerage. While there, he learned that in finance one must follow the letter and spirit of the law. BS started courting John after working at Marell for four years because he had a good reputation and an investment portfolio worth approximately $100 million with some 400 investors.

A hard worker, John acquired his clients through various networking avenues, including family, the country club, cocktail parties, and serving on boards of charitable organizations. He called one client group the Sharks. These were investors who took risks, made multiple transactions every month, and looked for short-term, high-yield investments. The second group he called Cessnas, because most of them owned twin-engine planes. This group was primarily employed in the medical field, but included a few bankers and lawyers. He called the final group the Turtles because they wanted stability and security. This group would normally trade only a few times a year.

John was highly trained and was not only comfortable discussing numbers with bankers and medical billing with physicians, but also had the people skills to convey complex financial products and solutions in understandable terms to his Turtles, who were primarily older and semiretired. This was one of the main reasons Al Dryer had wanted to hire him. "You've got charisma, John, and you know your way around people and financial products," Dryer explained.

At Marell and Pew, Skyler was John's trainer. Skyler had been in the business for 15 years and had worked for three of the top brokerage firms in the world. She had chosen to stay at Marell and Pew for so many years because of her family. Skyler quickly taught John some complicated tricks of the trade. For example, "Your big clients (Sharks and Cessnas) will like IPOs (initial public offerings) but you have to be careful about picking the right ones," Skyler said. "Before suggesting one, look at who is on their board of directors, cross-reference them to other IPO boards in the last 5–7 years. Next, cross-check everyone to see where the connections are, especially if they have good ties to the SEC

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

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EFFECTIVE TOOLS FOR TEACHING AND LEARNING

Instructor's Resource Manual. The *Instructor's Resource Manual* contains a wealth of information. Teaching notes for every chapter include a brief chapter summary, detailed lecture outline, and notes for using the "Ethical Dilemma" and "Resolving Ethical Business Challenges" sections. Detailed case notes point out the key issues involved and offer suggested answers to the questions. A separate section provides guidelines for using case analysis in teaching business ethics. Detailed notes are provided to guide the instructor in analyzing or grading the cases. Simulation role-play cases, as well as implementation suggestions, are included. For others involved in attempting to simulate more of the actual constructs students will face in their business careers we suggest accessing **http://www.businessreality.org/.**

Role-Play Cases. The Eighth Edition provides six behavioral simulation role-play cases developed for use in the business ethics course. The role-play cases and implementation methods can be found in the *Instructor's Resource Manual* and on the website. Role-play cases may be used as a culminating experience to help students integrate concepts covered in the text. Alternatively, the cases may be used as an ongoing exercise to provide students with extensive opportunities for interacting and making ethical decisions.

Role-play cases simulate a complex, realistic, and timely business ethics situation. Students form teams and make decisions based on an assigned role. The role-play case complements and enhances traditional approaches to business learning experiences because it (1) gives students the opportunity to practice making decisions that have business ethics consequences; (2) re-creates the power, pressures, and information that affect decision making at various levels of management; (3) provides students with a team-based experience that enriches their skills and understanding of group processes and dynamics; and (4) uses a feedback period to allow for the exploration of complex and controversial issues in business ethics decision making. The role-play cases can be used with classes of any size.

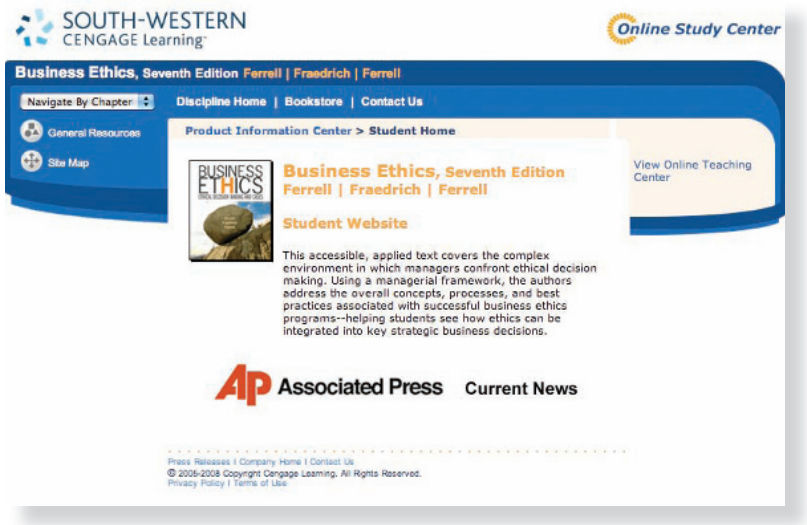
Test Bank and Exam View. The *Test Bank* provides multiple-choice and essay questions for each chapter and includes a mix of objective and application questions. *ExamView*, a computerized version of the Test Bank, provides instructors with all the tools they need to create, author/edit, customize, and deliver multiple types of tests. Instructors can import questions directly from the test bank, create their own questions, or edit existing questions.

Instructor's Resource CD-ROM. This instructor's CD provides a variety of teaching resources in electronic format, allowing for easy customization to meet specific instructional needs. Files include Word files of the Test Bank, along with its computerized version, *ExamView;* Lecture PowerPoint® slides; and Word and PDF files from the Instructor's Resource Manual.

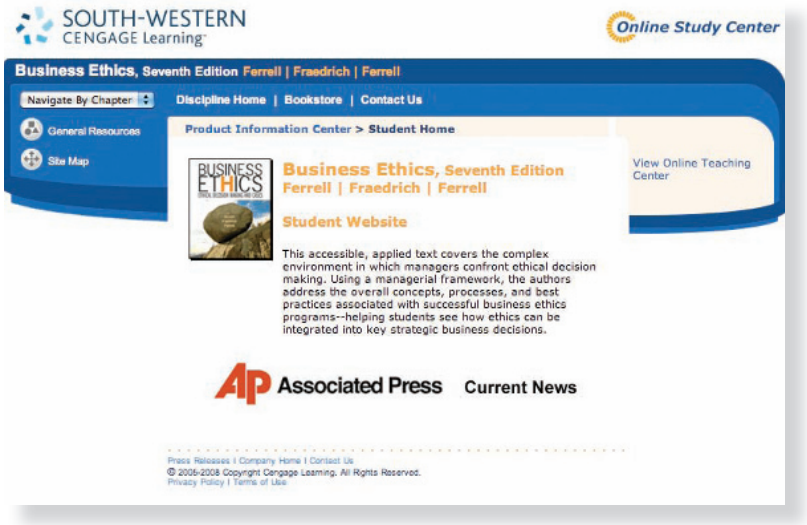
Videos. A DVD is also available to support the Eighth Edition. The seventeen segments can be used across several chapters, and the Video Guide (which appears at the end of the

Instructor Manual) contains a matrix intended to show the closest relationships between the videos and chapter topics. The Video Guide also includes summaries of each video as well as teaching guidelines and issues for discussion.

Instructor Companion Site. The Instructor Companion Site can be found at www.cengage.com/management/ferrell. It includes a complete Instructor Manual, Word files from both the Instructor Manual and Test Bank, and PowerPoint slides for easy downloading.



e-businessethics.com. Additional instructor resources can be found at www.e-businessethics.com. Also at e-businessethics.com, instructors can learn more about a teaching business ethics certificate program offered twice annually through the University of New Mexico. Instructors will find an opportunity to sign up for WSJ business ethics abstracts at www.professorjournal.com.



Student Companion Site. The Student Companion Site can also be found at www.cengage.com/management/ferrell. The website developed for the eighth edition provides up-to-date examples, issues, and interactive learning devices to assist students in improving their decision making skills. "The Business Ethics Learning Center" has been created to take advantage of information available on the Internet while providing new interactive skill-building exercises that can help students practice ethical decision making. The site contains links to companies and organizations highlighted in each chapter; Internet exercises; ACE (ACyber Evaluation) interactive quizzes, which help students master chapter content through multiple-choice questions; links to association, industry, and company codes of conduct; case website links; company and organizational examples; and academic resources, including links to business ethics centers throughout the world. Four Ethical Leadership Challenge scenarios are available for each chapter. Training devices, including Lockheed Martin's Gray Matters ethics game, are also available. A *Premium Companion Site* is also available with a number of online study

tools, including flashcards, additional interactive quizzes, student PowerPoint slides, crossword puzzles, and games.

WebTutor ™. Whether you want to Web-enable your class or teach entirely online, WebTutor provides customizable text-specific content within your course system. This content-rich, web-based teaching and learning aid reinforces chapter concepts and acts as an electronic student study guide. WebTutor provides students with interactive chapter review quizzes, critical-thinking, writing-improvement exercises, flashcards, PowerPoints, and links to online videos.

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We invite your comments, questions, or criticisms. We want to do our best to provide teaching materials that enhance the study of business ethics. Your suggestions will be sincerely appreciated.

O. C. Ferrell
John Fraedrich
Linda Ferrell

PART 1

An Overview of Business Ethics

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CHAPTER 1

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The Importance of Business Ethics

CHAPTER OBJECTIVES

- To explore conceptualizations of business ethics from an organizational perspective
- To examine the historical foundations and evolution of business ethics
- To provide evidence that ethical value systems support business performance
- To gain insight into the extent of ethical misconduct in the workplace and the pressures for unethical behavior

CHAPTER OUTLINE

Business Ethics Defined

Why Study Business Ethics?

A Crisis in Business Ethics

The Reasons for Studying Business Ethics

The Development of Business Ethics

Before 1960: Ethics in Business

The 1960s: The Rise of Social Issues in Business

The 1970s: Business Ethics as an Emerging Field

The 1980s: Consolidation

The 1990s: Institutionalization of Business Ethics

The Twenty-First Century: A New Focus on Business Ethics

Developing an Organizational and Global Ethical Culture

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(Securities and Exchange Commission). Finally, you want to check these people and the companies they have been associated with. Check every IPO these people were involved in and what Moody's ratings were prior to the IPO. As you know, Moody's is one of two IPO rating companies in the United States and they're hurting for revenue because of the financial downturn. If you see a bias in how they rate because of personal relations to the IPO people, you've got a winner," Skyler smiled.

During his five years at the company, Skyler had taught John about shorting, naked shorting, and churning. She explained shorting by using an example. "If I own 1,000 shares at $100/share and you think the stock is going to tank (go down), you 'borrow' my shares at $100/share, sell them, and the next week the stock goes down to $80/share. You call your broker and buy back the 1,000 shares at $80 and give me my 1,000 shares at $80/share. Do you see what happened?" Skyler asked. "You borrowed my shares and sold them for $100,000. The following week, when the company stock fell to $80, you repurchased those 1,000 shares for $80,000 and gave them back to me. In the meantime, you pocketed the difference of $20,000." Skyler went on, "Naked short selling is the same as shorting but you don't pay any money for the stock," explained Skyler. "There is a three-day grace period between buying and selling. That means you have at least three days of FREE MONEY!"

Al Dryer instructed John to wait to resign until late on Friday so that BS could send out packets to each of his accounts about switching companies. John thought about this, but was told by others this was standard practice. "But what about the noncompete clause I signed? It says I can't do that," said John to a few brokers not associated with either firm. Their response was, "It's done all the time." On Friday John did what BS asked and nothing happened. Six months went by and John's portfolio had increased to $150 million. Other brokers began imitating John's strategy. For example, for his Sharks, John would buy and sell at BS and call some of his buddies to do the same thing using money from his SHARKS. Another tactic involved selling futures contracts without providing evidence that he held the shares sold (naked shorting). While much of what he was doing was risky, John had become so successful that he guaranteed his Turtles against any loss.

Several years later John was buying and selling derivatives, a form of futures contract that gets its value from assets such as commodities, equities (stocks), bonds, interest rates, exchange rates, or even an index of weather conditions. While his risk-taking Shark group had expanded threefold, John's Cessna pool had all but dried up. However, his Turtles had grown dramatically to an average worth of $500,000. The portfolio he managed had topped $750 million, a lot more than he had when he started at BS ($500 million in Sharks and $250 million for Turtles).

"This year is going to be better than last year," said John to some of the brokers at BS. But expenses had been rising fast. John's expense account included country club memberships, sports tickets, trips for clients, etc. Instead of charging the firm, John would always pay them from his own pocket. By indirectly letting his clients know it was his money he was spending on them, his clients were grateful for his largess and those who would have grumbled about delays in the delivery of securities purchased were less apt to do so. John saw a great opportunity to make his heavy hitters happy with him. Unbeknownst to them, he would buy and sell stocks for these clients and later surprise them with the profits.

By this time, John was training new hires at BS, which would have taken away a lot of his personal and professional time if he had done it right. But John had a lot of other things on his mind. He had decided to get married and adopt children. His soon-to-be wife, Leslie, quit her job to be a full-time mom and was designing their new 18,000-square-foot home. With all these activities going on at once, John was not paying attention to the four new brokers and their training. Because John was a senior partner, he had to sign off on every trade they made. It became so time consuming to manage everything that he spent an hour a day just signing the four other brokers' trades.

Then one Monday morning John received a call from the SEC asking about some trades made

by the four new brokers. "It appears to us there may be some nonpublic information your brokers have concerning several IPOs," the agent said. "If they do have such information, this could be considered insider information. John, I'm calling you because we go way back to our college days, but I have to know," said the agent. John thanked him and went straight to the new brokers and asked them about the IPO. One of the new brokers replied, "John, you told us that in order to excel in this business, you need to be an expert on knowing exactly where things become legal and illegal. You said trust me, I've been doing this for 15 years, and I've never had a problem. We just did what you've taught us."

John knew that if they did have insider information, he'd probably be found partially responsible because he was supposed to be training them. At the very minimum, the SEC would start checking his trades over the past several years. He also knew that, when subjected to scrutiny, some of his past trades might be deemed questionable as well.

What should John do?

QUESTIONS • EXERCISES

1. What is/are John's ethical issues?
2. Are there any legal considerations for John?
3. Discuss the implications of each decision John has made and will make.

The ability to recognize and deal with complex business ethics issues has become a significant priority in twenty-first-century companies. In recent years, a number of well-publicized scandals resulted in public outrage about deception and fraud in business and a demand for improved business ethics and greater corporate responsibility. The publicity and debate surrounding highly visible legal and ethical lapses at a number of well-known firms, including AIG, Countrywide Financial, and Fannie Mae, highlight the need for businesses to integrate ethics and responsibility into all business decisions. The global financial crisis took a toll on consumer trust of financial services companies. A study of 650 U.S. consumers by Lightspeed Research and Cohn & Wolfe revealed that 66 percent of respondents did not feel that the financial services industry would help them to regain the wealth that they lost during the recession. Words used to describe this industry included greedy, impersonal, opportunistic, and distant. Table 1–1 summarizes the survey results.[1]

Largely in response to this crisis, business decisions and activities have come under greater scrutiny by many different constituents, including consumers, employees, investors, government regulators, and special interest groups. Additionally, new legislation and regulations designed to encourage higher ethical standards in business have been put in place.

The field of business ethics deals with questions about whether specific business practices are acceptable. For example, should a salesperson omit facts about a product's poor safety record in a sales presentation to a client? Should an accountant report inaccuracies that he or she discovered in an audit of a client, knowing the auditing company will probably be fired by the client for doing so? Should an automobile tire manufacturer intentionally conceal safety concerns to avoid a massive and costly tire recall? Regardless of their legality, others will certainly judge the actions taken in such situations as right or wrong, ethical or unethical. By its very nature, the field of business ethics is controversial, and there is no universally accepted approach for resolving its issues.

TABLE 1–1 American Distrust of the Financial Services Industry

Negative Responses Related to the Industry	%
Greedy	32
Impersonal	32
Opportunistic	26
Distant from me	22
Positive Responses Related to the Industry	**%**
Trustworthy	13
Honest	10
Ethical	5
Transparent	3
Sympathetic	3

Source: "New US Consumer Survey Shows High Distrust of Financial Services Companies," *Business Wire,* January 20, 2009, http://findarticles.com/p/articles/mi_m0EIN/is_2009_Jan_20/ai_n31202849/ (accessed May 27, 2009).

A Junior Achievement/Deloitte survey of teens showed that 71 percent feel prepared to make ethical decisions in the workplace. However, of those surveyed, 38 percent feel it is sometimes necessary to lie, cheat, plagiarize, or engage in violence to succeed. One-fourth think cheating on a test is acceptable and most can justify it saying that their desire to succeed is grounds for the behavior.[2] If today's students are tomorrow's leaders, there is likely to be a correlation between acceptable behavior today and tomorrow, adding to the argument that the leaders of today must be prepared for the ethical risks associated with this downward trend. According to another poll by Deloitte and Touche of teenagers aged 13 to 18 years old, when asked if people who practice good business ethics are more successful than those who don't, 69 percent of teenagers agreed.[3] On the other hand, another survey indicated that many students do not define copying answers from another student's paper or downloading copyrighted music or content for classroom work as cheating.[4]

Before we get started, it is important to state our philosophies regarding this book. First, we do not moralize by telling you what is right or wrong in a specific situation. Second, although we provide an overview of group and individual decision making processes, we do not prescribe any one philosophy or process as best or most ethical. Third, by itself, this book will not make you more ethical, nor will it tell you how to judge the ethical behavior of others. Rather, its goal is to help you understand and use your current values and convictions when making business decisions so that you think about the effects of those decisions on business and society. In addition, this book will help you understand what businesses are doing to improve their ethical conduct. To this end, we aim to help you learn to recognize and resolve ethical issues within business organizations. As a manager, you will be responsible for your decisions and the ethical conduct of the employees you supervise. The framework we develop in this book therefore focuses on how organizational ethical decisions are made and on ways companies can improve their ethical conduct.

In this chapter, we first develop a definition of business ethics and discuss why it has become an important topic in business education. We also discuss why studying business ethics can be beneficial. Next, we examine the evolution of business ethics in North America. Then we explore the performance benefits of ethical decision making for businesses. Finally, we provide a brief overview of the framework we use for examining business ethics in this text.

BUSINESS ETHICS DEFINED

The term *ethics* has many nuances. It has been defined as "inquiry into the nature and grounds of morality where the term morality is taken to mean moral judgments, standards and rules of conduct."[5] Ethics has also been called the study and philosophy of human conduct, with an emphasis on determining right and wrong. *The American Heritage Dictionary* offers these definitions of ethics: "The study of the general nature of morals and of specific moral choices; moral philosophy; and the rules or standards governing the conduct of the members of a profession."[6] One difference between an ordinary decision and an ethical one lies in "the point where the accepted rules no longer serve, and the decision maker is faced with the responsibility for weighing values and reaching a judgment in a situation which is not quite the same as any he or she has faced before."[7] Another difference relates to the amount of emphasis that decision makers place on their own values and accepted practices within their company. Consequently, values and judgments play a critical role when we make ethical decisions.

Building on these definitions, we can begin to develop a concept of business ethics. Most people would agree that high ethical standards require both businesses and individuals to conform to sound moral principles. However, some special aspects must be considered when applying ethics to business. First, to survive, businesses must earn a profit. If profits are realized through misconduct, however, the life of the organization may be shortened. Many firms, including Lehman Brothers and Enron, that made headlines due to wrongdoing and scandal ultimately went bankrupt or failed because of the legal and financial repercussions of their misconduct. Second, businesses must balance their desires for profits against the needs and desires of society. Maintaining this balance often requires compromises or trade-offs. To address these unique aspects of the business world, society has developed rules—both legal and implicit—to guide businesses in their efforts to earn profits in ways that do not harm individuals or society as a whole.

Most definitions of business ethics relate to rules, standards, and moral principles regarding what is right or wrong in specific situations. For our purposes, **business ethics** comprises the principles, values, and standards that guide behavior in the world of business. **Principles** are specific and pervasive boundaries for behavior that are universal and absolute. Principles often become the basis for rules. Some examples of principles include freedom of speech, fundamentals of justice, and equal rights to civil liberties. **Values** are used to develop norms that are socially enforced. Integrity, accountability, and trust are examples of values. Investors, employees, customers, interest groups, the legal system, and the community often determine whether a specific action is right or wrong, ethical or unethical. Although these groups are not necessarily "right," their judgments influence society's acceptance or rejection of a business and its activities.

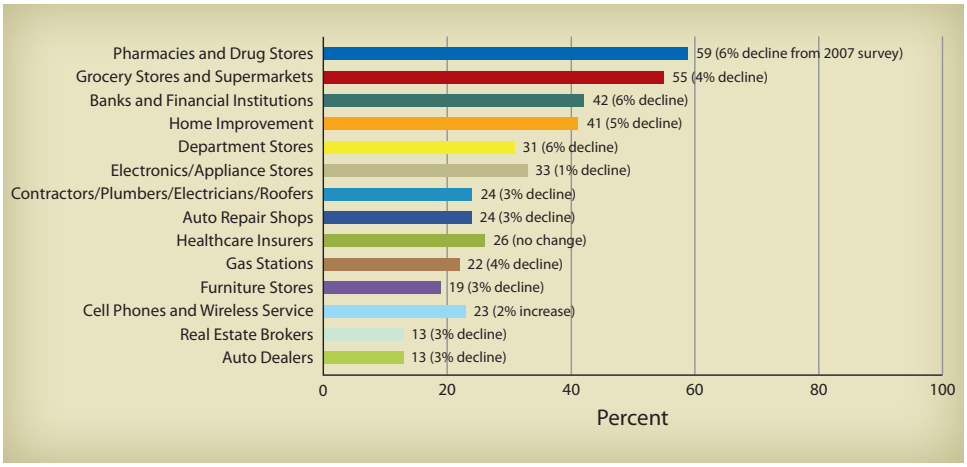
WHY STUDY BUSINESS ETHICS?

A Crisis in Business Ethics

As we've already mentioned, ethical misconduct has become a major concern in business today. The Ethics Resource Center conducted the National Business Ethics Survey (NBES) of about 3,000 U.S. employees to gather reliable data on key ethics and compliance outcomes and to help identify and better understand the ethics issues that are important to employees. The NBES found that observed misconduct is higher in large organizations—those with more than 500 employees—than in smaller ones and that there are also differences in observed misconduct across employee levels. Reporting of misconduct is most likely to come from upper-level management, as compared to lower-level supervisors and nonmanagement employees. Employees in lower-level positions have more of a tendency to not understand misconduct or be complacent about what misconduct they observe. Figure 1–1 shows the percentage of respondents who say that they trust a variety of business categories. Notice that the levels of consumer trust in most industries is declining. Among senior managers, 77 percent of employees report observed misconduct, while among nonmanagement, only 48 percent of employees report observed misconduct.[8]

Specific Issues Abusive behavior, harassment, accounting fraud, conflicts of interest, defective products, bribery, and employee theft are all problems cited as evidence of declining ethical standards. For example, Satyam Computer Services, an outsourcing firm in India, worked with more than one-third of the Fortune 500 companies. The chairman of the company disclosed that $1.04 billion in cash and assets did not exist and that earnings and assets were inflated for years. The scandal was compared to Enron.[9] A survey by Harris Interactive shows that corporate reputation is at its lowest point in the past decade of their annual "Reputation Quotient" polls. Eighty-eight percent rated the reputation of corporate America today as "not good" or "terrible." Among the least admired companies

FIGURE 1–1 Americans' Trust in Business (% of respondents who say they trust the following business categories a great deal or quite a lot)



Source: Better Business Bureau/Gallup Trust in Business Index, April 2008, http://www.bbb.org/us/sitepage.aspx?id =f36f50cc-8cb7-4507-9cfc-2f2d7aa2c3fc (accessed January 13, 2009).

are AIG, Halliburton, General Motors, Chrysler, Washington Mutual, Citigroup, Merrill Lynch, ExxonMobil, and Ford Motor Company. There remain companies that are admired by respondents, including Johnson & Johnson, Google, Sony, Coca-Cola, Kraft Foods, Amazon.com, Microsoft, General Mills, 3M, and Toyota Motor. The economic lapses associated with the recession have damaged the "emotional appeal" of many companies, which is often the strongest driver of reputation.[10]

Insider trading remains a serious issue in business and in ethics. Eugene Plotkin, a former Goldman Sachs executive, was sentenced to almost five years in prison for a case of insider trading that yielded about $6.7 million. The Harvard graduate worked with a former Merrill Lynch analyst, a New Jersey postal worker, and two workers at a *Business Week* printing press. The former Merrill Lynch employee provided tips to Plotkin at Goldman on mergers and acquisitions. Another angle involved getting prepublication copies of *Business Week* and trading on that information. The third element involved working with a New Jersey postal worker who served on the Bristol-Myers Squibb grand jury investigation and shared inside information with Plotkin.[11]

Inflating earnings involves attempting to embellish or enhance a firm's profitability in a manner that is inconsistent with past practice, common regulatory guidelines, or industry practice. Many companies maintain a focus on making short-term profits and know that analysts and investors critique the company according to its ability to "make the numbers." PricewaterhouseCoopers (PWC) was forced to pay $97.5 million to settle a class action lawsuit for involvement with AIG in overstating their earnings. This settlement is a small part of a larger case against both AIG and its former CEO, Hank Greenberg. AIG's improper accounting for reinsurance and other dealings led to a restatement of earnings in the amount of $3.9 billion. The lawsuit normally proceeds against the company and personnel first, with the related firms (such as PWC) paying a percentage of that settlement.[12] Highly publicized cases such as this one strengthen the perception that ethical standards in business need to be raised.

Ethics play an important role in the public sector as well. In government, several politicians and some high-ranking officials have experienced significant negative publicity and some have had to resign in disgrace over ethical indiscretions. Alaskan Senator Ted Stevens was convicted of 7 felony counts of corruption weeks before the election of President Barack Obama. He was charged with hiding $250,000 in gifts he had allegedly received from oil companies. The U.S. Department of Justice filed a motion to have the case dismissed against Stevens due to mishandled evidence, and the case was officially dropped. However, the impact of the negative publicity on the senator was significant and most likely contributed to his losing his bid for reelection.[13]

Irv Lewis "Scooter" Libby, a White House advisor, was indicted on five counts of criminal charges: one count of obstruction of justice, two counts of perjury, and two counts of making false statements.[14] Each count carries a $250,000 fine and maximum prison term of 30 years.

Several scientists have been accused of falsifying research data, which could invalidate later research based on their data and jeopardize trust in all scientific research. Bell Labs, for example, fired a scientist for falsifying experiments on superconductivity and molecular electronics and for misrepresenting data in scientific publications. Jan Hendrik Schon's work on creating tiny, powerful microprocessors seemed poised to significantly advance microprocessor technology and potentially bring yet another Nobel Prize in physics to the award-winning laboratory, a subsidiary of Lucent Technologies.[15] Hwang Woo-Suk was found to have faked some of his famous stem cell research in which he claimed to have created 30

cloned human embryos and made stem cell lines from skin cells of 11 people, as well as producing the world's first cloned dog. He also apologized for using eggs from his own female researchers, which was in breach of guidelines, but still denies fabricating his research.[16]

Even sports can be subject to ethical lapses. Manny Ramirez was suspended for 50 games from the Los Angeles Dodgers for violating the league's drug policy. Ramirez tested positive for a female fertility drug that has been taken by steroid users to increase testosterone levels. The ban on playing cost Ramirez $7.7 million of his $25 million annual salary. Ramirez stated that he was under a doctor's care for a "personal health issue" and indicated that he thought the medication was allowed. Baseball players are encouraged to check a hotline that identifies legal and illegal substances and encourages players to seek "therapeutic use exemptions" for legitimate use of banned substances.[17]

"Regardless of what an individual believes about a particular action, if society judges it to be unethical or wrong, whether correctly or not, that judgment directly affects the organization's ability to achieve its business goals."

Whether made in business, politics, science, or sports, most decisions are judged as either right or wrong, ethical or unethical. Regardless of what an individual believes about a particular action, if society judges it to be unethical or wrong, whether correctly or not, that judgment directly affects the organization's ability to achieve its business goals. For this reason alone, it is important to understand business ethics and recognize ethical issues.

The Reasons for Studying Business Ethics

Studying business ethics is valuable for several reasons. Business ethics is not merely an extension of an individual's own personal ethics. Many people believe that if a company hires good people with strong ethical values, then it will be a "good citizen" organization. But as we show throughout this text, an individual's personal values and moral philosophies are only one factor in the ethical decision making process. True, moral rules can be applied to a variety of situations in life, and some people do not distinguish everyday ethical issues from business ones. Our concern, however, is with the application of principles and standards in the business context. Many important ethical issues do not arise very often in the business context, although they remain complex moral dilemmas in one's own personal life. For example, although abortion and the possibility of human cloning are moral issues in many people's lives, they are usually not an issue in most business organizations.

Professionals in any field, including business, must deal with individuals' personal moral dilemmas because these issues affect everyone's ability to function on the job. Normally, a business does not establish rules or policies on personal ethical issues such as sex or the use of alcohol outside the workplace; indeed, in some cases, such policies would be illegal. Only when a person's preferences or values influence his or her performance on the job do an individual's ethics play a major role in the evaluation of business decisions.

Just being a good person and, in your own view, having sound personal ethics may not be sufficient to enable you to handle the ethical issues that arise in a business organization. It is important to recognize the relationship between legal and ethical decisions. Although abstract virtues linked to the high moral ground of truthfulness, honesty, fairness, and openness are often assumed to be self-evident and accepted by all employees, business-strategy decisions involve complex and detailed discussions. For example, there is considerable debate over what constitutes antitrust, deceptive advertising, and violations of the Foreign Corrupt Practices Act. A high level of personal moral development may

not prevent an individual from violating the law in a complicated organizational context where even experienced lawyers debate the exact meaning of the law. Some approaches to business ethics assume that ethics training is for people whose personal moral development is unacceptable, but that is not the case. Because organizations are culturally diverse and personal values must be respected, ensuring collective agreement on organizational ethics (that is, codes reasonably capable of preventing misconduct) is as vital as any other effort an organization's management may undertake.

Many people who have limited business experience suddenly find themselves making decisions about product quality, advertising, pricing, sales techniques, hiring practices, and pollution control. The values they learned from family, religion, and school may not provide specific guidelines for these complex business decisions. In other words, a person's experiences and decisions at home, in school, and in the community may be quite different from his or her experiences and decisions at work. Many business ethics decisions are close calls. In addition, managerial responsibility for the conduct of others requires knowledge of ethics and compliance processes and systems. Years of experience in a particular industry may be required to know what is acceptable. For example, Caraco Pharmaceutical Laboratories, a generic drug manufacturer, voluntarily recalled all tablets of its digoxin drug used by patients with heart failure and abnormal heart rhythms. The drug was recalled because of variation in sizing, which could impact the actual dosage received by a patient. The recall was designed to protect those who were using the drug and the company had to carefully assess the product and the potential harm it could cause in its more inconsistent form. Significant medical expertise and testing resulted in the recall.[18]

Studying business ethics will help you begin to identify ethical issues when they arise and recognize the approaches available for resolving them. You will also learn more about the ethical decision making process and about ways to promote ethical behavior within your organization. By studying business ethics, you may begin to understand how to cope with conflicts between your own personal values and those of the organization in which you work.

THE DEVELOPMENT OF BUSINESS ETHICS

The study of business ethics in North America has evolved through five distinct stages—(1) before 1960, (2) the 1960s, (3) the 1970s, (4) the 1980s, and (5) the 1990s—and continues to evolve in the twenty-first century (see Table 1–2).

Before 1960: Ethics in Business

Prior to 1960, the United States went through several agonizing phases of questioning the concept of capitalism. In the 1920s, the progressive movement attempted to provide citizens with a "living wage," defined as income sufficient for education, recreation, health, and retirement. Businesses were asked to check unwarranted price increases and any other practices that would hurt a family's "living wage." In the 1930s came the New Deal, which specifically blamed business for the country's economic woes. Business was asked to work more closely with the government to raise family income. By the 1950s, the New Deal had evolved into the Fair Deal by President Harry S. Truman; this program defined such matters as civil rights and environmental responsibility as ethical issues that businesses had to address.

Until 1960 ethical issues related to business were often discussed within the domain of theology or philosophy. Individual moral issues related to business were addressed in

TABLE 1–2 A Timeline of Ethical and Socially Responsible Concerns

1960s	1970s	1980s	1990s	2000s
Environmental issues	Employee militancy	Bribes and illegal contracting practices	Sweatshops and unsafe working conditions in third-world countries	Cybercrime
Civil rights issues	Human rights issues	Influence peddling	Rising corporate liability for personal damages (for example, cigarette companies)	Financial misconduct
Increased employee–employer tension	Covering up rather than correcting issues	Deceptive advertising	Financial mismanagement and fraud	Global issues, Chinese product safety
Changing work ethic	Disadvantaged consumer	Financial fraud (for example, savings and loan scandal)	Organizational ethical misconduct	Sustainability
Rising drug use		Transparency issues		Intellectual property theft

Source: Adapted from "Business Ethics Timeline," *Ethics Resource Center*, http://www.ethics.org/resources/business-ethics-timeline.asp (accessed May 27, 2009). Copyright © 2006, Ethics Resource Center (ERC). Used with permission of the ERC, 1747 Pennsylvania Ave., N.W., Suite 400, Washington, DC 2006, www.ethics.org.

churches, synagogues, and mosques. Religious leaders raised questions about fair wages, labor practices, and the morality of capitalism. For example, Catholic social ethics, which were expressed in a series of papal encyclicals, included concern for morality in business, workers' rights, and living wages; for humanistic values rather than materialistic ones; and for improving the conditions of the poor. Some Catholic colleges and universities began to offer courses in social ethics. Protestants also developed ethics courses in their seminaries and schools of theology and addressed issues concerning morality and ethics in business. The Protestant work ethic encouraged individuals to be frugal, work hard, and attain success in the capitalistic system. Such religious traditions provided a foundation for the future field of business ethics. Each religion applied its moral concepts not only to business but also to government, politics, the family, personal life, and all other aspects of life.

The 1960s: The Rise of Social Issues in Business

During the 1960s, American society turned to causes. An antibusiness attitude developed as many critics attacked the vested interests that controlled the economic and political sides of society—the so-called military-industrial complex. The 1960s saw the decay of inner cities and the growth of ecological problems such as pollution and the disposal of toxic and nuclear wastes. This period also witnessed the rise of consumerism—activities undertaken by independent individuals, groups, and organizations to protect their rights as consumers. In 1962 President John F. Kennedy delivered a "Special Message on Protecting the Consumer Interest" in which he outlined four basic consumer rights: the right to safety, the right to be informed, the right to choose, and the right to be heard. These came to be known as the **Consumers' Bill of Rights.**

The modern consumer movement is generally considered to have begun in 1965 with the publication of Ralph Nader's *Unsafe at Any Speed,* which criticized the auto industry

as a whole, and General Motors Corporation (GM) in particular, for putting profit and style ahead of lives and safety. GM's Corvair was the main target of Nader's criticism. His consumer protection organization, popularly known as Nader's Raiders, fought successfully for legislation that required automobile makers to equip cars with safety belts, padded dashboards, stronger door latches, head restraints, shatterproof windshields, and collapsible steering columns. Consumer activists also helped secure passage of several consumer protection laws such as the Wholesome Meat Act of 1967, the Radiation Control for Health and Safety Act of 1968, the Clean Water Act of 1972, and the Toxic Substance Act of 1976.[19]

After Kennedy came President Lyndon B. Johnson and the Great Society, which extended national capitalism and told the business community that the U.S. government's responsibility was to provide the citizen with some degree of economic stability, equality, and social justice. Activities that could destabilize the economy or discriminate against any class of citizens began to be viewed as unethical and unlawful.

The 1970s: Business Ethics as an Emerging Field

Business ethics began to develop as a field of study in the 1970s. Theologians and philosophers had laid the groundwork by suggesting that certain principles could be applied to business activities. Using this foundation, business professors began to teach and write about corporate **social responsibility,** an organization's obligation to maximize its positive impact on stakeholders and to minimize its negative impact. Philosophers increased their involvement, applying ethical theory and philosophical analysis to structure the discipline of business ethics. Companies became more concerned with their public images, and as social demands grew, many businesses realized that they had to address ethical issues more directly. The Nixon administration's Watergate scandal focused public interest on the importance of ethics in government. Conferences were held to discuss the social responsibilities and ethical issues of business. Centers dealing with issues of business ethics were established. Interdisciplinary meetings brought business professors, theologians, philosophers, and businesspeople together. President Jimmy Carter attempted to focus on personal and administrative efforts to uphold ethical principles in government. The Foreign Corrupt Practices Act was passed during his administration, making it illegal for U.S. businesses to bribe government officials of other countries.

By the end of the 1970s, a number of major ethical issues had emerged, such as bribery, deceptive advertising, price collusion, product safety, and the environment. *Business ethics* became a common expression and was no longer considered an oxymoron. Academic researchers sought to identify ethical issues and describe how businesspeople might choose to act in particular situations. However, only limited efforts were made to describe how the ethical decision making process worked and to identify the many variables that influence this process in organizations.

The 1980s: Consolidation

In the 1980s, business academics and practitioners acknowledged business ethics as a field of study. A growing and varied group of institutions with diverse interests promoted its study. Business ethics organizations grew to include thousands of members. Five hundred courses in business ethics were offered at colleges across the country, with more than 40,000 students enrolled. Centers for business ethics provided publications, courses, conferences, and seminars. Business ethics was also a prominent concern within such leading companies

as General Electric, Chase Manhattan, General Motors, Atlantic Richfield, Caterpillar, and S. C. Johnson & Son, Inc. Many of these firms established ethics and social policy committees to address ethical issues.

In the 1980s, the **Defense Industry Initiative on Business Ethics and Conduct** (DII) was developed to guide corporate support for ethical conduct. In 1986 eighteen defense contractors drafted principles for guiding business ethics and conduct.[20] The organization has since grown to nearly 50 members. This effort established a method for discussing best practices and working tactics to link organizational practice and policy to successful ethical compliance. The DII includes six principles. First, DII supports codes of conduct and their widespread distribution. These codes of conduct must be understandable and provide details on more substantive areas. Second, member companies are expected to provide ethics training for their employees as well as continuous support between training periods. Third, defense contractors must create an open atmosphere in which employees feel comfortable reporting violations without fear of retribution. Fourth, companies need to perform extensive internal audits and develop effective internal reporting and voluntary disclosure plans. Fifth, DII insists that member companies preserve the integrity of the defense industry. Finally, member companies must adopt a philosophy of public accountability.[21]

The 1980s ushered in the Reagan–Bush eras, with the accompanying belief that self-regulation, rather than regulation by government, was in the public's interest. Many tariffs and trade barriers were lifted, and businesses merged and divested within an increasingly global atmosphere. Thus, while business schools were offering courses in business ethics, the rules of business were changing at a phenomenal rate because of less regulation. Corporations that once were nationally based began operating internationally and found themselves mired in value structures where accepted rules of business behavior no longer applied.

The 1990s: Institutionalization of Business Ethics

The administration of President Bill Clinton continued to support self-regulation and free trade. However, it also took unprecedented government action to deal with health-related social issues such as teenage smoking. Its proposals included restricting cigarette advertising, banning vending machine sales, and ending the use of cigarette logos in connection with sports events.[22] Clinton also appointed Arthur Levitt as chairman of the Securities and Exchange Commission in 1993. Levitt unsuccessfully pushed for many reforms that could have prevented the accounting ethics scandals exemplified by Enron and WorldCom.[23]

The **Federal Sentencing Guidelines for Organizations** (FSGO), approved by Congress in November 1991, set the tone for organizational ethical compliance programs in the 1990s. The guidelines, which were based on the six principles of the DII,[24] broke new ground by codifying into law incentives to reward organizations for taking action to prevent misconduct such as developing effective internal legal and ethical compliance programs.[25] Provisions in the guidelines mitigate penalties for businesses that strive to root out misconduct and establish high ethical and legal standards.[26] On the other hand, under FSGO, if a company lacks an effective ethical compliance program and its employees violate the law, it can incur severe penalties. The guidelines focus on firms taking action to prevent and detect business misconduct in cooperation with government regulation. At the heart of the FSGO is the carrot-and-stick approach: By taking preventive action against misconduct, a company may avoid onerous penalties should a violation occur. A mechanical approach using legalistic logic will not suffice to avert serious penalties. The company must develop corporate values, enforce its own code of ethics, and strive to prevent misconduct.

The Twenty-First Century: A New Focus on Business Ethics

Although business ethics appeared to become more institutionalized in the 1990s, new evidence emerged in the early 2000s that more than a few business executives and managers had not fully embraced the public's desire for high ethical standards. For example, Bruce Bent, Sr. and his son Bruce Bent II were accused of engaging in fraud in misleading investors, ratings firms, and trustees when the assets of their Reserve Primary Fund fell. The accused reassured investors that the company had ample resources to support the broader declines in the financial market when, in fact, they did not. The Fund had $785 million in Lehman commercial paper, which ultimately became worthless.[27]

Arthur Andersen, a "Big Five" accounting firm, was convicted of obstructing justice after shredding documents related to its role as Enron's auditor.[28] The reputation of the once venerable accounting firm disappeared overnight, along with most of its clients, and the firm ultimately went out of business. Later the Supreme Court overruled the Arthur Andersen obstruction-of-justice conviction, but it was too late for the firm to recover. In addition to problems with its auditing of Enron, Arthur Andersen also faced questions surrounding its audits of other companies that were charged with employing questionable accounting practices, including Halliburton, WorldCom, Global Crossing, Dynegy, Qwest, and Sunbeam.[29] These accounting scandals made it evident that falsifying financial reports and reaping questionable benefits had become part of the culture of many companies. Firms outside the United States, such as Royal Ahold in the Netherlands and Parmalat in Italy, became major examples of accounting misconduct from a global perspective.

> *The company must develop corporate values, enforce its own code of ethics, and strive to prevent misconduct.*

Such abuses increased public and political demands to improve ethical standards in business. In a survey of 20,000 people across 20 countries, trust in global companies had declined significantly.[30] To address the loss of confidence in financial reporting and corporate ethics, Congress in 2002 passed the **Sarbanes–Oxley Act,** the most far-reaching change in organizational control and accounting regulations since the Securities and Exchange Act of 1934. The new law made securities fraud a criminal offense and stiffened penalties for corporate fraud. It also created an accounting oversight board that requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reports to investors and other interested parties. Additionally, the law requires top executives to sign off on their firms' financial reports, and they risk fines and long prison sentences if they misrepresent their companies' financial position. The legislation further requires company executives to disclose stock sales immediately and prohibits companies from giving loans to top managers.[31]

The 2004 amendment to the FSGO requires that a business's governing authority be well informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm's leadership, usually the board of directors. The board is required to oversee the discovery of risks and to design, implement, and modify approaches to deal with those risks.

The Sarbanes–Oxley Act and the FSGO have institutionalized the need to discover and address ethical and legal risk. Top management and the board of directors of a corporation are accountable for discovering risk associated with ethical conduct. Such specific industries as the public sector, energy and chemicals, health care, insurance, and retail have to discover the

unique risk associated with their operations and develop an ethics program to prevent ethical misconduct before it creates a crisis. Most firms are developing formal and informal mechanisms to have interactive communication and transparency about issues associated with the risk of misconduct. Business leaders should view that their greatest danger is not discovering serious misconduct or illegal activities somewhere in the organization. Unfortunately, most managers do not view the risk of an ethical disaster as important as the risk associated with fires, natural disasters, or technology failure. Ethical disasters can be significantly more damaging to a company's reputation than risks that are managed through insurance and other methods. The great investor Warren Buffett has stated that it is impossible to eradicate all wrongdoing in a large organization and that one can only hope that the misconduct is small and is caught in time. Buffett's fears came true in 2008 when the financial system collapsed because of pervasive, systemic use of instruments such as credit default swaps, risky debt such as subprime lending, and corruption in major corporations. The government was forced to step in and bail out many financial companies. Later, because of the weak financial system and reduced consumption, the government also had to step in to help major automotive companies GM and Chrysler. The U.S. government is now a majority shareholder in GM, an unprecedented move. Not since the Great Depression and President Franklin Delano Roosevelt has the United States seen such widespread government intervention and regulation—something that most deem necessary, but which is nevertheless worrisome to free market capitalists.

The basic assumptions of capitalism are under debate as countries around the world work to stabilize markets and question those that managed the money of individual corporations and nonprofits. The financial crisis caused many to question government institutions that provide oversight and regulation. As changes are made, there is a need to address issues related to law, ethics, and the required level of compliance necessary for government and business to serve the public interest.

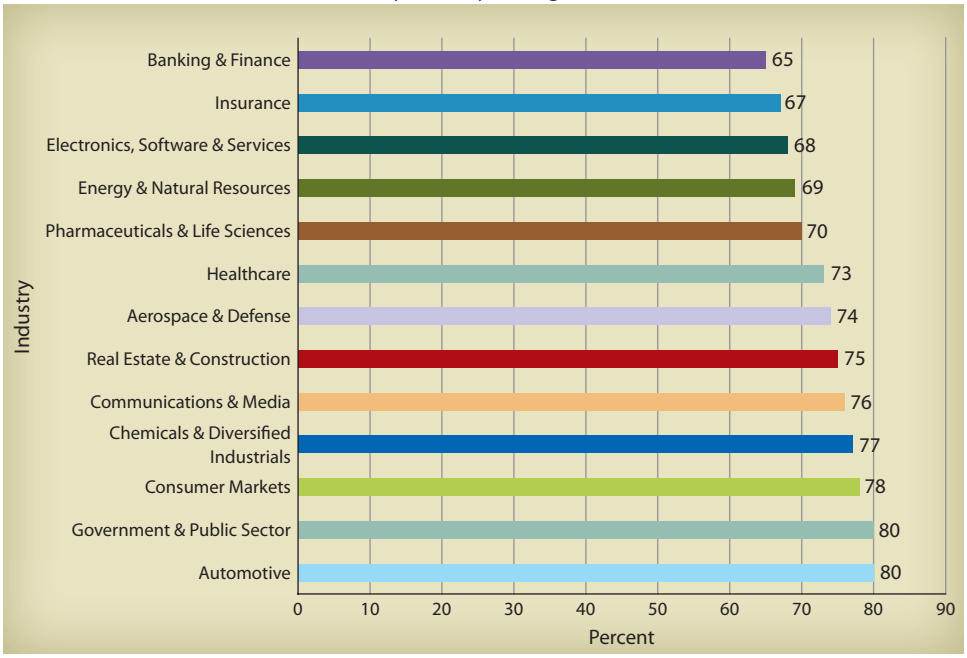
In the KPMG Forensic Integrity Survey, employees were asked whether they had "personally seen" or had "firsthand knowledge of" misconduct within their organizations over the prior 12-month period. Roughly three-quarters of employees— 76 percent—reported that they had observed misconduct in the prior 12-month period.[32]

Figure 1–2 shows the results of misconduct by industry; there are generally high levels of observed misconduct across all industries. Employees in highly regulated financial industries, such as banking, finance, and insurance, reported relatively lower rates of misconduct within their organizations compared with others. While employees working in the public sector, which has not been subject to many of the new regulatory mandates placed on its private-sector counterparts, reported relatively higher rates of misconduct compared with others.

DEVELOPING AN ORGANIZATIONAL AND GLOBAL ETHICAL CULTURE

The current trend is away from legally based compliance initiatives in organizations to cultural initiatives that make ethics a part of core organizational values. To develop more ethical corporate cultures, many businesses are communicating core values to their employees by creating ethics programs and appointing ethics officers to oversee them. The ethical component of a corporate culture relates to the values, beliefs, and established and enforced patterns of conduct that employees use to identify and respond to ethical issues. The term **ethical culture** can be viewed as the character or decision making process that employees

FIGURE 1–2 Prevalence of Misconduct by Industry During the Prior 12 Months



Source: KPMG LLP (U.S.) 2008, http://www.kpmg.com.br/publicacoes/forensic/Integrity_Survey_2008_2009.pdf (accessed August 4, 2009).

use to determine whether their responses to ethical issues are right or wrong. Ethical culture is used to describe the component of corporate culture that captures the values and norms that an organization defines as appropriate conduct. The goal of an ethical culture is to minimize the need for enforced compliance of rules and maximize the use of principles that contribute to ethical reasoning in difficult or new situations. An ethical culture creates shared values and support for ethical decisions and is driven by top management.

Globally, businesses are working more closely together to establish standards of acceptable behavior. We are already seeing collaborative efforts by a range of organizations to establish goals and mandate minimum levels of ethical behavior, from the European Union, the North American Free Trade Agreement (NAFTA), the Common Market of the Southern Cone (MERCOSUR), and the World Trade Organization (WTO) to, more recently, the Council on Economic Priorities' Social Accountability 8000 (SA 8000), the Ethical Trading Initiative, and the U.S. Apparel Industry Partnership. Some companies will not do business with organizations that do not support and abide by these standards. The development of global codes of ethics, such as the Caux Round Table, highlights common ethical concerns for global firms. The Caux Round Table (www.cauxroundtable.org) is a group of businesses, political leaders, and concerned interest groups that desire responsible behavior in the global community.

THE BENEFITS OF BUSINESS ETHICS

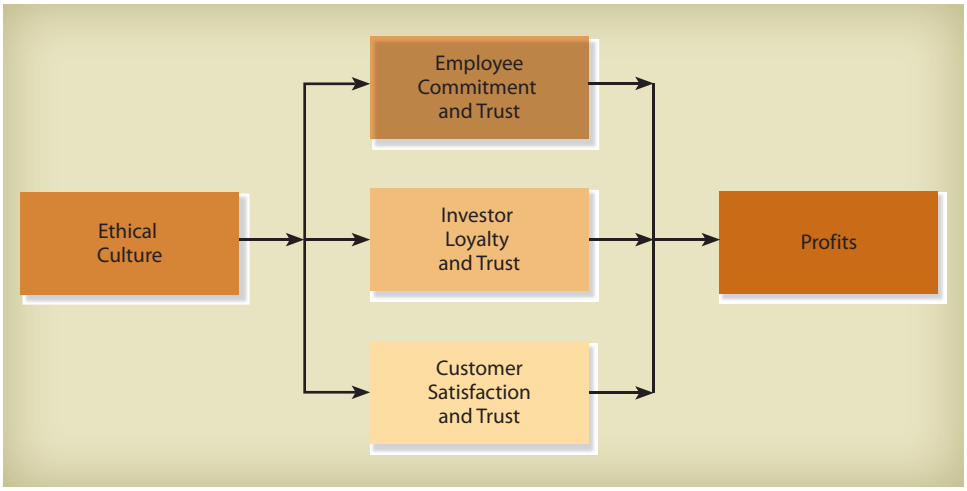
The field of business ethics continues to change rapidly as more firms recognize the benefits of improving ethical conduct and the link between business ethics and financial performance. Both research and examples from the business world demonstrate that

building an ethical reputation among employees, customers, and the general public pays off. Figure 1–3 provides an overview of the relationship between business ethics and organizational performance. Although we believe there are many practical benefits to being ethical, many businesspeople make decisions because they believe a particular course of action is simply the right thing to do as a responsible member of society. Ricoh's Chairman, Masamitsu Sakurai, one of Ethisphere's 100 Most Influential People in Business Ethics, states that a foundational commitment to the environment creates a financial advantage. Ricoh transitioned to a flexible, cell-based production system that reduced carbon dioxide emissions and increased productivity, implemented additional emission reductions and waste reduction plans, and selectively placed clean ventilation points along the production line. These activities, as well as others, managed to cut carbon dioxide emissions by 85 percent and cut production costs in half.[33] Among the rewards for being more ethical and socially responsible in business are increased efficiency in daily operations, greater employee commitment, increased investor willingness to entrust funds, improved customer trust and satisfaction, and better financial performance. The reputation of a company has a major effect on its relationships with employees, investors, customers, and many other parties.

Ethics Contribute to Employee Commitment

Employee commitment comes from employees who believe their future is tied to that of the organization and their willingness to make personal sacrifices for the organization.[34] The more a company is dedicated to taking care of its employees, the more likely it is that the employees will take care of the organization. The NBES survey indicates that 79 percent of employees agree that ethics is important in continuing to work for their employer. It is also interesting to note that approximately 20 percent of employees are *not* concerned about the ethical environment of their organization.[35] This group is very complacent and has the potential for misconduct without guidance and ethical leadership. Issues that may foster the development of an ethical culture for employees include the absence of abusive behavior, a safe work environment, competitive salaries, and the fulfillment of all

FIGURE 1–3 The Role of Organizational Ethics in Performance



contractual obligations toward employees. An ethics and compliance program can support values and appropriate conduct. Social programs that may improve the ethical culture range from work–family programs and stock ownership plans to community service. Home Depot associates, for example, participate in disaster-relief efforts after hurricanes and tornadoes by rebuilding roofs, repairing water damage, planting trees, and clearing roads in their communities. Because employees spend a considerable amount of their waking time at work, a commitment by the organization to goodwill and respect for its employees usually increases the employees' loyalty to the organization and their support of its objectives. After years of bad publicity regarding environmental damage and its poor treatment of workers, Wal-Mart appears to have realized the importance of corporate social responsibility to a company's bottom line. Over 92 percent of Wal-Mart associates now have health insurance, and Wal-Mart has been working hard to improve diversity as well. In 2008 alone, Wal-Mart received 37 separate awards and distinctions for its diversity efforts. The company has taken strides toward being more sustainable as well—by doing everything from introducing low-emissions vehicles to its shipping fleet and installing solar panels on store rooftops. Wal-Mart has even stated a goal to be zero-waste.[36]

Employees' perception that their firm has an ethical culture leads to performance-enhancing outcomes within the organization.[37] For the sake of both productivity and teamwork, it is essential that employees both within and between departments throughout the organization share a common vision of trust. The influence of higher levels of trust is greatest on relationships within departments or work groups, but trust is a significant factor in relationships between departments as well. Consequently, programs that create a work environment that is trustworthy make individuals more willing to rely and act on the decisions and actions of their coworkers. In such a work environment, employees can reasonably expect to be treated with full respect and consideration by their coworkers and superiors. Trusting relationships between upper management and managers and their subordinates contribute to greater decision making efficiencies. One survey found that when employees see values such as honesty, respect, and trust applied frequently in the workplace, they feel less pressure to compromise ethical standards, observe less misconduct, are more satisfied with their organizations overall, and feel more valued as employees.[38]

The ethical culture of a company seems to matter to employees. According to a report on employee loyalty and work practices, companies viewed as highly ethical by their employees were six times more likely to keep their workers.[39] Also, employees who view their company as having a strong community involvement feel more loyal to their employers and feel positive about themselves.

Ethics Contribute to Investor Loyalty

Ethical conduct results in shareholder loyalty and can contribute to success that supports even broader social causes and concerns. Former Wal-Mart CEO Lee Scott has stated that "As businesses, we have a responsibility to society. We also have an extraordinary opportunity. Let me be clear about this point, there is no conflict between delivering value to shareholders and helping solve bigger societal problems. In fact, they can build upon each other when developed, aligned, and executed right."[40]

Investors today are increasingly concerned about the ethics, social responsibility, and reputation of companies in which they invest, and various socially responsible mutual funds and asset management firms can help investors purchase stock in ethical companies.

Investors are also recognizing that an ethical culture provides a foundation for efficiency, productivity, and profits. On the other hand, investors know too that negative publicity, lawsuits, and fines can lower stock prices, diminish customer loyalty, and threaten a company's long-term viability. Many companies accused of misconduct have experienced dramatic declines in the value of their stock when concerned investors divested their stocks and bonds. Warren Buffett and his company Berkshire Hathaway command significant respect from investors because of their track record of financial returns and the integrity of their organizations. Buffett says, "I want employees to ask themselves whether they are willing to have any contemplated act appear the next day on the front page of their local paper—to be read by their spouses, children and friends—with the reporting done by an informed and critical reporter." The high level of accountability and trust Buffett places in his employees translates into investor trust and confidence.[41]

TIAA-CREF investor participants were asked would they choose a financial services company with strong ethics or higher returns. Surprisingly, 92 percent of respondents said they would choose ethics while only 5 percent chose higher returns.[42]

Investors look at the bottom line for profits or the potential for increased stock prices or dividends. But they also look for any potential flaws in the company's performance, conduct, and financial reports. Therefore, gaining investors' trust and confidence is vital to sustaining the financial stability of the firm.

"Customer satisfaction is one of the most important factors in successful business strategy."

Ethics Contribute to Customer Satisfaction

It is generally accepted that customer satisfaction is one of the most important factors in successful business strategy. Although a company must continue to develop, alter, and adapt products to keep pace with customers' changing desires and preferences, it must also seek to develop long-term relationships with customers and its stakeholders. Patagonia, Inc. has engaged in a broad array of environmentally, socially responsible and ethical behaviors over many years to better connect with its target markets. The company has donated more than $31 million to over 1,000 environmentally oriented causes. Employees can volunteer for an environmental group and get up to two months pay. The entire clothing line was sourced using organic cotton in 1996. Targeting Generation Y, the company is selling "Vote the Environment" t-shirts and donates $5 from each to the League of Conservation Voters. In addition, the company is currently creating the Patagonia National Park to protect wildland ecosystems and biodiversity in Chile and Argentina. All new facilities are being built with LEED certification showing their commitment to green building and the environment.[43]

For most businesses, both repeat purchases and an enduring relationship of mutual respect and cooperation with their customers are essential for success. By focusing on customer satisfaction, a company continually deepens the customer's dependence on the company, and as the customer's confidence grows, the firm gains a better understanding of how to serve the customer so the relationship may endure. Successful businesses provide an opportunity for customer feedback, which can engage the customer in cooperative problem solving. As is often pointed out, a happy customer will come back, but a disgruntled customer will tell others about his or her dissatisfaction with a company and discourage friends from dealing with it.

The public's trust is essential to maintaining a good long-term relationship between a business and consumers. The Millennium Poll of 25,000 citizens in 23 countries found

that almost 60 percent of people focus on social responsibility ahead of brand reputation or financial factors when forming impressions of companies.[44] As social responsibility becomes more important for companies, it has been suggested that corporate social responsibility is a sign of good management and that it may, according to one study, indicate good financial performance. However, another study indicates that the reverse may be true, that companies who have good financial performance are able to spend more money on social responsibility.[45] Google would be an example of such a company. Google shows extreme care for its employees at its Googleplex headquarters in Mountain View, CA. Investment in their employees satisfaction and retention involves providing bicycles for efficient travel between meetings, lava lamps, massage chairs, shared work cubicles to allow for intellectual stimulation and idea generation, laptops for every employee, foosball, pool tables, volleyball courts, assorted video games, pianos, ping pong tables, lap pools, gyms, yoga and dance classes, meditation classes, wine tasting groups, film clubs, salsa dancing clubs, healthy lunches for staff at a wide variety of cafes, outdoor seating for "brainstorming," and snack rooms packed with various snacks and drinks.[46]

When an organization has a strong ethical environment, it usually focuses on the core value of placing customers' interests first. Putting customers first does not mean that the interests of employees, investors, and local communities should be ignored, however. An ethical culture that focuses on customers incorporates the interests of all employees, suppliers, and other interested parties in decisions and actions. Employees working in an ethical environment support and contribute to the process of understanding customers' demands and concerns. Ethical conduct toward customers builds a strong competitive position that has been shown to affect business performance and product innovation positively.

Ethics Contribute to Profits

A company cannot nurture and develop an ethical culture unless it has achieved adequate financial performance in terms of profits. Businesses with greater resources—regardless of their staff size—have the means to practice social responsibility while serving their customers, valuing their employees, and establishing trust with the public. Ethical conduct toward customers builds a strong competitive position that has been shown to affect business performance and product innovation positively.[47] Green Mountain Coffee Company, which sells products under the Green Mountain, Newman's Own, and Keurig brands, has built a strong reputation on social responsibility. The company donates to local and coffee-growing communities, as well as buys carbon offsets. Also, 28 percent of its coffee purchases are Fair Trade certified. Its CSR activities have led to more business. Organizations such as Creighton University chose to purchase Green Mountain Coffee products because students and educators appreciate the company's environmentally friendly practices.[48] Every day, business newspapers and magazines offer new examples of the consequences of business misconduct. It is worth noting, however, that most of these companies have learned from their mistakes and recovered after they implemented programs to improve ethical and legal conduct.

Ample evidence shows that being ethical pays off with better performance. As indicated earlier, companies that are perceived by their employees as having a high degree of honesty and integrity have a much higher average total return to shareholders than do companies perceived as having a low degree of honesty and integrity.[49] A recent study demonstrates that, even using a variety of measurement methods, companies actively engaging in corporate social responsibility have higher pre-tax income than firms that are

merely focused on financial performance; therefore ambition and performance are not in conflict with being ethical.[50] These results provide strong evidence that corporate concern for ethical conduct is becoming a part of strategic planning toward obtaining the outcome of higher profitability. Rather than being just a compliance program, ethics is becoming one of the management issues within the effort to achieve competitive advantage.

OUR FRAMEWORK FOR STUDYING BUSINESS ETHICS

We have developed a framework for this text to help you understand how people make ethical decisions and deal with ethical issues. Table 1–3 summarizes each element in the framework and describes where each topic is discussed in this book.

In Part One, we provide an overview of business ethics. Chapter 1 defines the term *business ethics* and explores the development and importance of this critical business area. In Chapter 2, we explore the role of various stakeholder groups in social responsibility and corporate governance.

Part Two focuses on ethical issues and the institutionalization of business ethics. In Chapter 3, we examine business issues that create ethical decision making in organizations. In Chapter 4, we look at the institutionalization of business ethics including both mandatory and voluntary societal concerns.

In Part Three, we delineate the ethical decision making process and then look at both individual factors and organizational factors that influence decisions. Chapter 5 describes the ethical decision making process from an organizational perspective. Chapter 6 explores individual factors that may influence ethical decisions in business, including moral philosophies and cognitive moral development. Chapter 7 focuses on the organizational dimensions including corporate culture, relationships, and conflicts.

In Part Four, we explore systems and processes associated with implementing business ethics into global strategic planning. Chapter 8 discusses the development of an effective ethics program. In Chapter 9, we examine issues related to implementing and auditing ethics programs. And finally, Chapter 10 considers ethical issues in a global context.

We hope that this framework will help you to develop a balanced understanding of the various perspectives and alternatives available to you when making ethical business decisions. Regardless of your own personal values, the more you know about how individuals make decisions, the better prepared you will be to cope with difficult ethical decisions. Such knowledge will help you improve and control the ethical decision making environment in which you work.

It is your job to make the final decision in an ethical situation that affects you. Sometimes that decision may be right; sometimes it may be wrong. It is always easy to look back with hindsight and know what one should have done in a particular situation. At the time, however, the choices might not have been so clear. To give you practice making ethical decisions, Part Five of this book contains a number of cases. In addition, each chapter begins with a vignette, "An Ethical Dilemma," and ends with a minicase, "Resolving Ethical Business Challenges," that involves ethical problems. We hope they will give you a better sense of the challenges of making ethical decisions in the real business world.

TABLE 1–3 Our Framework for Studying Business Ethics

Chapter	Highlights
1. The Importance of Business Ethics	• Definitions
	• Reasons for studying business ethics
	• History
	• Benefits of business ethics
2. Stakeholder Relationships, Social Responsibility, and Corporate Governance	• Stakeholder relationships
	• Stakeholder influences in social responsibility
	• Corporate governance
3. Emerging Business Ethics Issues	• Recognizing an ethical issue
	• Honesty, fairness, and integrity
	• Ethical issues and dilemmas in business: abusive and disruptive behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy
	• Determining an ethical issue in business
4. The Institutionalization of Business Ethics	• Mandatory requirements
	• Voluntary requirements
	• Core practices
	• Federal Sentencing Guidelines for Organizations
	• Sarbanes–Oxley Act
5. Ethical Decision Making and Ethical Leadership	• Ethical issue intensity
	• Individual factors in decision making
	• Organizational factors in decision making
	• Opportunity in decision making
	• Business ethics evaluations and intentions
	• The role of leadership in a corporate culture
	• Leadership styles influence ethical decisions
	• Habits of strong ethical leaders

(continued)

TABLE 1–3 Our Framework for Studying Business Ethics *(continued)*

Chapter	Highlights
6. Individual Factors: Moral Philosophies and Values	• Moral philosophies, including teleological development philosophies; and cognitive moral deontological, relativist, virtue ethics, and justice philosophies
	• Stages of cognitive moral development
7. Organizational Factors: The Role of Ethical Culture and Relationships	• Corporate culture
	• Interpersonal relationships
	• Whistle-blowing
	• Opportunity and conflict
8. Developing an Effective Ethics Program	• Ethics programs
	• Codes of ethics
	• Program responsibility
	• Communication of ethical standards
	• Systems to monitor and enforce ethical standards
	• Continuous improvement of ethics programs
9. Implementing and Auditing Ethics Programs	• Implementation programs
	• Ethics audits
10. Business Ethics in a Global Economy	• Ethical perceptions economy
	• Culture and cultural relations
	• Multinational corporations
	• Universal ethics
	• Global ethics issues

SUMMARY

This chapter provides an overview of the field of business ethics and introduces the framework for the discussion of business ethics. Business ethics comprises principles and standards that guide behavior in the world of business. Investors, employees, customers, interest groups, the legal system, and the community often determine whether a specific action is right or wrong, ethical or unethical.

Studying business ethics is important for many reasons. Recent incidents of unethical activity in business underscore the widespread need for a better understanding of the

factors that contribute to ethical and unethical decisions. Individuals' personal moral philosophies and decision making experience may not be sufficient to guide them in the business world. Studying business ethics will help you begin to identify ethical issues and recognize the approaches available to resolve them.

The study of business ethics evolved through five distinct stages. Before 1960, business ethics issues were discussed primarily from a religious perspective. The 1960s saw the emergence of many social issues involving business and the idea of social conscience as well as a rise in consumerism, which culminated with Kennedy's Consumers' Bill of Rights. Business ethics began to develop as an independent field of study in the 1970s, with academics and practitioners exploring ethical issues and attempting to understand how individuals and organizations make ethical decisions. These experts began to teach and write about the idea of corporate social responsibility, an organization's obligation to maximize its positive impact on stakeholders and to minimize its negative impact. In the 1980s, centers of business ethics provided publications, courses, conferences, and seminars, and many companies established ethics committees and social policy committees. The Defense Industry Initiative on Business Ethics and Conduct was developed to guide corporate support for ethical conduct; its principles had a major impact on corporate ethics.

However, less government regulation and an increase in businesses with international operations raised new ethical issues. In the 1990s, government continued to support self-regulation. The FSGO sets the tone for organizational ethics programs by providing incentives for companies to take action to prevent organizational misconduct. The twenty-first century ushered in a new set of ethics scandals, suggesting that many companies had not fully embraced the public's desire for higher ethical standards. The Sarbanes–Oxley Act therefore stiffened penalties for corporate fraud and established an accounting oversight board. The current trend is away from legally based ethical initiatives in organizations toward cultural initiatives that make ethics a part of core organizational values. The ethical component of a corporate culture relates to the values, beliefs, and established and enforced patterns of conduct that employees use to identify and respond to ethical issues. The term *ethical culture* describes the component of corporate culture that captures the rules and principles that an organization defines as appropriate conduct. It can be viewed as the character or decision making process that employees use to determine whether their responses to ethical issues are right or wrong.

Research and anecdotes demonstrate that building an ethical reputation among employees, customers, and the general public provides benefits that include increased efficiency in daily operations, greater employee commitment, increased investor willingness to entrust funds, improved customer trust and satisfaction, and better financial performance. The reputation of a company has a major effect on its relationships with employees, investors, customers, and many other parties and thus has the potential to affect its bottom line.

Finally, this text introduces a framework for studying business ethics. Each chapter addresses some aspect of business ethics and decision making within a business context. The major concerns are ethical issues in business, stakeholder relationships, social responsibility and corporate governance, emerging business ethics issues, the institutionalization of business ethics, understanding the ethical decision making process, moral philosophies and cognitive moral development, corporate culture, organizational relationships and conflicts, developing an effective ethics program, implementing and auditing the ethics program, and global business ethics.

IMPORTANT TERMS FOR REVIEW

business ethics
principles
values
Consumers' Bill of Rights
social responsibility
Defense Industry Initiative on Business Ethics and Conduct
Federal Sentencing Guidelines for Organizations
Sarbanes–Oxley Act
ethical culture

RESOLVING ETHICAL BUSINESS CHALLENGES*

Frank Garcia was just starting out as a salesperson with Acme Corporation. Acme's corporate culture was top-down, or hierarchical. Because of the competitive nature of the medical supplies industry, few mistakes were tolerated. Otis Hillman was a buyer for Thermocare, a national hospital chain. Frank's first meeting with Otis was a success, resulting in a $500,000 contract. This sale represented a significant increase for Acme and an additional $1,000 bonus for Frank.

Some months later, Frank called on Thermocare, seeking to increase the contract by $500,000. "Otis, I think you'll need the additional inventory. It looks as if you didn't have enough at the end of last quarter," said Frank.

"You may be right. Business has picked up. Maybe it's because of your product, but then again, maybe not. It's still not clear to me whether Acme is the best for us. Speaking of which, I heard that you have season tickets to the Cubs!" replied Otis.

Frank thought for a moment and said, "Otis, I know that part of your increases is due to our quality products. How about we discuss this over a ball game?"

"Well, OK," Otis agreed.

By the seventh-inning stretch, Frank had convinced Otis that the additional inventory was needed and offered to give Thermocare a pair of season tickets. When Frank's boss, Amber, heard of the sale, she was very pleased. "Frank, this is great. We've been trying to get Thermocare's business for a long time. You seem to have connected with their buyer." As a result of the Thermocare account, Frank received another large bonus check and a letter of achievement from the vice president of marketing.

Two quarters later, Frank had become one of the top producers in the division. At the beginning of the quarter, Frank had run the numbers on Thermocare's account and found that business was booming. The numbers showed that Otis's business could probably handle an additional $750,000 worth of goods without hurting return on assets. As Frank went over the figures with Otis, Otis's response was, "You know, Frank, I've really enjoyed the season tickets, but this is a big increase." As the conversation meandered, Frank soon found out that Otis and his wife had never been to Cancun, Mexico. Frank had never been in a situation like this before, so he excused himself to another room and called Amber about what he was thinking of doing.

"Are you kidding!" responded Amber. "Why are you even calling me on this? I'll find the money somewhere to pay for it."

"Is this OK with Acme?" asked Frank.

"You let me worry about that," Amber told him.

When Frank suggested that Otis and his wife be his guests in Cancun, the conversation seemed to

go smoothly. In Cancun, Otis decided to purchase the additional goods, for which Frank received another bonus increase and another positive letter from headquarters.

Some time later, Amber announced to her division that they would be taking all of their best clients to Las Vegas for a thank-you party. One of those invited was Thermocare. When they arrived, Amber gave each person $500 and said, "I want you to know that Acme is very grateful for the business that you have provided us. As a result of your understanding the qualitative differences of our products, we have doubled our production facilities. This trip and everything that goes with it for the next few days is our small way of saying thank you. Every one of you has your salesperson here. If there is anything that you need, please let him or her know, and we'll try to accommodate you. Have a good time!"

That night Otis saw Frank at dinner and suggested to him that he was interested in attending an "adult entertainment" club. When Frank came to Amber about this, she said, "Is he asking you to go with him?"

"No, Amber, not me!"

"Well, then, if he's not asking you to go, I don't understand why you're talking to me. Didn't I say we'd take care of their needs?"

"But what will Acme say if this gets out?" asked Frank.

"Don't worry; it won't," said Amber.

QUESTIONS • EXERCISES

1. What are the potential ethical issues faced by Acme Corporation?
2. What should Acme do if there is a desire to make ethics a part of its core organizational values?
3. Identify the ethical issues of which Frank needs to be aware.
4. Discuss the advantages and disadvantages of each decision that Frank could make.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Business ethics focuses mostly on personal ethical issues.	**Yes**	**No**
2. Business ethics deals with right or wrong behavior within a particular organization.	**Yes**	**No**
3. An ethical culture is based upon the norms and values of the company.	**Yes**	**No**
4. Business ethics contributes to investor loyalty.	**Yes**	**No**
5. The trend is away from cultural or ethically based initiatives to legal initiatives in organizations.	**Yes**	**No**
6. Investments in business ethics do not support the bottom line.	**Yes**	**No**

ANSWERS: **1. No.** Business ethics focuses on organizational concerns (legal and ethical—employees, customers, suppliers, society). **2. Yes.** That stems from the basic definition. **3. Yes.** Norms and values help create an organizational culture and are key in supporting or not supporting ethical conduct. **4. Yes.** Many studies have shown that trust and ethical conduct contribute to investor loyalty. **5. No.** Many businesses are communicating their core values to their employees by creating ethics programs and appointing ethics officers to oversee them. **6. No.** Ethics initiatives cause consumer, employee, and shareholder loyalty and positive behavior that contributes to the bottom line.

CHAPTER 2

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Stakeholder Relationships, Social Responsibility, and Corporate Governance

CHAPTER OBJECTIVES

- To identify stakeholders' roles in business ethics
- To define social responsibility
- To examine the relationship between stakeholder orientation and social responsibility
- To delineate a stakeholder orientation in creating corporate social responsibility
- To explore the role of corporate governance in structuring ethics and social responsibility in business
- To list the steps involved in implementing a stakeholder perspective in social responsibility and business ethics

CHAPTER OUTLINE

Stakeholders Define Ethical Issues in Business

Identifying Stakeholders

A Stakeholder Orientation

Social Responsibility and the Importance of a Stakeholder Orientation

Social Responsibility and Ethics

Corporate Governance Provides Formalized Responsibility to Stakeholders

Views of Corporate Governance

The Role of Boards of Directors

Implementing a Stakeholder Perspective

Step 1: Assessing the Corporate Culture

Step 2: Identifying Stakeholder Groups

Step 3: Identifying Stakeholder Issues

Step 4: Assessing Organizational Commitment to Social Responsibility

Step 5: Identifying Resources and Determining Urgency

Step 6: Gaining Stakeholder Feedback

AN ETHICAL DILEMMA*

Carla knew something was wrong when Jack got back to his desk. He had been with Aker & Aker Accounting (A&A) for 17 years, starting there right after graduation and progressing through the ranks. Jack was a strong supporter of the company, and that was why Carla had been assigned to him. Carla had been with A&A for two years. She had graduated in the top 10 percent of her class and passed the CPA exam on the first try. She had chosen A&A over one of the "Big Four" firms because A&A was the biggest and best firm in Smallville, Ohio, where her husband, Frank, managed a locally owned machine tools company. She and Frank had just purchased a new home when things started to turn strange with Jack, her boss.

"What's the matter, Jack?" Carla asked.

"Well, you'll hear about it sooner or later. I've been denied a partner's position. Can you imagine that? I have been working 60- and 70-hour weeks for the last 10 years, and all that management can say to me is 'not at this time,'" complained Jack.

Carla asked, "So what else did they say?"

Jack turned red and blurted out, "They said maybe in a few more years. I've done all that they've asked me to do. I've sacrificed a lot, and now they say a few more years. It's not fair."

"What are you going to do?" Carla asked.

"I don't know," Jack said. "I just don't know."

Six months later, Carla noticed that Jack was behaving oddly. He came in late and left early. One Sunday Carla went into the office for some files and found Jack copying some of the software that A&A used in auditing and consulting. A couple of weeks later, at a dinner party, Carla overheard a conversation about Jack doing consulting work for some small firms. Monday morning, she asked him if what she had heard was true.

Jack responded, "Yes, Carla, it's true. I have a few clients that I do work for on occasion."

"Don't you think there's a conflict of interest between you and A&A?" asked Carla.

"No," said Jack. "You see, these clients are not technically within the market area of A&A. Besides, I was counting on that promotion to help pay some extra bills. My oldest son decided to go to a private university, which is an extra $25,000 each year. Plus our medical plan at A&A doesn't

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

cover some of my medical problems. And you don't want to know the cost. The only way I can afford to pay for these things is to do some extra work on the side."

"But what if A&A finds out?" Carla asked. "Won't they terminate you?"

"I don't want to think about that. Besides, if they don't find out for another six months, I may be able to start my own company."

"How?" asked Carla.

"Don't be naive, Carla. You came in that Sunday. You know."

Carla realized that Jack had been using A&A software for his own gain. "That's stealing!" she said.

"Stealing?" Jack's voice grew calm. "Like when you use the office phones for personal long-distance calls? Like when you decided to volunteer to help out your church and copied all those things for them on the company machine? If I'm stealing, you're a thief as well. But let's not get into this discussion. I'm not hurting A&A and, who knows, maybe within the next year I'll become a partner and can quit my night job."

Carla backed off from the discussion and said nothing more. She couldn't afford to antagonize her boss and risk bad performance ratings. She and Frank had bills, too. She also knew that she wouldn't be able to get another job at the same pay if she quit. Moving to another town was not an option because of Frank's business. She had no physical evidence to take to the partners, which meant that it would be her word against Jack's, and he had 17 years of experience with the company.

QUESTIONS • EXERCISES

1. Identify the ethical issues in this case.
2. Assume you are Carla. Discuss your options and what the consequences of each option might be.
3. Assume you are Jack. Discuss your options.
4. Discuss any additional information you feel you might need before making your decision.

Business ethics issues, conflicts, and successes revolve around relationships. Building effective relationships is considered one of the more important areas of business today. A business exists because of relationships between employees, customers, shareholders or investors, suppliers, and managers who develop strategies to attain success. In addition, an organization usually has a governing authority often called a board of directors that provides oversight and direction to make sure that the organization stays focused on objectives in an ethical, legal, and socially acceptable manner. When unethical acts are discovered in organizations, it is often found that in most instances there is knowing cooperation or compliancy that facilitates the acceptance and perpetuation of unethical conduct.[1] Therefore, relationships are not only associated with organizational success but also with organizational misconduct.

A stakeholder framework helps identify the internal stakeholders such as employees, boards of directors, and managers and external stakeholders such as customers, special interest groups, regulators, and others who agree, collaborate, and have confrontations on ethical issues. Most ethical issues exist because of conflicts in values and belief patterns about right and wrong between and within stakeholder groups. This framework allows a firm to identify, monitor, and respond to the needs, values, and expectations of different stakeholder groups.

The formal system of accountability and control of ethical and socially responsible behavior is corporate governance. In theory, the board of directors provides oversight for

all decisions and use of resources. Ethical issues relate to the role of the board of directors, shareholder relationship, internal control, risk management, and executive compensation. Ethical leadership is associated with appropriate corporate governance.

In this chapter, we first focus on the concept of stakeholders and examine how a stakeholder framework can help understand organizational ethics. Then we identify stakeholders and the importance of a stakeholder orientation. Using the stakeholder framework, social responsibility is explored, including the various dimensions of social responsibility. Next, corporate governance as a dimension of social responsibility and ethical decision making is covered to provide an understanding of the importance of oversight in responding to stakeholders. Finally, we provide the steps for implementing a stakeholder perspective in creating social responsibility and ethical decisions in business.

STAKEHOLDERS DEFINE ETHICAL ISSUES IN BUSINESS

In a business context, customers, investors and shareholders, employees, suppliers, government agencies, communities, and many others who have a "stake" or claim in some aspect of a company's products, operations, markets, industry, and outcomes are known as **stakeholders.** These groups are influenced by business, but they also have the ability to influence businesses; thus, the relationship between companies and their stakeholders is a two-way street.[2]

Sometimes activities and negative press generated by special interest groups can force a company to change its practices. For example, People for the Ethical Treatment of Animals (PETA) launched a campaign again McDonald's to try to force the company to halt inhumane treatment of chickens among its egg suppliers. McDonald's did change their policies, although they deny that PETA's actions had any direct effect. More recently, PETA has targeted McDonald's again—this time focusing on the ways that chickens are raised and slaughtered at the company's meat suppliers. Burger King, on the other hand, received an award from PETA in 2008 for its improvements in animal welfare.[3] Many firms experienced conflicts with key stakeholders, and consequently damaged their reputations and shareholder confidence during the 2008–2009 financial crisis. While many threats to reputation stem from uncontrollable events and the environment, ethical misconduct is more difficult to overcome than poor financial performance. Stakeholders who are most directly affected by negative events will have a corresponding shift in their perceptions of a firm's reputation. On the other hand, firms such as financial institutions that receive negative publicity for misconduct destroy trust and tarnish their reputations, which will make it more difficult to retain existing customers or attract new ones.[4]

Consider the decision made by Bear Stearns, at the time an investment bank, to allow managers to invest clients' money in high-risk, highly leveraged portfolio instruments, which were backed in part by subprime mortgages. While losing money is not a crime, Ralph Cioffi and Matthew Tannin, the founders and portfolio managers of two Bear Stearns hedge funds, are charged with making false statements in the months leading to the funds' demise. These Bear Stearns managers made reassuring public statements to investors ("we are very comfortable with exactly where we are") on April 25, 2007, although private e-mails days earlier stated "if we believe the internal report is anywhere close to accurate, I think we should close the funds now." The plaintiff's class action lawyers claimed that

Bear Stearns' problems were compounded two months later when Bear Stearns CEO James E. Cayne assured investors that "the balance sheet, capital base, and liquidity profile have never been stronger. Bear Stearns' risk exposures to high-profile sectors are moderate and well-controlled."[5] Several months later the company sought emergency funding from the government and was sold to JP Morgan Chase.[6] Of course it's impossible to know if CEO Cayne knew the true state of the financial situation at the time he made his comment, but the damage to the reputation of the company from these events was fatal. Once the credibility of a firm's statements has been destroyed, the reputation of the company and trust with stakeholders is almost impossible to recover. While prosecutors asked questions after the firm's collapse, at this time there is no active criminal inquiry into the CEO's statements. To maintain trust and confidence with stakeholders, CEOs and other top managers are expected to tell the truth to prevent customers and investors from being damaged by the failure to receive timely and accurate information. Providing untruthful or deceptive information to stakeholders, if not illegal, is unethical.

The financial crisis was based on a failure to consider the ramifications of unethical decision making affecting all stakeholders, including society and the economic system. The foundation of the crisis was subprime loans, involving lending money to people who could not possibly repay their loans. Many companies engaged in providing fictitious financial information. For example, in California a Mexican strawberry picker with an income of $14,000 who spoke no English was lent all the money he needed to buy a house for $720,000.[7] This reckless disregard for the impact on financial organizations that purchased the loan obligations, which could never be repaid, was at the heart of the 2008–2009 financial crisis.

Ethical misconduct and decisions that damage stakeholders will generally impact the company's reputation both from investor confidence and consumer confidence perspectives. As investor perceptions and decisions begin to take their toll, shareholder value will drop, exposing the company to consumer scrutiny that can increase the damage. Reputation is a factor in the consumers' perceptions of product attributes and corporate image features that lead to consumer willingness to purchase goods and services at profitable prices. Bailed-out bank Citigroup halted payments of some bonuses after public backlash became a problem. Public disgust and outrage over the payment of bonuses to executives in failing financial firms was high after AIG paid retention bonuses to its executives, even after the government had spent billions to rescue the firm. Citigroup determined that the issue was too politically sensitive, and made the ethically questionable decision to hold off on making the payments until the political climate cooled down.[8] Some scandals may lead to boycotts and aggressive campaigns to dampen sales and earnings. Nike experienced such a backlash from its use of offshore subcontractors to manufacture its shoes and clothing. When Nike claimed no responsibility for the subcontractors' poor working conditions and extremely low wages, some consumers demanded greater accountability and responsibility by engaging in boycotts, letter-writing campaigns, and public service announcements. Nike ultimately responded to the growing negative publicity by changing its practices and becoming a model company in managing offshore manufacturing.[9]

New reforms to improve corporate accountability and transparency also suggest that other stakeholders—including banks, attorneys, and public accounting firms—can play a major role in fostering responsible decision making.[10] Stakeholders apply their values and standards to many diverse issues—working conditions, consumer rights, environmental conservation, product safety, and proper information disclosure—that may or may not directly affect an individual stakeholder's own welfare. We can assess the level of social

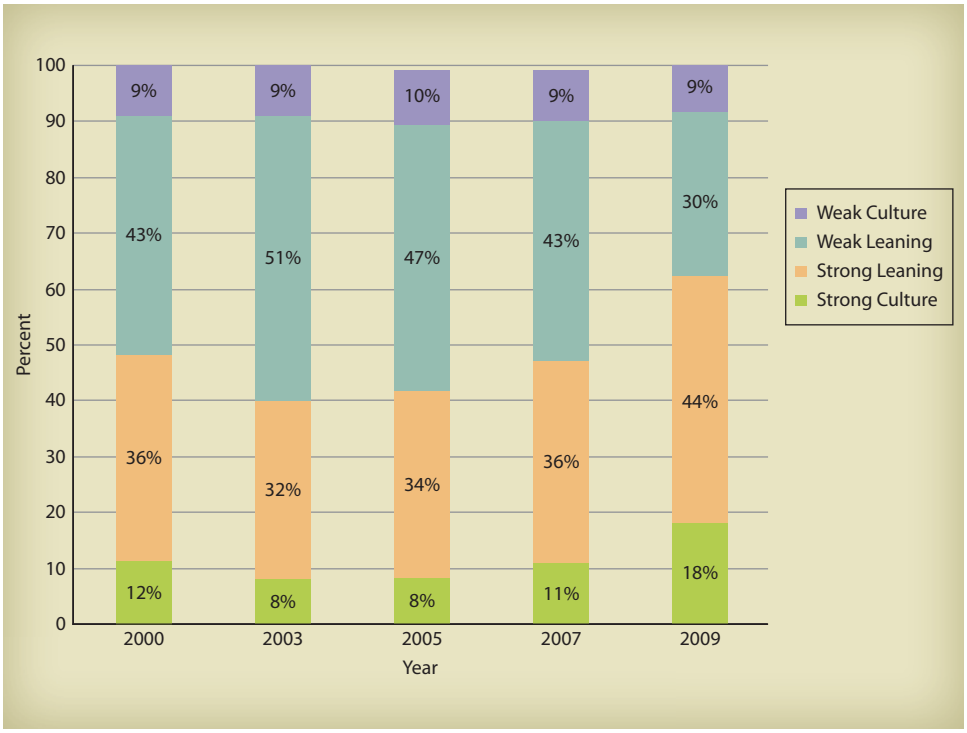
responsibility that an organization bears by scrutinizing its effects on the issues of concern to its stakeholders.[11]

Stakeholders provide resources that are more or less critical to a firm's long-term success. These resources may be both tangible and intangible. Shareholders, for example, supply capital; suppliers offer material resources or intangible knowledge; employees and managers grant expertise, leadership, and commitment; customers generate revenue and provide loyalty and positive word-of-mouth promotion; local communities provide infrastructure; and the media transmits positive corporate images. When individual stakeholders share similar expectations about desirable business conduct, they may choose to establish or join formal communities that are dedicated to better defining and advocating these values and expectations. Stakeholders' ability to withdraw—or to threaten to withdraw—these needed resources gives them power over businesses.[12]

Identifying Stakeholders

We can identify two different types of stakeholders. **Primary stakeholders** are those whose continued association is absolutely necessary for a firm's survival; these include employees, customers, investors, and shareholders, as well as the governments and communities that provide necessary infrastructure. Some firms take actions that can damage relationships with primary stakeholders. Figure 2-1 indicates that, after experiencing some declines in 2007, strong ethical corporate cultures are back on the rise, with strong cultures making

FIGURE 2–1 After Declining, Strength of Organizational Culture is on the Rise Again



Note: Due to rounding, some totals do note equal 100 percent.

Source: "2009 National Business Ethics Survey: Ethics in the Recession," (Washington D.C.: Ethics Resource Center, 2009): p. 14.

a large 9% jump in 2009. Ethical corporate cultures are linked to positive relationships with stakeholders. Concern for stakeholders' needs and expectations is necessary to avoid ethical conflicts.

Secondary stakeholders do not typically engage in transactions with a company and thus are not essential for its survival; these include the media, trade associations, and special interest groups. The American Association of Retired People (AARP), a special interest group, works to support retirees' rights such as health care benefits. Both primary and secondary stakeholders embrace specific values and standards that dictate what constitutes acceptable or unacceptable corporate behaviors. It is important for managers to recognize that while primary groups may present more day-to-day concerns, secondary groups cannot be ignored or given less consideration in the ethical decision making process.[13] Table 2–1 shows a select list of issues important to various stakeholder groups and how corporations impact these issues.

Figure 2–2 offers a conceptualization of the relationship between businesses and stakeholders. In this **stakeholder interaction model,** there are two-way relationships between the firm and a host of stakeholders. In addition to the fundamental input of investors, employees, and suppliers, this approach recognizes other stakeholders and explicitly acknowledges the dialogue that exists between a firm's internal and external environments.

A Stakeholder Orientation

The degree to which a firm understands and addresses stakeholder demands can be referred to as a **stakeholder orientation.** This orientation comprises three sets of activities: (1) the organization-wide generation of data about stakeholder groups and assessment of the firm's effects on these groups, (2) the distribution of this information throughout the firm, and (3) the organization's responsiveness as a whole to this intelligence.[14]

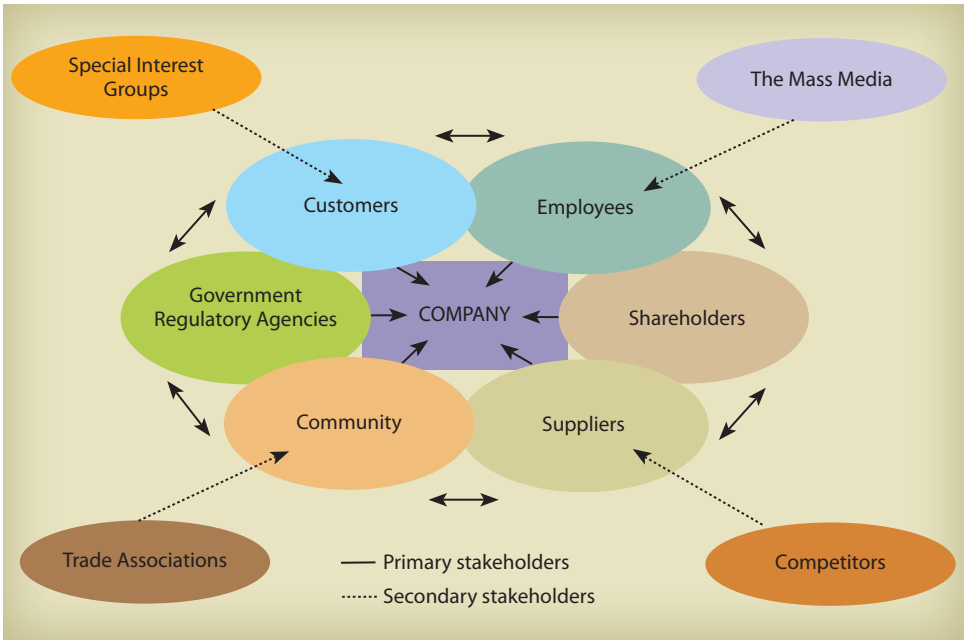
Generating data about stakeholders begins with identifying the stakeholders that are relevant to the firm. Relevant stakeholder communities should be analyzed on the basis of the power that each enjoys as well as by the ties between them. Next, the firm should characterize the concerns about the business's conduct that each relevant stakeholder group shares. This information can be derived from formal research, including surveys, focus groups, internet searches, or press reviews. For example, Ford Motor Company obtains input on social and environmental responsibility issues from company representatives, suppliers, customers, and community leaders. Shell has an online discussion forum where website visitors are invited to express their opinions on the company's activities and their implications. Employees and managers can also generate this information informally as they carry out their daily activities. For example, purchasing managers know about suppliers' demands, public relations executives about the media, legal counselors about the regulatory environment, financial executives about investors, sales representatives about customers, and human resources advisers about employees. Finally, the company should evaluate its impact on the issues that are important to the various stakeholders it has identified.[15]

Given the variety of the employees involved in the generation of information about stakeholders, it is essential that this intelligence be circulated throughout the firm. This requires that the firm facilitate the communication of information about the nature of relevant stakeholder communities, stakeholder issues, and the current impact of the firm on these issues to all members of the organization. The dissemination of stakeholder

TABLE 2–1 Examples of Stakeholder Issues and Associated Measures of Corporate Impacts

Stakeholder Groups and Issues	Potential Indicators of Corporate Impact on These Issues
Employees	
1. Compensation and benefits	• Ratio of lowest wage to national legal minimum or to local cost of living
2. Training and development	• Changes in average years of training of employees
3. Employee diversity	• Percentages of employees from different genders and races
4. Occupational health and safety	• Standard injury rates and absentee rates
5. Communications with management	• Availability of open-door policies or ombudsmen
Customers	
1. Product safety and quality	• Number of product recalls over time
2. Management of customer complaints	• Number of customer complaints and availability of procedures to answer them
3. Services to disabled customers	• Availability and nature of measures taken to ensure services to disabled customers
Investors	
1. Transparency of shareholder communications	• Availability of procedures to inform shareholders about corporate activities
2. Shareholder rights	• Frequency and type of litigation involving violations of shareholder rights
Suppliers	
1. Encouraging suppliers in developing countries	• Prices offered to suppliers in developed countries in comparison to countries' other suppliers
2. Encouraging minority suppliers	• Percentage of minority suppliers
Community	
1. Public health and safety protection	• Availability of emergency response plan
2. Conservation of energy and materials	• Data on reduction of waste produced and comparison to industry
3. Donations and support of local organizations	• Annual employee time spent in community service
Environmental Groups	
1. Minimizing the use of energy	• Amount of electricity purchased; percentage of "green" electricity
2. Minimizing emissions and waste	• Type, amount, and designation of waste generated
3. Minimizing adverse environmental effects of goods and services	• Percentage of product weight reclaimed after use

FIGURE 2–2 Interactions between a Company and Its Primary and Secondary Stakeholders



Source: Adapted from Isabelle Maignan, O. C. Ferrell, and Linda Ferrell, "A Stakeholder Model for Implementing Social Responsibility in Marketing," *European Journal of Marketing* 39 (2005): 956–977. Used with permission.

intelligence can be organized formally through activities such as newsletters and internal information forums.[16]

A stakeholder orientation is not complete unless it includes activities that address stakeholder issues. For example, many Chinese manufacturers and companies that use Chinese suppliers have been under attack in recent years over concern for product safety. From lead-tainted toys at Mattel, melamine-tainted dairy products, and potentially deadly generic drugs (which is a highly lucrative $75 billion a year business that employs over five million Chinese people)—China has faced serious allegations and criticisms over its lack of oversight and concern for consumer welfare.[17]

The responsiveness of the organization as a whole to stakeholder intelligence consists of the initiatives that the firm adopts to ensure that it abides by or exceeds stakeholder expectations and has a positive impact on stakeholder issues. Such activities are likely to be specific to a particular stakeholder group (for example, family-friendly work schedules) or to a particular stakeholder issue (for example, pollution reduction programs). These responsiveness processes typically involve the participation of the concerned stakeholder groups. Kraft, for example, includes special interest groups and university representatives in its programs to become sensitized to present and future ethical issues.

A stakeholder orientation can be viewed as a continuum in that firms are likely to adopt the concept to varying degrees. To gauge a given firm's stakeholder orientation, it is necessary to evaluate the extent to which the firm adopts behaviors that typify both the generation and dissemination of stakeholder intelligence and responsiveness to it. A given organization may generate and disseminate more intelligence about certain stakeholder communities than about others and, as a result, may respond to that intelligence differently.[18]

SOCIAL RESPONSIBILITY AND THE IMPORTANCE OF A STAKEHOLDER ORIENTATION

From the perspective of social responsibility, business ethics embodies values, norms, and expectations that reflect a concern of major stakeholders, including consumers, employees, shareholders, suppliers, competitors, and the community. In other words, these stakeholders have concerns about what is fair, just, or in keeping with respect for stakeholders' rights.

Many businesspeople and scholars have questioned the role of ethics and social responsibility in business. Legal and economic responsibilities are generally accepted as the most important determinants of performance: "If this is well done," say classical theorists, "profits are maximized more or less continuously and firms carry out their major responsibilities to society."[19] Some economists believe that if companies address economic and legal issues, they are satisfying the demands of society and that trying to anticipate and meet additional needs would be almost impossible. Milton Friedman has been quoted as saying that "the basic mission of business [is] thus to produce goods and services at a profit, and in doing this, business [is] making its maximum contribution to society and, in fact, being socially responsible."[20] Even with the business ethics scandals of the twenty-first century, Friedman suggests that although those individuals guilty of wrongdoing should be held accountable, the market is a better deterrent than new laws and regulations at deterring firms from wrongdoing.[21] Thus, Friedman would diminish the role of stakeholders such as the government and employees in requiring that businesses demonstrate responsible and ethical behavior.

This Darwinian form of capitalism has been exported to many developing countries, such as Russia, and is associated with a "Wild West" economy where anything goes in business. Friedman's capitalism is a far cry from Adam Smith's, one of the founders of capitalism. Smith created the concept of the invisible hand and spoke about self-interest; however, he went on to explain that "this common good is associated with six psychological motives and that each individual has to produce for the common good, with values such as Propriety, Prudence, Reason, Sentiment and promoting the happiness of mankind."[22] These values could be associated with the needs and concerns of stakeholders. Smith established normative expectations for motives and behaviors in his theories about the invisible hand.

In the twenty-first century, Friedman's form of capitalism is being replaced by Smith's original concept of capitalism (or what is now called enlightened capitalism), a notion of capitalism that reemphasizes stakeholder concerns and issues. This shift may be occurring faster in developed countries than in those still being developed. The recent involvement of the government in owning major interest in General Motors and AIG, and minority ownership of large banks such as Citigroup, changes the face of capitalism in the United States. The government's $819 billion stimulus package passed in 2009 increased its reach and provided funding to reshape energy, health care, and education policy. Theodore Levitt, a renowned business professor, once wrote that although profits are required for business just like eating is required for living, profit is not the purpose of business any more than eating is the purpose of life.[23] Norman Bowie, a well-known philosopher, extended Levitt's sentiment by noting that focusing on profit alone can create an unfavorable paradox that causes a firm to fail to achieve its objective. Bowie contends that when a business also cares about the well-being of stakeholders, it earns trust and cooperation that ultimately reduce costs and increase productivity.[24]

It should be obvious from this discussion that ethics and social responsibility cannot be just a reactive approach to issues as they arise. Only if firms make ethical concerns a part of their foundation and incorporate ethics in their business strategy can social responsibility as a concept be embedded in daily decision making. Herman Miller is an office furniture company that is known for its social responsibility initiatives. The company is one of a few office furniture producers in the world that are certified by the Business and Institutional Furniture Manufacturers Association to be exceptionally low-emissions.[25] A description of corporate social responsibility should include rights and duties, consequences and values—all of which refer to specific strategic decisions. The ethical component of business strategy should be capable of providing an assessment of top management, work group, and individual behavior as it relates to ethical decisions. Table 2–2 lists *Fortune*'s best and worst companies in terms of social responsibility.

SOCIAL RESPONSIBILITY AND ETHICS

The concepts of ethics and social responsibility are often used interchangeably, although each has a distinct meaning. In Chapter 1, we defined the term *social responsibility* as an organization's obligation to maximize its positive impact on stakeholders and to minimize its negative impact. PNC Financial Services Group, for example, contributes $28 million annually in grants and corporate sponsorships to arts, community improvement, and educational causes. The company also supports employees with flexible work schedules and backup and holiday daycare, as well as a free daycare center for new parents. For its operations and technology center in Pittsburgh, the company built the nation's largest "green building," conforming to environmental guidelines on site planning, energy efficiency, water conservation, material conservation, and indoor environmental quality. It also built several "green" bank branches in New Jersey.[26]

Another example of a company being green is Whole Foods, which installs solar panels on many of its stores and buys wind power credits to offset more than 100 percents of its non-renewable energy use.[27] General Electric also pledged to decrease pollution and double research and development spending on cleaner technologies.[28] Wal-Mart has also joined the growing ranks of green companies. It has a number of environmentally friendlier stores, which reduce energy consumption and pollution. Wal-Mart hopes to take what it learns from the stores and use it in all of the new stores that it builds.[29] Like Wal-Mart and General Electric, many businesses have tried to determine what relationships, obligations, and duties are appropriate between the organization and various stakeholders. Social responsibility can be viewed as a contract with society, whereas business ethics involves carefully thought-out rules or heuristics of business conduct that guide decision making.

If social responsibility is considered an important corporate concern, then it does need quantitative credibility. Employee satisfaction, consumer loyalty, and other stakeholder concerns can be quantified to some extent, but some of the values and other dimensions are more qualitative. The International Organization for Standardization (ISO) established ISO 26000, which is a corporate social responsibility regulation that cannot be used for certification purposes or audits but is meant as a guideline to encourage discussions on the role of social responsibility and the importance of stakeholders. ISO 1400 is an environmental regulation standard any business can adopt to help it reduce its carbon footprint, pollution, and waste.[30] Many U.S. firms are purchasing renewable energy, especially solar and wind power, to reduce their carbon footprints. The United States is the leading wind power generator in the world, producing around 21 percent of the world's supply.[31] Whereas corporate responsibility needs quantitative credibility, significant aspects are more qualitative in nature: employee satisfaction, customer motivations, company values, and ethical decision making processes, for instance. All to some extent can be broken down into quantitative data, but the essence of them cannot. However, they also shift constantly, which makes yesterday's survey an addition to today's recycle bin.[32]

There are four levels of social responsibility—economic, legal, ethical, and philanthropic—and they can be viewed as steps (see Figure 2–3).[33] At the most basic level, companies have an economic responsibility to be profitable so that they can provide a return on investment to their owners and investors, create jobs for the community, and contribute

FIGURE 2–3 Steps of Social Responsibility

Source: Adapted from Archie B. Carroll, "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders," *Business Horizons* (July–August 1991): 42, Figure 3.

goods and services to the economy. Of course, businesses are also expected to obey all laws and regulations. Business ethics, as previously defined, comprises principles and standards that guide behavior in the world of business. Finally, philanthropic responsibility refers to activities that are not required of businesses but promote human welfare or goodwill. Ethics, then, is one dimension of social responsibility.

The term **corporate citizenship** is often used to express the extent to which businesses strategically meet the economic, legal, ethical, and philanthropic responsibilities placed on them by their various stakeholders.[34] Corporate citizenship has four interrelated dimensions: strong sustained economic performance, rigorous compliance, ethical actions beyond what the law requires, and voluntary contributions that advance the reputation and stakeholder commitment of the organization. A firm's commitment to corporate citizenship indicates a strategic focus on fulfilling the social responsibilities that its stakeholders expect of it. Corporate citizenship involves acting on the firm's commitment to the corporate citizenship philosophy and measuring the extent to which it follows through by actually implementing citizenship initiatives. Table 2–3 lists some of the world's most ethical companies, all of which have demonstrated commitment to stakeholders.

Reputation is one of an organization's greatest intangible assets with tangible value. The value of a positive reputation is difficult to quantify, but it is very important. A single negative incident can influence perceptions of a corporation's image and reputation instantly and for years afterwards. Corporate reputation, image, and brands are more important than ever and are among the most critical aspects of sustaining relationships with constituents including investors, customers, financial analysts, media, and government watchdogs. It takes companies decades to build a great reputation, yet just one slip can cost a company dearly. Although an organization does not control its reputation in a direct sense, its actions, choices, behaviors, and consequences do influence the reputation that exists in perceptions of stakeholders. Companies such as Exxon Mobil, Chevron Corporation, and Royal Dutch Shell Plc. received low ratings from the public in a corporate reputation survey for what the public perceived as the "heartless" spike in prices at the pump while the companies were enjoying record profits. A recent Gallup survey found that more consumers than not feel negative toward industries. Over 55 percent of consumers view their mood as negative, with only 7 percent ranking it positive.[35]

TABLE 2–3 A Selection of the World's most Ethical Companies

Trader Joe's	Salesforce.com, Inc.
Xerox	Honeywell International
Nike	Texas Instruments, Inc.
T-Mobile	Unilever
Intel Corporation	Rockwell Automation
General Electric	Waste Management
PepsiCo	Zappos.com
AstraZeneca	Dell Inc.
Stonyfield Farm	Cisco Systems
General Mills	IKEA

Source: "2009 World's Most Ethics Companies," Ethisphere Institute, http://ethisphere.com/wme2009/ (accessed June 2, 2009).

CORPORATE GOVERNANCE PROVIDES FORMALIZED RESPONSIBILITY TO STAKEHOLDERS

Most businesses, and often courses taught in colleges of business, operate under the belief that the purpose of business is to maximize profits for shareholders. In 1919 the Michigan Supreme Court in the case of *Dodge v. Ford Motor Co.*[36] ruled that a business exists for the profit of shareholders and the board of directors should focus on that objective. On the other hand, the stakeholder model places the board of directors in the central position to balance the interests and conflicts of the various constituencies. External control of the corporation includes not only government regulation but also key stakeholders including employees, consumers, and communities to exert pressures to responsible conduct. Many of the obligations to balance stakeholder interests have been institutionalized in legislation that provides incentives for responsible conduct. Shareholders have been pushing for more power in the boardroom, as many feel their interests have not been well represented in issues such as executive compensation.

Today, the failure to balance stakeholder interests can result in a failure to maximize shareholders' wealth. Oftentimes, money managers fail to handle their clients' money as carefully as they handle their own. This can result in risky trades and even large losses, as many have seen in the extreme cases of the unethical conduct of people such as Allen Stanford or Bernard Madoff.[37] Most firms are moving more toward a balanced stakeholder model as they see that this approach will sustain the relationships necessary for long-run success.

Both directors and officers of corporations are fiduciaries for the shareholders. Fiduciaries are persons placed in positions of trust who use due care and loyalty in acting on behalf of the best interests of the organization. There is a duty of care, also called a *duty of diligence*, to make informed and prudent decisions.[38] Directors have a duty to avoid ethical misconduct in their director role and to provide leadership in decisions to prevent ethical misconduct in the organization.

Directors are not held responsible for negative outcomes if they are informed and diligent in their decision making. Questions arose when firms such as Countrywide Financial engaged in misconduct, such as granting subprime loans to customers who could not afford them. This means board members have an obligation to request information, research, use accountants and attorneys, and obtain the services of ethical compliance consultants. The National Association of Corporate Directors, which is a board of directors trade group, has helped to formulate a guide to boards to help them to do a better job of governing corporate America.[39]

The duty of loyalty means that all decisions should be in the interests of the corporation and its stakeholders. Conflicts of interest exist when a director uses the position to obtain personal gain, usually at the expense of the organization. For example, before the Sarbanes–Oxley Act in 2002, directors could give themselves and officers interest-free loans. Scandals at Tyco, Kmart, and WorldCom are all associated with officers receiving personal loans that damaged the corporation.

Officer compensation packages challenge directors, especially those on the board and not independent. Directors have an opportunity to vote for others' compensation in return for their own increased compensation. After the financial crisis began in late 2008, many top executives at failed firms received multimillion dollar bonuses in spite of the fact that their

companies required huge government bailouts simply to stay afloat. AIG received a great deal of criticism after it paid out $165 million in bonuses to executives, even after the company received $180 billion in bailout money. Many feel that large executive bonuses point to a pervasive culture of greed and a sense of entitlement that has caused many of the problems on Wall Street in recent years.[40] Opportunities to know about the investments, business ventures, and stock market information create issues that could violate the duty of loyalty. Insider trading of a firm's stock has very specific rules, and violations can result in serious punishment. The obligations of directors and officers for legal and ethical responsibility interface and fit together based on their fiduciary relationships. Ethical values should guide decisions and buffer the possibility of illegal conduct. With increased pressure on directors to provide oversight for organizational ethics, there is a trend toward directors receiving training to increase their competency in ethics programs development, as well as other areas such as accounting. Automated systems to monitor and measure the occurrence of ethical issues within the organization are increasingly being used to assist in this oversight process.

To remove the opportunity for employees to make unethical decisions, most companies have developed formal systems of accountability, oversight, and control—known as **corporate governance.** *Accountability* refers to how closely workplace decisions are aligned with a firm's stated strategic direction and its compliance with ethical and legal considerations. *Oversight* provides a system of checks and balances that limit employees' and managers' opportunities to deviate from policies and strategies and that prevent unethical and illegal activities. *Control* is the process of auditing and improving organizational decisions and actions.

A clear delineation of accountability helps employees, customers, investors, government regulators, and other stakeholders understand why and how the organization chooses and achieves its goals. Corporate governance establishes fundamental systems and processes: for preventing and detecting misconduct, for investigating and disciplining, and for recovery and continuous improvement. Effective corporate governance creates a compliance and ethics culture so that employees feel that integrity is at the core of competitiveness.[41] Even if a company has adopted a consensus approach for decision making, there should be oversight and authority for delegating tasks, making difficult and sometimes controversial decisions, balancing power throughout the firm, and maintaining ethical compliance. Governance also provides mechanisms for identifying risks and for planning for recovery when mistakes or problems occur.

The development of stakeholder orientation should interface with the corporation's governance structure. Corporate governance is also part of a firm's corporate culture that establishes the integrity of all relationships. A governance system that does not provide checks and balances creates opportunities for top managers to put their own self-interests before those of important stakeholders. While many people lost their investments, some CEOs were able to profit off of the latest recession, even as their companies and shareholders fared poorly. Some directors even tweaked performance targets in order to make goals easier to achieve so that they could receive more bonus money. Bonuses have become a very contentious issue—as they are the part of an executive's pay most tied to performance. Many people are asking why executives continue to receive bonuses as their companies fail, but most of the time bonuses are tied to targets other than stock prices.[42] Concerns about the need for greater corporate governance are not limited to the United States. Reforms in governance structures and issues are occurring all over the world.[43] In many nations, companies are being pressured to implement stronger corporate governance mechanisms by international investors, by the process of becoming privatized after years of unaccountability as state companies, or by the desire to imitate successful governance movements in the United States, Japan, and the European Union.[44]

TABLE 2–4 Corporate Governance Issues

Executive compensation
Composition and structure of the board of directors
Auditing and control
Risk management
CEO selection and termination decisions
Integrity of financial reporting
Stakeholder participation and input into decisions
Compliance with corporate governance reform
Role of the CEO in board decisions
Organizational ethics programs

Table 2–4 lists examples of major corporate governance issues. These issues normally involve strategic-level decisions and actions taken by boards of directors, business owners, top executives, and other managers with high levels of authority and accountability. Although these people have often been relatively free from scrutiny, changes in technology, consumer activism, government attention, recent ethical scandals, and other factors have brought new attention to such issues as transparency, executive pay, risk and control, resource accountability, strategic direction, stockholder rights, and other decisions made for the organization.

Views of Corporate Governance

To better understand the role of corporate governance in business today, it is important to consider how it relates to fundamental beliefs about the purpose of business. Some organizations take the view that as long as they are maximizing shareholder wealth and profitability, they are fulfilling their core responsibilities. Other firms, however, believe that a business is an important member, even citizen, of society and therefore must assume broad responsibilities that include complying with social norms and expectations. From these assumptions, we can derive two major approaches to corporate governance: the shareholder model and the stakeholder model.[45]

The **shareholder model of corporate governance** is founded in classic economic precepts, including the goal of maximizing wealth for investors and owners. For publicly traded firms, corporate governance focuses on developing and improving the formal system for maintaining performance accountability between top management and the firms' shareholders.[46] Thus, a shareholder orientation should drive a firm's decisions toward serving the best interests of investors. Underlying these decisions is a classic agency problem, where ownership (that is, investors) and control (that is, managers) are separate. Managers act as agents for investors, whose primary goal is increasing the value of the stock they own. However, investors and managers are distinct parties with unique insights, goals, and values with respect to the business. Managers, for example, may have motivations beyond stockholder value, such as market share, personal compensation, or attachment to particular products and projects. Because of these potential differences, corporate governance mechanisms are needed to align investor and management interests. The shareholder model has been criticized for

its somewhat singular purpose and focus because there are other ways of "investing" in a business. Suppliers, creditors, customers, employees, business partners, the community, and others also invest their resources into the success of the firm.[47]

The **stakeholder model of corporate governance** adopts a broader view of the purpose of business. Although a company has a responsibility for economic success and viability to satisfy its stockholders, it also must answer to other stakeholders, including employees, suppliers, government regulators, communities, and special interest groups with which it interacts. Due to limited resources, companies must determine which of their stakeholders are primary. Once the primary groups have been identified, managers must then implement the appropriate corporate governance mechanisms to promote the development of long-term relationships.[48] This approach entails creating governance systems that consider stakeholder welfare in tandem with corporate needs and interests.

Although these two approaches seem to represent the ends of a continuum, the reality is that the shareholder model is a more restrictive precursor to the stakeholder orientation. Many businesses have evolved into the stakeholder model as a result of government initiatives, consumer activism, industry activity, and other external forces.

The Role of Boards of Directors

For public corporations, boards of directors hold the ultimate responsibility for their firms' success or failure, as well as for the ethics of their actions. This governing authority is being held responsible by the 2004 and 2007 amendments to the Federal Sentencing Guidelines for Organizations (FSGO) for creating an ethical culture that provides leadership, values, and compliance. The members of a company's board of directors assume legal responsibility for the firm's resources and decisions, and they appoint its top executive officers. Board members have a fiduciary duty, meaning they have assumed a position of trust and confidence that entails certain responsibilities, including acting in the best interests of those they serve. Thus, board membership is not intended as a vehicle for personal financial gain; rather, it provides the intangible benefit of ensuring the success of both the organization and people involved in the fiduciary arrangement. The role and expectations of boards of directors assumed greater significance after the accounting scandals of the early 2000s and the 2008–2009 financial crisis motivated many shareholders and other stakeholders to demand greater accountability from boards.[49] The U.S. Treasury Secretary, Timothy Geithner, is trying to change how the government goes about overseeing risk-taking in financial markets. He is pushing for stricter rules on financial management and controls on hedge funds and money market mutual funds. He believes that the United States needs greater openness and transparency, greater oversight and enforcement, and clearer more common sense language in the financial system.[50]

The traditional approach to directorship assumed that board members managed the corporation's business. Research and practical observation have shown that boards of directors rarely, if ever, perform the management function.[51] Compensation of directors can be a difficult ethical area. When considering executive pay raises, directors may put their own self-interest above the interests of the shareholders.[52] First, boards meet only a few times a year, which precludes them from managing effectively. In addition, the complexity of modern organizations mandates full attention on a daily basis. Thus, boards of directors are concerned primarily with monitoring the decisions made by executives on behalf of the company. This includes choosing top executives, assessing their performance, helping set strategic direction, and ensuring that oversight, control, and accountability mechanisms are in place. In sum, board members assume ultimate authority for their organization's effectiveness and subsequent performance.

Many CEOs have lost their jobs because the board of directors was scared. Notable examples include Michael Eisner from Disney, Carly Fiorina from Hewlett-Packard, and Rick Wagoner of General Motors. The main reason for the CEO firings was that the boards feared financial losses stemming from shareholder lawsuits against the chairs of Enron and WorldCom over their roles in the collapse of those firms. Both settlements called for the directors to pay large sums from their own pockets.[53]

Greater Demands for Accountability and Transparency. Just as improved ethical decision making requires more of employees and executives, so too are boards of directors feeling greater demands for accountability and transparency. In the past, board members were often retired company executives or friends of current executives, but the trend today is toward "outside directors" who have little vested interest in the firm before assuming the director role. Inside directors are corporate officers, consultants, major shareholders, or others who benefit directly from the success of the organization. Directors today are increasingly chosen for their expertise, competence, and ability to bring diverse perspectives to strategic discussions. Outside directors are also thought to bring more independence to the monitoring function because they are not bound by past allegiances, friendships, a current role in the company, or some other issue that may create a conflict of interest.

> *Directors today are increasingly chosen for their expertise, competence, and ability to bring diverse perspectives to strategic discussions.*

Many of the corporate scandals uncovered in recent years might have been prevented if each of the companies' boards of directors had been better qualified, more knowledgeable, and less biased. Shareholder involvement in changing the makeup of boards has always run into difficulties. Most boards are not true democracies, with shareholders ultimately wielding little power over decisions.[54] A survey by *USA Today* found that corporate boards have considerable overlap. More than 1,000 corporate board members sit on four or more company boards, and of the nearly 2,000 boards of directors in the United States, more than 22,000 of their members are linked to boards of more than one company. For example, of the 1,000 largest companies, one-fifth share at least one board member with another top 1,000 firms. This overlap creates the opportunity for conflicts of interest in decision making and limits the independence of individual boards of directors. To counteract act this, luxury retailer Saks Inc. voted to hold annual board member elections, as opposed to every three years, and that directors must receive a majority of votes to win. The change is part of an effort to improve accountability at the company, which, along with many other retailers, suffered a serious decline in share prices over the course of 2008 and 2009.[55] In some cases, it seems that individuals earned placement on multiple boards of directors because they gained a reputation for going along with top management and never asking questions. This may foster a corporate culture that limits outside oversight of top managers' decisions.

Although labor and public pension fund activities have waged hundreds of proxy battles in recent years, they rarely have much effect on the target companies. Now shareholder activists are attacking the process by which directors themselves are elected. Shareholders at Saks are not the only ones to vote to change board election rules. Resolutions at hundreds of companies require directors to gain a majority of votes cast to join the board. It is hoped that this practice will make boards of directors more attentive and accountable.[56]

Executive Compensation. One of the biggest issues that corporate boards of directors face is **executive compensation.** In fact, most boards spend more time deciding how much to compensate top executives than they do ensuring the integrity of the company's financial reporting systems.[57] How executives are compensated for their leadership, organizational service, and performance has become a controversial topic. Indeed, 73 percent of respondents in a *BusinessWeek*/Harris poll indicated they believe that top officers of large U.S. companies receive too much compensation, while only 21 percent reported executive compensation as "just about the right amount."[58] U.S. lawmakers subpoenaed the names of American International Group (AIG) executives who received $165 million in bonuses after the company was bailed out by the government. The firm stated that it decided to make the publicly unpopular payments because many of them were contractually required. Nevertheless, the move seemed arrogant and out of touch to many lawmakers and stakeholders, and former AIG CEO Edward Liddy requested the executives return the bonuses.[59]

Many people believe that no executive is worth millions of dollars in annual salary and stock options, even if he or she has brought great financial return to investors. Their concerns often center on the relationship between the highest-paid executives and median employee wages in the company. If this ratio is perceived as too large, then critics believe that either employees are not being compensated fairly or high executive salaries represent an improper use of company resources. According to the AFL-CIO, average executive pay is $10.4 million. Executive bonuses alone are an average of $336,248—this is nine times what the average salaried worker receives in pay each year. Add to this that companies have received nearly a billion dollars in government bailout money—money that comes from taxpayers.[60] Understandably, many stakeholders are angry about this situation. Because of this enormous difference, the business press is now usually careful to support high levels of executive compensation only when it is directly linked to strong company performance.

Although the issue of executive compensation has received much attention in the media of late, some business owners have long recognized its potential ill effects. In the early twentieth century, for example, capitalist J. P. Morgan implemented a policy that limited the pay of top managers in businesses that he owned to no more than 20 times the pay of any other employee.[61]

Other people argue that because executives assume so much risk on behalf of the company, they deserve the rewards that follow from strong company performance. In addition, many executives' personal and professional lives meld to the point that they are "on call" 24 hours a day. Because not everyone has the skill, experience, and desire to become an executive, with the accompanying pressure and responsibility, market forces dictate a high level of compensation. When the pool of qualified individuals is limited, many corporate board members feel that offering large compensation packages is the only way to attract and retain top executives and so ensure that their firms are not left without strong leadership. In an era when top executives are increasingly willing to "jump ship" to other firms that offer higher pay, potentially lucrative stock options, bonuses, and other benefits, such thinking is not without merit.[62]

Executive compensation is a difficult but important issue for boards of directors and other stakeholders to consider because it receives much attention in the media, sparks shareholder concern, and is hotly debated in discussions of corporate governance. One area for board members to consider is the extent to which executive compensation is linked to company performance. Plans that base compensation on the achievement of several performance goals, including profits and revenues, are intended to align the interests of owners with management. Amid rising complaints about excessive executive compensation, an increasing number of corporate boards are imposing performance targets on the stock and stock options they include

in their CEOs' pay package. The SEC proposed that companies disclose how they compensate lower-ranking employees, as well as top executives. This was part of a review of executive pay policies that addresses the belief that many financial corporations have historically taken on too much risk. The SEC believes that compensation may be linked to excessive risk-taking.[63] Another issue is whether performance-linked compensation encourages executives to focus on short-term performance at the expense of long-term growth.[64] Shareholders today, however, may be growing more concerned about transparency than short-term performance and executive compensation. One study determined that companies that divulge more details about their corporate governance practices generate higher shareholder returns than less transparent companies.[65]

IMPLEMENTING A STAKEHOLDER PERSPECTIVE

An organization that develops effective corporate governance and understands the importance of business ethics and social responsibility in achieving success should develop some processes for managing these important concerns. Although there are many different approaches, we provide some steps that have been found effective to utilize the stakeholder framework in managing responsibility and business ethics. The steps include (1) assessing the corporate culture, (2) identifying stakeholder groups, (3) identifying stakeholder issues, (4) assessing organizational commitment to social responsibility, (5) identifying resources and determining urgency, and (6) gaining stakeholder feedback. The importance of these steps is to include feedback from relevant stakeholders in formulating organizational strategy and implementation.

> *The SEC believes that compensation may be linked to excessive risk-taking.*

Step 1: Assessing the Corporate Culture

To enhance organizational fit, a social responsibility program must align with the corporate culture of the organization. The purpose of this first step is to identify the organizational mission, values, and norms that are likely to have implications for social responsibility. In particular, relevant existing values and norms are those that specify the stakeholder groups and stakeholder issues that are deemed most important by the organization. Very often, relevant organizational values and norms can be found in corporate documents such as the mission statement, annual reports, sales brochures, or websites. For example, Green Mountain Coffee is a pioneer in helping struggling coffee growers by paying them fair trade prices. The company also offers microloans to coffee-growing families, to underwrite business ventures that diversify agricultural economies. It was number one on the *Business Ethics* "100 Best Corporate Citizens" for several years.[66]

Step 2: Identifying Stakeholder Groups

In managing this stage, it is important to recognize stakeholder needs, wants, and desires. Many important issues gain visibility because key constituencies such as consumer groups, regulators, or the media express an interest. When agreement, collaboration, or even confrontations exist on an issue, there is a need for a decision making process. A model

of collaboration to overcome the adversarial approaches to problem solving has been suggested. Managers can identify relevant stakeholders who may be affected by or may influence the development of organizational policy.

Stakeholders have some level of power over a business because they are in the position to withhold, or at least threaten to withhold, organizational resources. Stakeholders have the most power when their own survival is not really affected by the success of the organization and when they have access to vital organizational resources. For example, most consumers of shoes do not need to buy Nike shoes. Therefore, if they decide to boycott Nike, they have to endure only minor inconveniences. Nevertheless, their loyalty to Nike is vital to the continued success of the sport apparel giant. The proper assessment of the power held by a given stakeholder community also requires an evaluation of the extent to which that community can collaborate with others to pressure the firm.

Step 3: Identifying Stakeholder Issues

"Stakeholders have the most power when their own survival is not really affected by the success of the organization"

Together, steps 1 and 2 lead to the identification of the stakeholders who are both the most powerful and legitimate. The level of power and legitimacy determines the degree of urgency in addressing their needs. Step 3 consists then in understanding the nature of the main issues of concern to these stakeholders. Conditions for collaboration exist when problems are so complex that multiple stakeholders are required to resolve the issue and the weaknesses of adversarial approaches are understood.

For example, obesity in children is becoming an issue across groups and stakeholders.[67] The United States is the most obese nation, with almost 40 percent of the population obese or overweight, and this has caused a huge rise in health problems.

While Americans have traditionally not supported government health care plans, increasing health care costs are causing some stakeholders to reconsider their stance. Currently, 6 out of 10 people put off going to the doctor because of the high cost, with a quarter saying that someone in their family has had trouble paying off medical bills. In fact, 59 percent of people believe that health care reform is a very high priority, and 67 percent believe that a public medical insurance plan should be available for people.[68] The current administration is working to create a national plan to address the health care crisis. As a result, stakeholder concerns have pushed the government into taking action on this important issue.

Step 4: Assessing Organizational Commitment to Social Responsibility

Steps 1 through 3 consist of generating information about social responsibility among a variety of influencers in and around the organization. Step 4 brings these three first stages together to arrive at an understanding of social responsibility that specifically matches the organization of interest. This general definition will then be used to evaluate current practices and to select concrete social responsibility initiatives. Firms such as Starbucks have selected activities that address stakeholder concerns. Starbucks has formalized its initiatives in official documents such as annual reports, web pages, and company brochures. Starbucks has a website devoted to social responsibility. Starbucks is concerned with the environment and integrates policies and programs throughout all aspects of operations to

minimize their environmental impact. They also have many community-building programs that help them be good neighbors and contribute positively to the communities where their partners and customers live, work, and play.[69]

Step 5: Identifying Resources and Determining Urgency

The prioritization of stakeholders and issues, along with the assessment of past performance, provides for allocating resources. Two main criteria can be considered: First is the level of financial and organizational investments required by different actions; second is the urgency when prioritizing social responsibility challenges. When the challenge under consideration is viewed as significant and when stakeholder pressures on the issue could be expected, then the challenge can be considered as urgent. For example, Wal-Mart has been the focus of legislation in Maryland, which tried to make the retailer pay more for its employee health care. The legislation failed in its attempt to require employers with more than 10,000 workers to spend at least 8 percent of their payroll on employee health care.[70] Twenty-two other states are now considering this legislation. Wal-Mart has now offered to improve health care benefits for its employees as a direct result of the pressure.[71]

Step 6: Gaining Stakeholder Feedback

Stakeholder feedback can be generated through a variety of means. First, stakeholders' general assessment of the firm and its practices can be obtained through satisfaction or reputation surveys. Second, to gauge stakeholders' perceptions of the firm's contributions to specific issues, stakeholder-generated media such as blogs, websites, podcasts, and newsletters can be assessed. Third, more formal research may be conducted using focus groups, observation, and surveys. Many watchdog groups have utilized the web to inform consumers and to publicize their messages. For example, Consumer Watchdog, a California-based group that keeps an eye on everything from education to the oil industry, applauded Costco for breaking with oil industry norms and seeking to sell fairly priced fuel. Costco announced that it would adjust gas prices in hot months, when heat causes gas to expand, so that consumers get the same amount of energy out of every gallon they pump.[72]

SUMMARY

Business ethics, issues, and conflicts revolve around relationships. Customers, investors and shareholders, employees, suppliers, government agencies, communities, and many others who have a stake or claim in some aspect of a company's products, operations, markets, industry, and outcomes are known as stakeholders. They are both influenced by and have the ability to affect businesses. Stakeholders provide both tangible and intangible resources that are more or less critical to a firm's long-term success, and their ability to withdraw—or to threaten to withdraw—these resources gives them power. Stakeholders define significant ethical issues in business.

Primary stakeholders are those whose continued association is absolutely necessary for a firm's survival, whereas secondary stakeholders do not typically engage in transactions with a company and thus are not essential for its survival. The stakeholder interaction model suggests that there are two-way relationships between the firm and a host of stakeholders. The degree to which a firm understands and addresses stakeholder demands

can be expressed as a stakeholder orientation, which includes three sets of activities: (1) the generation of data across the firm about its stakeholder groups and the assessment of the firm's effects on these groups, (2) the distribution of this information throughout the firm, and (3) the responsiveness of every level of the firm to this intelligence. A stakeholder orientation can be viewed as a continuum in that firms are likely to adopt the concept to varying degrees.

Although the concepts of business ethics and social responsibility are often used interchangeably, the two terms have distinct meanings. Social responsibility in business refers to an organization's obligation to maximize its positive impact and minimize its negative impact on society. There are four levels of social responsibility—economic, legal, ethical, and philanthropic—and they can be viewed as a pyramid. The term *corporate citizenship* is often used to communicate the extent to which businesses strategically meet the economic, legal, ethical, and philanthropic responsibilities placed on them by their various stakeholders.

From a social responsibility perspective, business ethics embodies standards, norms, and expectations that reflect a concern of major stakeholders including consumers, employees, shareholders, suppliers, competitors, and the community. Only if firms include ethical concerns in their foundational values and incorporate ethics in their business strategy can social responsibility as a value be embedded in daily decision making.

Most businesses operate under the assumption that the main purpose of business is to maximize profits for shareholders. The stakeholders model places the board of directors in the central position to balance the interests and conflicts of the various constituencies. Both directors and officers of corporations are fiduciaries for the shareholders. Fiduciaries are persons placed in positions of trust who use due care and loyalty in acting on behalf of the best interests of the organization. There is a duty of care (also called a duty of diligence) to make informed and prudent decisions. Directors have a duty to avoid ethical misconduct in their director role and to provide leadership in decisions to prevent ethical misconduct in the organization. To remove the opportunity for employees to make unethical decisions, most companies have developed formal systems of accountability, oversight, and control, known as corporate governance. Accountability refers to how closely workplace decisions are aligned with a firm's stated strategic direction and its compliance with ethical and legal considerations. Oversight provides a system of checks and balances that limit employees' and managers' opportunities to deviate from policies and strategies and that prevent unethical and illegal activities. Control is the process of auditing and improving organizational decisions and actions.

There are two perceptions of corporate governance, which can be viewed as a continuum. The shareholder model is founded in classic economic precepts, including the maximization of wealth for investors and owners. The stakeholder model adopts a broader view of the purpose of business that includes satisfying the concerns of other stakeholders, from employees, suppliers, and government regulators to communities and special interest groups.

Two major elements of corporate governance that relate to ethical decision making are the role of the board of directors and executive compensation. The members of a public corporation's board of directors assume legal responsibility for the firm's resources and decisions. Important issues related to corporate boards of directors include accountability, transparency, and independence. Boards of directors are also responsible for appointing and setting the compensation for top executive officers, a controversial topic. Concerns about executive pay may center on the often-disproportionate relationship between the highest-paid executives and median employee wages in the company.

IMPORTANT TERMS FOR REVIEW

stakeholder
primary stakeholder
secondary stakeholder
stakeholder interaction model
stakeholder orientation
corporate citizenship
reputation
corporate governance
shareholder model of corporate governance
stakeholder model of corporate governance
executive compensation

RESOLVING ETHICAL BUSINESS CHALLENGES*

Kent was getting pressure from his boss, parents, and wife about the marketing campaign for Broadway Corporation's new video game called "Lucky." He had been working for Broadway for about two years, and the Lucky game was his first big project. After Kent and his wife, Amy, graduated from college, they decided to go back to their hometown of Las Cruces, New Mexico, near the Mexican border. Kent's father knew the president of Broadway, which enabled Kent to get a job in its marketing department. Broadway is a medium-size company with about 500 employees, making it one of the largest employers in Las Cruces. Broadway develops, manufactures, and markets video arcade games.

Within the video arcade industry, competition is fierce. Games typically have a life cycle of only 18 to 24 months. One of the key strategies in the industry is providing unique, visually stimulating games by using color graphics technology, fast action, and participant interaction. The target markets for Broadway's video products are children aged 5 to 12 and teenagers aged 13 to 19. Males constitute 75 percent of the market.

When Kent first started with Broadway, his task was to conduct market research on the types of games that players desired. His research showed that the market wanted more action (violence), quicker graphics, multiple levels of difficulty, and sound. Further research showed that certain tones and types of sound were more pleasing than others. As part of his research, Kent also observed people in video arcades, where he found that many became hypnotized by a game and would quickly put in quarters when told to do so. Research suggested that many target consumers exhibited the same symptoms as compulsive gamblers. Kent's research results were well received by the company, which developed several new games using his information. The new games were instant hits with the market.

In his continuing research, Kent found that the consumer's level of intensity increased as the game's intensity level increased. Several reports later, Kent suggested that target consumers might be willing, at strategic periods in a video game, to insert multiple coins. For example, a player who wanted to move to a higher level of difficulty would have to insert two coins; to play the final level, three coins would have to be inserted. When the idea was tested, Kent found it did increase game productivity.

Kent also noticed that video games that gave positive reinforcements to the consumer, such as audio cues, were played much more frequently than others. He reported his findings to Brad, Broadway's president, who asked Kent to apply

the information to the development of new games. Kent suggested having the machines give candy to the game players when they attained specific goals. For the teen market, the company modified the idea: The machines would give back coins at certain levels during the game. Players could then use the coins at strategic levels to play a "slot-type" chance opening of the next level. By inserting an element of chance, these games generated more coin input than output, and game productivity increased dramatically. These innovations were quite successful, giving Broadway a larger share of the market and Kent a promotion to product manager.

Kent's newest assignment was the Lucky game—a fast-action scenario in which the goal was to destroy the enemy before being destroyed. Kent expanded on the slot-type game for the older market, with two additions. First, the game employed virtual reality technology, which gives the player the sensation of actually being in the game. Second, keeping in mind that most of the teenage consumers were male, Kent incorporated a female character who, at each level, removed a piece of her clothing and taunted the player. A win at the highest level left her nude. Test market results suggested that the two additions increased profitability per game dramatically.

Several weeks later, Brad asked about the Lucky project. "I think we've got a real problem, Brad," Kent told him. "Maybe the nudity is a bad idea. Some people will be really upset about it." Brad was displeased with Kent's response.

Word got around fast that the Lucky project had stalled. During dinner with his parents, Kent mentioned the Lucky project, and his dad said something that affected Kent. "You know, son, the Lucky project will bring in a great deal of revenue for Broadway, and jobs are at stake. Some of your coworkers are upset with your stand on this project. I'm not telling you what to do, but there's more at stake here than just a video game."

The next day Kent had a meeting with Brad about Lucky. "Well," Brad asked, "what have you decided?"

Kent answered, "I don't think we should go with the nudity idea."

Brad answered, "You know, Kent, you're right. The U.S. market just isn't ready to see full nudity as well as graphic violence in arcades in their local malls. That's why I've contacted an Internet provider who will take our game and put it on the Internet as an adult product. I've also checked out the foreign markets and found that we can sell the machines to the Mexican market if we tone down the violence. The Taiwanese joint venture group has okayed the version we have now, but they would like you to develop something that is more graphic in both areas. You see, they already have similar versions of this type of game now, and their market is ready to go to the next level. I see the Internet market as secondary because we can't get the virtual reality equipment and software into an Internet mode. Maybe when PCs get faster, we'll be able to tap into it at that level, but not now. So, Kent, do you understand what you need to be doing on Lucky?"

QUESTIONS • EXERCISES

1. What are the ethical and legal issues?
2. What are Kent's options?
3. Discuss the acceptability and commercial use of sex, violence, and gambling in the United States.
4. Are marketing sex, violence, and gambling acceptable in other countries if they fit their culture?

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Social responsibility in business refers to maximizing the visibility of social involvement.	**Yes**	**No**
2. Stakeholders provide resources that are more or less critical to a firm's long-term success.	**Yes**	**No**
3. Three primary stakeholders are customers, special interest groups, and the media.	**Yes**	**No**
4. The most significant influence on ethical behavior in the organization is the opportunity to engage in unethical behavior.	**Yes**	**No**
5. The stakeholder perspective is useful in managing social responsibility and business ethics.	**Yes**	**No**

ANSWERS **1. No**. Social responsibility refers to an organization's obligation to maximize its positive impact on society and minimize its negative impact. **2. Yes**. These resources are both tangible and intangible. **3. No**. Although customers are primary stakeholders, special interest groups and the media are usually considered secondary stakeholders. **4. No**. Other influences such as corporate culture have more impact on ethical decisions within the organization. **5. Yes**. The six steps to implement this approach were provided in this chapter.

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PART 2

Ethical Issues and the Institutionalization of Business Ethics

Chapter 3: Emerging Business Ethics Issues 56

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CHAPTER 3

Emerging Business Ethics Issues

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CHAPTER OBJECTIVES

- **To define ethical issues in the context of organizational ethics**
- **To examine ethical issues as they relate to the basic values of honesty, fairness, and integrity**
- **To delineate abusive and intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy as business ethics issues**
- **To examine the challenge of determining an ethical issue in business**

CHAPTER OUTLINE

Recognizing an Ethical Issue

Honesty

Fairness

Integrity

Ethical Issues and Dilemmas in Business

Abusive or Intimidating Behavior

Lying

Conflicts of Interest

Bribery

Corporate Intelligence

Discrimination

Sexual Harassment

Environmental Issues

Fraud

Consumer Fraud

Financial Misconduct

Insider Trading

Intellectual Property Rights

Privacy Issues

The Challenge of Determining an Ethical Issue in Business

AN ETHICAL DILEMMA*

As Lavonda sat in the Ethics Office of the vice president of Emma-Action Pharmaceuticals (EAP), she was worried. Because she was new in the company and didn't know the unwritten rules, the chain-of-command philosophy, and the employees and associates around her very well, her time in the office was very uncomfortable. Given how well things had started, it was painful for her to remember how she had gotten here.

Lavonda had been lured away from her last company because of her expertise in the pharmaceutical industry and her early success in management. Out of college just three and a half years, she had gotten out of the gate remarkably quickly. She had helpful mentors, challenging tasks that she excelled in, and came in below budget on each assignment. Lavonda was typically described as effective and efficient; in fact, at the last company, they even started to call her "E."

But the lure of a six-figure salary, the encounter with Allen (her future boss at EAP), and the chance to be close to her elderly mother made it nearly impossible for Lavonda to say no. She loved her mother and, being an only child, felt responsible for her. Her mother once said that she would prefer to take her own life rather than move to a nursing home.

In the beginning, Lavonda's immediate supervisor, Allen, had been very charming and taught her about the company, its products, the salespeople, and the politics. She knew from experience that she would have to earn the respect of the salespeople she would manage, all of whom were 10 years her senior, and the fact that these men had never had a female boss was just another hurdle to overcome. Allen had helped her find a nice house in a good neighborhood, had assisted with the moving, and eventually had become more than her superior. The months slipped by, and their relationship had become "close," to the point where they began to discuss living arrangements. And then something strange happened—she heard a story about Allen and Karline.

Karline, who had come to EAP six months prior to Lavonda, worked in Human Resources, and in a few short months she had become head of the HR department at EAP amidst rumors of Allen "helping" her get the promotion. Six more months passed, and Lavonda learned that the rumors about Karline and Allen were probably true. She heard the same type of scenario that she had experienced for herself: friend, helping with housing, possible intimacy, and so on. The rumors became so intense that Lavonda confronted

Allen about them and discovered that they were true. Devastated, Lavonda ended the relationship with Allen in a heated confrontation, but it seemed as though Allen didn't understand that it was over.

Weeks went by with little contact between the two of them, and then one afternoon Allen stopped by her office. He apologized for his behavior, and Lavonda accepted his apology. But the next day he stopped by and began to touch and even grope Lavonda. She made a joke of it to defuse the situation, but several days later Allen repeated the same behavior, making several sexual remarks. He asked, "Honey, why can't it be like it was before?" and then whispered some graphic sexual language.

Lavonda's face reddened and she said, "Allen, you are a pig. How dare you say such things to me! You've crossed the line. I've never heard such filth. Don't you ever say such things to me again, or I'll report you to Human Resources!"

Several weeks went by, and Lavonda got a phone call from Allen in which he described even more sexually suggestive things. Every few days, Allen would stop by or call and remind her of some "private" experience they had together, using vulgar sexual language. He would taunt her by saying, "Lavonda, you know you want this from me." It became almost a daily ritual. Allen never wrote any of the things that he described to her, being sure not to leave tangible proof of his behavior, but occasionally he would grab or attempt to grab her sexually.

Eventually, Lavonda had had enough and went to the Human Resources department to complain formally about Allen, his sexual advances, and the hostile environment that they had created. The person she met at HR was Karline. As Lavonda described the situation in detail, she finally said, "Karline, I need you to help me. What Allen is doing to me is wrong and illegal. I can't get my work done. He's undermining my position with my sales staff, he's giving me poor evaluations, and he's suggesting that I could change all that if I wanted to!"

Karline's response was, "Lavonda, I've heard what you've said, but I also have had people come to me with some very disturbing reports about you as well. For example, you and Allen were supposedly sleeping together, and he is your direct supervisor. If this was the case, then it should have been reported immediately; but it wasn't. You have no tangible evidence except for your word. Even if I believed you, the allegation that you had been sexually active with Allen can be construed as making all of what you've said mutual or consensual. If that's the case, then I would have to fire you because of the superior–employee ethics code, and a letter would go into your permanent file that would probably haunt your career for years to come. From my perspective, we can call this an informal and confidential meeting that is not to be repeated, or you can continue this formally and take your chances. It's your call, Lavonda, but you should know that I am disinclined to support your accusations."

In shock, Lavonda mumbled a thank you to Karline and left her office. The next day Allen stopped by, smiled, waved his finger at her and said, "Your performance review is next week, and it doesn't look good. By the way, just so you know, the pharmaceutical industry is quite small, and I have friends at all the majors. Oh, I forgot to tell you how sorry I am for your mother and her cancer diagnosis. Chemo and the side effects are very draining. I'm glad that you're close by to help her through the ordeal. They say it takes months to fully recover. It would be horrible if you weren't here to help her and she had to go to a nursing home. Those places scare me."

Lavonda said, "Allen, why are you doing this to me? I'm not fond of you anymore. We have no future together. Doesn't that tell you something?"

Allen smiled and said, "It tells me that you're not interested in a permanent relationship, which is good, because neither am I. And you know that if you want to be promoted or go to another company with a good recommendation, it all starts with me. Lavonda, there might be another 'solution' to your perceived problem. You know that new sales rep you just hired out of school, Soo-Chin? Well, if you could have her assigned to me and maybe 'coax her in the right way,' I know of a position in the company that would be a promotion for you and you wouldn't be around me. But everything depends upon the success of your coaxing."

So now here Lavonda was, about to meet with the vice president of ethical affairs. As she got up from the chair, she pondered her alternatives and what had led her there. In school she had learned that each company had its own individual code of ethics, but she didn't know the reality of the code at EAP until it was too late.

QUESTIONS • EXERCISES

1. Keeping in mind the facts and timeline of this situation, discuss Lavonda's situation in terms of legal and ethical issues.
2. Discuss Lavonda's alternatives and possible professional and private outcomes for her.
3. Is Allen in violation of sexual harassment and/or sexual discrimination laws in the United States?
4. Certainly Allen has damaged Lavonda's performance level; however, discuss whether he has created a legally hostile work environment.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

Stakeholders' ethical concerns determine whether specific business actions and decisions are perceived as ethical or unethical. In the case of the government, community, and society, what was merely an ethical issue can soon become a legal debate and eventually law. Most ethical conflicts in which there are perceived dangers turn into litigation. Additionally, stakeholders often raise ethical issues when they exert pressure on businesses to make decisions that serve their particular agendas. For example, corporate shareholders often demand that managers make decisions that boost short-term earnings, thus maintaining or increasing the value of the shares of stock they own in that firm. Atlanta-based home builder Beazer Homes was issued a cease and desist order by the SEC when it was discovered that the company had fraudulently manipulated funds to smooth earnings fluctuations. When the real estate market was booming in Atlanta, the company put portions of its earnings in "rainy day funds" that it planned to use later to smooth out reported income during slow times. The company clearly anticipated that the housing bubble would burst, and was trying to find a way to keep investors happy over the long term. However, its solution was deemed illegal.[1]

People make ethical decisions only after they recognize that a particular issue or situation has an ethical component; thus, a first step toward understanding business ethics is to develop ethical issue awareness. Ethical issues typically arise because of conflicts among individuals' personal moral philosophies and values, the values and culture of the organizations in which they work, and those of the society in which they live. The business environment presents many potential ethical conflicts. For example, a company's efforts to achieve its organizational objectives may collide with its employees' endeavors to fulfill their own personal goals. Similarly, consumers' desires for safe and quality products may conflict with a manufacturer's need to earn adequate profits. The ambition of top executives to secure sizable increases in compensation may conflict with the desires of shareholders to control costs and increase the value of the corporation. For example, for companies being helped by the government bailout, strict rules for executive pay have been established retroactively. For example, any firm receiving funds is restricted

from paying top performers bonuses equal to more than one-third of their total annual compensation. The compensation rules will mostly apply to more than 350 banks. Bank of America CEO Kenneth D. Lewis was paid $16.4 million in 2007. Under the bailout plan his 2009 compensation would be limited to $2.25 million.[2] A manager's wish to hire specific employees that he or she likes may be at odds with the organization's intent to hire the best-qualified candidates, as well as with society's aim to offer equal opportunity to women and members of minority groups.

Characteristics of the job, the culture, and the organization of the society in which one does business can also create ethical issues. Gaining familiarity with the ethical issues that frequently arise in the business world will help you identify and resolve them when they occur.

In this chapter, we consider some of the ethical issues that are emerging in business today, including how these issues arise from the demands of specific stakeholder groups. In the first half of the chapter, we explain certain universal ethical concepts that pervade business ethics, such as honesty, fairness, and integrity. The second half of the chapter explores a number of emerging ethical issues, including abusive and intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy. We also examine the challenge of determining an ethical issue in business. Because of the global financial meltdown, there are certain practices and products that have or will become issues and will either be defined as illegal or unethical in the coming years. It is important that you understand that what was once legal can become an ethical issue, resulting in well-known practices becoming illegal.

RECOGNIZING AN ETHICAL ISSUE

Although we have described a number of relationships and situations that may generate ethical issues, in practice it can be difficult to recognize specific ethical issues. Failure to acknowledge such ethical issues is a great danger in any organization, particularly if business is treated as a "game" in which ordinary rules of fairness do not apply. Sometimes people who take this view are willing to do things that are not only unethical but also illegal so that they can maximize their own position or boost the profits of their organization. Those involved in the marketplace have an additional set of values related to profit, increased revenue, earnings per share, sales, return on assets, and/or return on investment that must be addressed. All or part of these objectives come into play within business and impact what people will do and how they justify their actions. In one's home life, one does not have the profit motive with which to contend. To be clear, businesspeople do not have a unique set of values from others; rather, the values they have are weighted differently when doing business activities because of the additional responsibilities associated with the marketplace.

Business decisions, like personal decisions, involve an unsettled situation or dilemma. Just because an activity is considered an ethical issue does not mean the behavior is necessarily unethical. An ethical issue is simply a situation, a problem, or even an opportunity that requires thought, discussion, or investigation to make a decision. And because the business world is dynamic, new ethical issues are emerging all the time. Table 3–1 defines specific ethical issues identified by employees in the National Business Ethics Survey (NBES). Three types of misconduct make up 30 percent of the ethical problems within organizations. Putting one's own interests ahead of the organization, abusive behavior, and lying to employees are all personal in nature, but these activities are

TABLE 3-1 Specific Types of Observed Misconduct.

	2009	2007
Company Resource Abuse	23%	N/A
Abusive behavior	22%	21%
Lying to employees	19%	20%
Email or internet abuse	18%	18%
Conflicts of interest	16%	22%
Discrimination	14%	12%
Lying to stakeholders	12%	14%
Employee benefit violations	11%	N/A
Health or safety violations	11%	15%
Employee privacy breach	10%	N/A
Improper hiring practices	10%	10%
Falsifying time or expenses	10%	N/A
Poor product quality	9%	10%
Stealing	9%	12%
Sexual harassment	7%	10%
Substance abuse	7%	N/A
Document alteration	6%	6%
Misuse of company's confidential information	6%	6%
Customer privacy breach	6%	N/A
Environmental violations	4%	6%

Source: "2009 National Business Ethics Survey: Ethics in the Recession," (Washington D.C.: Ethics Resource Center, 2009): p. 32–33.

sometimes committed by individuals in the belief that they are furthering organizational goals. Misreporting hours worked, safety violations, and provision of low-quality goods and services are the top three issues that directly relate to the firm's agenda. Table 3–1 compares the percentage of employees who observed specific types of misconduct over the past two National Business Ethics Surveys.

Employees could select more than one form of misconduct; therefore, each type of misconduct represents the percentage of employees who saw that particular act. Although Table 3–1 documents many types of ethical issues that exist in organizations, it is impossible to list every conceivable ethical issue. Any type of manipulation, deceit, or even just the absence of transparency in decision making can create harm to others. For example, collusion is a secret agreement between two or more parties for a fraudulent, illegal, or deceitful purpose. "Deceitful purpose" is the relevant phrase in regard to business ethics, in that it suggests trickery, misrepresentation, or a strategy designed to lead others to believe one truth but not the entire truth.

Honesty

Honesty refers to truthfulness or trustworthiness. To be honest is to tell the truth to the best of your knowledge without hiding anything. Confucius defined several levels of honesty. The shallowest is called *Li,* and it relates to the superficial desires of a person. A key principle to *Li* is striving to convey feelings that outwardly are or appear to be honest but that are ultimately driven by self-interest. The second level is *Yi,* or righteousness, where a person does what is right based on reciprocity. The deepest level of honesty is called *Ren,* and it is based on an understanding of and empathy toward others. The Confucian version of Kant's Golden Rule is to treat your inferiors as you would want superiors to treat you. As a result, virtues such as familial honor and reputation for honesty become paramount.

Issues related to honesty also arise because business is sometimes regarded as a "game" governed by its own rules rather than by those of society. Author Eric Beversluis suggests that honesty is a problem because people often reason along these lines:

1. Business relationships are a subset of human relationships that are governed by their own rules, which, in a market society, involve competition, profit maximization, and personal advancement within the organization.
2. Business can therefore be considered a game people play, comparable in certain respects to competitive sports such as basketball or boxing.
3. Ordinary rules and morality do not hold in games like basketball or boxing. (What if a basketball player did unto others as he would have them do unto him? What if a boxer decided it was wrong to try to injure another person?)
4. Logically, then, if business is a game like basketball or boxing, ordinary ethical rules do not apply.[3]

This type of reasoning leads many people to conclude that anything is acceptable in business. Indeed, several books have compared business to warfare—for example, *The Guerrilla Marketing Handbook* and *Sun Tsu: The Art of War for Managers*. The common theme in these books is that surprise attacks, guerrilla warfare, and other warlike tactics are necessary to win the battle for consumers' dollars. An example of this mentality at work is Larry Ellison, the CEO of Oracle. Ellison's warlike mentality is demonstrated by his decision to sell PeopleSoft's technology and let most of its 8,000 employees go. PeopleSoft CEO Craig Conway stated that "Ellison has followed a page straight out of Genghis Khan." Ellison has frequently recited phrases of the thirteenth-century Mongol warlord such as "It's not enough that we win; everyone else must lose."[4] Ellison was ordered to donate $100 million to charity and pay another $22 million to the attorneys who sued him for alleged stock-trading abuses. Ellison argues that he acted in good faith and in the best interests of Oracle and Oracle's shareholders.[5]

This business-as-war mentality may foster the idea that honesty is unnecessary in business. In addition, an intensely competitive environment creates the potential for companies to engage in questionable conduct. For example, as competition in the market for beer intensified, Miller, Coors, and Anheuser-Busch increasingly created advertising and offered products that appealed to younger consumers, even though marketing to minors under the age of 21 is illegal.

Many argue, however, that business is not a game like basketball or boxing; because people are not economically self-sufficient, they cannot withdraw from the game of business. Therefore, business ethics must not only make clear what rules apply in the

"game" of business but must also develop rules appropriate to the involuntary nature of participation in it.[6]

Because of the economic motive, many in business can become confused with the opposite of honesty—dishonesty. Dishonesty can be broadly defined as a lack of integrity, incomplete disclosure, and an unwillingness to tell the truth. Dishonesty is also synonymous with lying, cheating, and stealing. Lying, cheating, and stealing are the actions usually associated with dishonest conduct. The causes of dishonesty are complex and relate to both individual and organizational pressures. Many employees lie to help achieve performance objectives. For example, they may be asked to lie about when a customer will receive a purchase. Lying can be segmented into (1) causing damage or harm; (2) a "white lie," which doesn't cause damage but can be called an excuse or something told to benefit someone else; and (3) statements that are obviously meant to engage or entertain with no malice. These definitions will become important to the remainder of this chapter.

Fairness

Fairness is the quality of being just, equitable, and impartial. Fairness clearly overlaps with other commonly used terms such as justice, equity, equality, and morality. There are three fundamental elements that seem to motivate people to be fair: equality, reciprocity, and optimization. In business, **equality** is about how wealth or income is distributed between employees within a company, a country, or across the globe.

Reciprocity is an interchange of giving and receiving in social relationships. Reciprocity occurs when an action that has an effect upon another is reciprocated with an action that has an approximately equal effect upon the other. Reciprocity is the return of small favors that are approximately equal in value. For example, reciprocity implies that workers be compensated with wages that are approximately equal to their effort. An ethical issue about reciprocity for business is the amount CEOs and other executives are paid in relation to their employees. Is a 431 to 1 pay ratio an example of ethical reciprocity? That is the average wage distance between a CEO and a production worker in the United States.

> *Dishonesty can be broadly defined as a lack of integrity, incomplete disclosure, and an unwillingness to tell the truth.*

Optimization is the trade-off between equity (that is, equality or fairness) and efficiency (that is, maximum productivity). Discriminating on the basis of gender, race, or religion is generally considered to be unfair because these qualities have little bearing upon a person's ability to do a job. The optimal way is to choose the employee who is the most talented, most proficient, most educated, and most able. Ideas of fairness are sometimes shaped by vested interests. One or both parties in the relationship may view an action as unfair or unethical because the outcome was less beneficial than expected.

Integrity

Integrity is one of the most important and often-cited terms regarding virtue, and refers to being whole, sound, and in an unimpaired condition. In an organization, it means uncompromising adherence to ethical values. Integrity is connected to acting ethically; in

other words, there are substantive or normative constraints on what it means to act with integrity. This usually rests on an organization's enduring values and unwillingness to deviate from standards of behavior.

At a minimum, businesses are expected to follow all applicable laws and regulations. In addition, organizations should not knowingly harm customers, clients, employees, or even other competitors through deception, misrepresentation, or coercion. Although businesspeople often act in their own economic self-interest, ethical business relations should be grounded on honesty, integrity, fairness, justice, and trust. Buyers should be able to trust sellers; lenders should be able to trust borrowers. Failure to live up to these expectations or to abide by laws and standards destroys trust and makes it difficult, if not impossible, to continue business exchanges.[7] These virtues become the glue that holds business relationships together, making everything else more effective and efficient.

ETHICAL ISSUES AND DILEMMAS IN BUSINESS

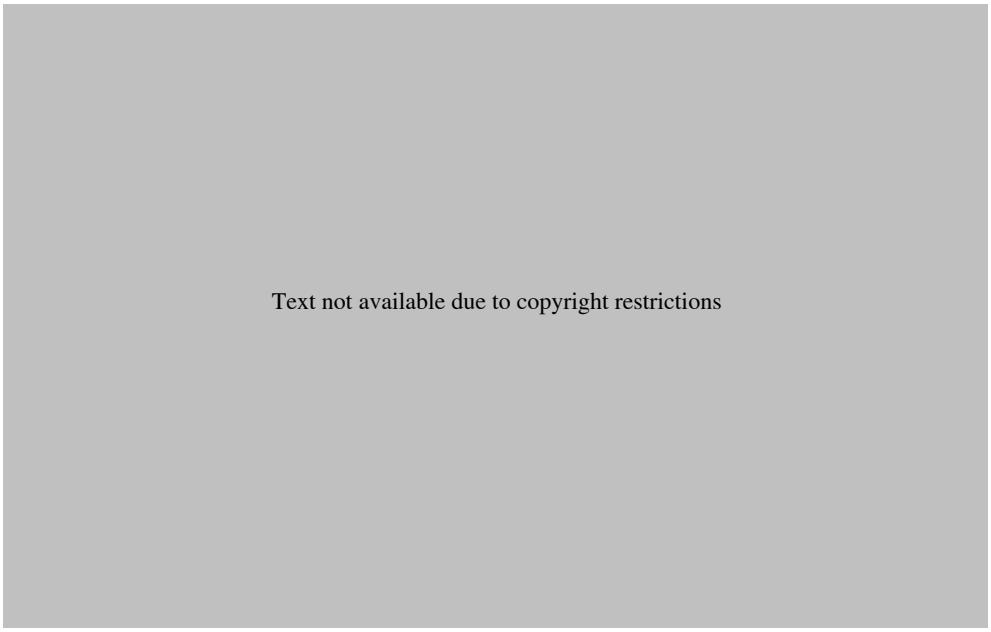
As mentioned earlier, stakeholders define a business's ethical issues. An **ethical issue** is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several actions that must be evaluated as right or wrong, ethical or unethical. An **ethical dilemma** is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several wrong or unethical actions. There is not simply one right or ethical choice in a dilemma, only less unethical or illegal choices as perceived by any and all stakeholders.

A constructive next step toward identifying and resolving ethical issues is to classify the issues that are relevant to most business organizations. In this section, we classify ethical issues in relation to abusive or intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy issues. In addition, a short review of the financial industry, its problem products, and the Securities and Exchange Commission are given.

Figure 3–1 reflects the ethical issues that are most likely to have impact on shareholder value for companies over the next five years. It is interesting to note that executives feel that their companies' shareholder value will be significantly affected by job loss and offshoring jobs when outsourcing to improve efficiency. Surprisingly, the ability to exert political influence or political involvement is also a major issue.

Abusive or Intimidating Behavior

Abusive or **intimidating behavior** is the most common ethical problem for employees, but what does it mean to be abusive or intimidating? The concepts can mean anything—physical threats, false accusations, being annoying, profanity, insults, yelling, harshness, ignoring someone, and unreasonableness—and the meaning of these words can differ by person. It is important to understand that with each term there is a continuum. For example, what one person may define as yelling might be another's definition of normal speech. Civility in our society has been a concern, and the workplace is no exception. The productivity level of many organizations has been damaged by the time spent unraveling abusive relationships.



Is it abusive behavior to ask an employee to complete a project rather than be with a family member or relative in a crisis situation? What does it mean to speak profanely? Is profanity only related to specific words or terms that are common in today's business world? If you are using words that are normal in your language but others consider profanity, have you just insulted, abused, or disrespected them?

Within the concept of abusive behavior or intimidation, intent should be a consideration. If the employee was trying to convey a compliment, then it was probably a mistake. What if a male manager asks his female subordinate if she has a date for tonight because she is dressed so nice? Does the way (voice inflection) a word is said become important? Add to this the fact that we now live in a multicultural environment doing business and working with many different cultural groups and the businessperson soon realizes the depth of the ethical and legal issues that may arise. Finally, you have the problem of word meanings by age and within cultures. Is it okay to say "honey" to an employee, fellow employee, employee friend, and/or your superior, and does it depend on gender or location? For example, if you were to call a friend that worked with you "honey" in southern Illinois, Arkansas, or Kentucky, do you have the same acceptability factor in northern Illinois, Michigan, or Minnesota? Does abusive behavior vary by different genders? It is possible the term *honey* could be acceptable speech in some environments, and be construed as being abusive or intimidating in other situations?

Bullying is associated with a hostile workplace where someone (or a group) considered a target is threatened, harassed, belittled, or verbally abused or overly criticized. Bullying may create what some may call a hostile environment, but this term is generally associated with sexual harassment. Bullying can cause psychological damage that can result in health-endangering consequences to the target. As Table 3–2 indicates, bullying can use a

TABLE 3-2 Actions Associated with Bullies

1. Spreading rumors to damage others
2. Blocking others' communication in the workplace
3. Flaunting status or authority to take advantage of others
4. Discrediting others' ideas and opinions
5. Use of e-mails to demean others
6. Failing to communicate or return communication
7. Insults, yelling, and shouting
8. Using terminology to discriminate by gender, race, or age
9. Using eye or body language to hurt others or their reputation
10. Taking credit for others' work or ideas

Source: Cathi McMahan, "Are You A Bully?" *Inside Seven*, California Department of Transportation Newsletter, June 1999, page 6.

mix of verbal, nonverbal, and manipulative threatening expressions to damage workplace productivity. One may wonder why workers tolerate such activities; the problem is that 81 percent of workplace bullies are supervisors. Bullying happens more than people realize. For example, 37 percent (54 million) of American workers have been bullied at work and when witnesses are included it rises to 49 percent (71.5 million), and an estimated 72 percent of the perpetrators are employers.[8]

The concept of "bullying" in the workplace is now considered a legal issue. Some suggest that employers take the following steps to minimize workplace bullying:

- They should have policies in place that make it clear that bullying behaviors will not be tolerated.
- The employee handbook should emphasize that workers must treat each other with respect.
- Employers should encourage employees who feel bullied to report the conduct, much the same as discriminatory harassment complaints are handled.[9]

Bullying can also occur between companies that are in intense competition. Even respected companies such as Intel have been accused of monopolistic bullying. A competitor, Advanced Micro Devices (AMD), claimed in a lawsuit that 38 companies, including Dell and Sony, were strong-arming customers into buying Intel chips rather than those marketed by AMD. The AMD lawsuit seeks billions of dollars and will take years to litigate. In many cases, the alleged misconduct can have not only monetary and legal implications but also can threaten reputation, investor confidence, and customer loyalty. A front-cover *Forbes* headline stated "Intel to AMD: Drop Dead." An example of the intense competition and Intel's ability to use its large size won it the high-profile Apple account, displacing IBM and Freescale. ADM said it had no opportunity to bid because Intel offered to deploy 600 Indian engineers to help Apple software run more smoothly on Intel chips.[10] Intel's actions have landed it in trouble in the European Union, however, where courts found the company guilty of antitrust violations and anticompetitive behavior regarding competitor Advanced Micro Devices (AMD). AMD

alleged that Intel was preventing the company from being competitive through such practices as paying computer makers rebates for using Intel chips and selling chips at below cost. The EU courts sided with AMD and Intel was fined a record $1.45 billion, which it continues to fight in courts. The EU is notoriously hard on antitrust cases. Microsoft too has been found guilty and has racked up $2 billion in fines over multiple years in the EU.[11]

Lying

Earlier in this chapter, we discussed the definitions of **lying** and how it relates to distorting the truth. We mentioned three types of lies, one of which is joking without malice. The other two can become very troublesome for businesses. For example, one can lie by commission or omission. *Commission lying* is creating a perception or belief by words that intentionally deceive the receiver of the message, for example, lying about being at work, expense reports, or carrying out work assignments. Commission lying also entails intentionally creating "noise" within the communication that knowingly confuses or deceives the receiver. *Noise* can be defined as technical explanations that the communicator knows the receiver does not understand. It can be the intentional use of communication forms that make it difficult for the receiver to actually hear the true message. Using legal terms or terms relating to unfamiliar processes and systems to explain what was done in a work situation facilitate this type of lie.

Lying by commission can involve complex forms, procedures, contracts, words that are spelled the same but have different meanings, or refuting the truth with a false statement. Forms of commission lying include puffery in advertising. For example, saying that a product is "homemade" when it is made in a factory is lying. "Made from scratch" in cooking technically means that all ingredients within the product were distinct and separate and were not combined prior to the beginning of the production process. One can lie by commission by showing a picture of the product that does not reflect the actual product. This happens frequently in business. For example, a national fast-food chain came out with a new product that had lettuce in it. There are many types of lettuce and the lettuce used in the national ad campaign both in print and TV used romaine lettuce. Yet this fast-food chain does not purchase that variety; it purchases iceberg lettuce. The obvious reason for using romaine in the ad is that it is prettier or more appealing than shredded iceberg lettuce. Another example is Schick's complaint against Gillette, alleging that the latter's claims for its Mach 3 Turbo Razor as "the world's best shave" and "the best a man can get" are false and misleading.

Omission lying is intentionally not informing the channel member of any differences, problems, safety warnings, or negative issues relating to the product, service, or company that significantly affects awareness, intention, or behavior. A classic example for decades was the tobacco manufacturers that did not allow negative research to appear on cigarettes and cigars. The drug Vioxx is being questioned because the manufacturer allegedly did not inform consumers as to the degree and occurrence of side effects, one of which is death. Finally, when lying damages others, it can be the focus of a lawsuit. For example, prosecutors and civil lawsuits often reduce misconduct to lying about a fact such as financial performance that has the potential to damage others. CEOs at AIG, Lehman Brothers, Fannie Mae, and Freddie Mac were scrutinized to see if they told the truth about the financial conditions of their companies.

When a lie becomes unethical in business, it is based on the context and intent to distort the truth. A lie becomes illegal if it is determined by the judgment of courts to damage others. Some businesspeople may believe that one must lie a little or that the occasional lie is sanctioned by the organization. The question you need to ask is whether lies are distorting openness and transparency and other values that are associated with ethical behavior.

Conflicts of Interest

A **conflict of interest** exists when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group. The medical industry has been faced with many accusations of conflicts of interest with doctors and medical schools regarding payments. For example, Harvard Medical School received an 'F' grade on its conflict of interest policies from the American Medical Student Association. One professor alone was forced to disclose 47 company affiliations from which he was receiving money.[12] To address the problem, a government panel has called for full disclosure of all payments made to doctors, researchers, and universities. The fear is that financial donations from medical and pharmaceutical companies could sway researchers' findings and what is taught in classrooms.[13]

To avoid conflicts of interest, employees must be able to separate their private interests from their business dealings.

To avoid conflicts of interest, employees must be able to separate their private interests from their business dealings. Organizations must also avoid potential conflicts of interest when providing products.[14] The U.S. General Accounting Office has found conflicts of interest when the government has awarded bids on defense contracts. The conflicts of interest usually relate to hiring friends, relatives, or retired military officers to enhance the probability of getting the contract.[15]

Bribery

Bribery is the practice of offering something (usually money) in order to gain an illicit advantage. The key issue regarding whether or not something is considered bribery is determining whether the act is illicit or contrary to accepted morality or convention. Bribery therefore is defined as an unlawful act, but it can be a business ethics issue. The reason is that bribery can be defined differently in varying situations and cultural environments.

Bribery can be defined many ways. For example, there is something called active corruption or **active bribery,** meaning that the person who promises or gives the bribe commits the offense. **Passive bribery** is an offense committed by the official who receives the bribe. It is not an offense, however, if the advantage was permitted or required by the written law or regulation of the foreign public official's country, including case law.

Small **facilitation payments** made to obtain or retain business or other improper advantages do not constitute bribery payments. In some countries, such payments are made to induce public officials to perform their functions, such as issuing licenses or permits. However, criminalization by other countries does not seem a practical or effective complementary action. In many developed countries, it is generally recognized that employees should not accept bribes, personal payments, gifts, or special favors from people who hope to influence the outcome of a decision. However, bribery is an accepted

way of doing business in many countries. Bribes have been associated with the downfall of many managers, legislators, and government officials. One source estimates that some $80 billion is paid out worldwide in the form of bribes or some other payoff every year.[16]

When a government official accepts a bribe, it is usually from a business that seeks some favor—perhaps a chance to influence legislation that affects it. Giving bribes to legislators or public officials, then, is a business ethics issue. The U.S. Department of Justice cracked down on cases of bribery involving hundreds of companies. Under these investigations Halliburton Company agreed to pay nearly $600 million after bribing officials in Nigeria in order to win oil contracts.[17]

Corporate Intelligence

Many issues related to corporate intelligence have surfaced in the last few years. Defined broadly, **corporate intelligence** is the collection and analysis of information on markets, technologies, customers, and competitors, as well as on socioeconomic and external political trends. There are three distinct types of intelligence models: a passive monitoring system for early warning, tactical field support, and support dedicated to top-management strategy. Today, theft of trade secrets is estimated at $100 billion. One explanation is the increase in people with intelligence-gathering competence and the proliferation of advanced technology.[18]

Corporate intelligence (CI) involves an in-depth discovery of information from corporate records, court documents, regulatory filings, and press releases, as well as any other background information that can be found about a company or its executives. Corporate intelligence is a legitimate inquiry into meaningful information that can be used in staying competitive. Corporate intelligence, like other areas in business, can be abused if due diligence is not taken to maintain legal and ethical methods of discovery. Computers, LANs (local-area networks), and the Internet have made the theft of trade secrets very easy. Proprietary information like secret formulas, manufacturing schematics, merger or acquisition plans, and marketing strategies all have tremendous value. NewRiver Inc. brought a suit against the investment research firm Morningstar Inc., accusing it of using Internet espionage to copy information off of a patented system for handling mutual fund prospectuses. Morningstar does not deny accessing the system, but claims it was only for "benchmarking purposes," and claims that it did not enter any password-protected areas of the site.[19] A lack of security and proper training allows one to use a variety of techniques to gain access to a company's vital information. Some techniques for accessing valuable corporate information include physically removing the hard drive and copying the information to another machine, hacking, dumpster diving, social engineering, bribery, and hiring away key employees.

Hacking is considered one of the top three methods for obtaining trade secrets. Currently, there are over 100,000 websites that offer free downloadable and customizable hacking tools that require no in-depth knowledge of protocols or Internet protocol addressing. Hacking has three categories: system, remote, and physical. **System hacking** assumes that the attacker already has access to a low-level, privileged-user account. **Remote hacking** involves attempting to remotely penetrate a system across the Internet. A remote hacker usually begins with no special privileges and tries to obtain higher level or administrative access. Several forms of this type of hacking include unexpected input, buffer overflows, default configurations, and poor system administrator practices. **Physical hacking** requires that the CI agent enter a facility personally. Once inside, he or she can find a vacant or

unsecured workstation with an employee's login name and password. Next, the CI agent searches for memos or unused letterheads and inserts the documents into the corporate mail system. Or the CI agent could gain physical access to a server or telephone room, look for remote-access equipment, note any telephone numbers written on wall jacks, and place a protocol analyzer in a wiring closet to capture data, user names, and passwords.

Social engineering is another popular method of obtaining valuable corporate information. The basic goals are the same as hacking. **Social engineering** is the tricking of individuals into revealing their passwords or other valuable corporate information. Tactics include casual conversations with relatives of company executives and sending e-mail claiming to be a system administrator that asks for passwords under the guise of "important system administration work." Another common social engineering trick is **shoulder surfing,** in which someone simply looks over an employee's shoulder while he or she types in a password. **Password guessing** is another easy social engineering technique. If a person can find out personal things about someone, he or she might be able to use that information to guess a password. For example, a child's name, birthdays and anniversaries, and Social Security numbers are all common passwords and are easily guessed or figured out by someone trying to do so.

Dumpster diving is messy but very successful for acquiring trade secrets. Once trash is discarded onto a public street or alley, it is considered fair game. Trash can provide a rich source of information for any CI agent. Phone books can give a hacker names and numbers of people to target and impersonate. Organizational charts contain information about people who are in positions of authority within the organization. Memos provide small amounts of useful information and assist in the creation of authentic-looking fake memos.

Whacking is wireless hacking. To eavesdrop on wireless networks, all a CI agent needs is the right kind of radio and to be within range of a wireless transmission. Once tapped into a wireless network, an intruder can easily access anything on both the wired and wireless networks because the data sent over networks is usually unencrypted. If a company is not using wireless networking, an attacker can pose as a janitor and insert a rogue wireless access node into a supposedly secure hard-wired network.

Phone eavesdropping is yet another tool in the game of CI agent. A person with a digital recording device can monitor and record a fax line. By playing the recording back an intruder can reproduce an exact copy of a message without anyone's knowledge. Even without monitoring a fax line, a fax sent to a "communal" fax machine can be read or copied. By picking up an extension or by tapping a telephone, it is possible to record the tones that represent someone's account number and password using a tape recorder. The tape recording can then be replayed over the telephone to gain access to someone else's account.

Discrimination

Although a person's racial and sexual prejudices belong to the domain of individual ethics, racial and sexual discrimination in the workplace creates ethical issues within the business world. **Discrimination** on the basis of race, color, religion, sex, marital status, sexual orientation, public assistance status, disability, age, national origin, or veteran status is illegal in the United States. Additionally, discrimination on the basis of political opinions or affiliation with a union is defined as harassment.

A company in the United States can be sued if it (1) refuses to hire an individual, (2) maintains a system of employment that unreasonably excludes an individual from

employment, (3) discharges an individual, or (4) discriminates against an individual with respect to hiring, employment terms, promotion, or privileges of employment as it relates to the definition of discrimination.

Race, gender, and age discrimination are a major source of ethical and legal debate in the workplace. Between 75,000 and 80,000 charges of discrimination are filed annually with the **Equal Employment Opportunity Commission** (EEOC).[20] Discrimination remains a significant ethical issue in business despite nearly 40 years of legislation attempting to outlaw it. For example, there are only two black chairs/CEOs of Fortune 500 companies: Richard D. Parsons of Dime Savings Bank of New York, and Ursula Burns of Xerox, who is also the first-ever African American woman to be CEO of a Fortune 500 company.

Once dominated by European American men, the U.S. workforce today includes significantly more women, African Americans, Hispanics, and other minorities, as well as disabled and older workers. Experts project that within the next 50 years, Hispanics will represent 24 percent of the population, and African Americans and Asian/Pacific Islanders will comprise 13 percent and 9 percent, respectively.[21] These groups have traditionally faced discrimination and higher unemployment rates and been denied opportunities to assume leadership roles in corporate America. Another form of discrimination involves discriminating against individuals on the basis of age. The **Age Discrimination in Employment Act** specifically outlaws hiring practices that discriminate against people between the ages of 49 and 69, as well as those that require employees to retire before the age of 70. Despite this legislation, charges of age discrimination persist in the workplace. For example, the EEOC has charged Sidley Austin Brown & Wood, a Chicago-based international law firm with over 1,500 lawyers, with age discrimination when it selected "partners" for expulsion from the firm on account of their age. The act prohibits employers with 20 or more employees from making employment decisions, including decisions regarding the termination of employment, on the basis of age or from requiring retirement after the age of 40. EEOC trial attorney Deborah Hamilton stated that "having the power to fire an employee does not mean that a law firm or any other covered employer can do so because of the employee's age, if the employee is over 40. That is a violation of the ADEA and that the making of unlawful age-based selections for termination is precisely what EEOC is targeting in this lawsuit."[22] For example, Lockheed Martin Global Telecommunications settled its age discrimination lawsuit filed by eight older employees for $773,000. Sprint Nextel settled its age discrimination lawsuit for $57 million. The settlement involves around 1,700 former Sprint employees. After legal fees ($21 million) each plaintiff will receive a settlement between $4,000 and $35,000, for an average of $20,000.[23]

> *Race, gender, and age discrimination are a major source of ethical and legal debate in the workplace.*

A survey by the American Association for Retired Persons (AARP), an advocacy organization for people aged 50 years and older, highlighted how little most companies value older workers. When the AARP mailed invitations to 10,000 companies for a chance to compete for a listing in *Modern Maturity* magazine as one of the "best employers for workers over 50," it received just 14 applications. Given that nearly 20 percent of the nation's workers will be 55 years old or over by 2015, many companies need to change their approach toward older workers.[24]

To help build workforces that reflect their customer base, many companies have initiated **affirmative action programs,** which involve efforts to recruit, hire, train, and promote qualified individuals from groups that have traditionally been discriminated against on the basis of race, gender, or other characteristics. Such initiatives may be imposed by federal law on an employer that contracts or subcontracts for business with the federal government, as part of a settlement agreement with a state or federal agency, or by court order.[25] For example, Safeway, a chain of supermarkets, established a program to expand opportunities for women in middle- and upper-level management after settling a sex-discrimination lawsuit.[26] However, many companies voluntarily implement affirmative action plans in order to build a more diverse workforce.[27] For example, a Chicago real estate developer decided to help employers identify available female workers by launching the Female Employment Initiative, an outreach program designed to create opportunities for women in the construction industry through training programs, counseling and information services, and referral listings.[28]

Although many people believe that affirmative action requires that quotas be used to govern employment decisions, it is important to note that two decades of Supreme Court rulings have made it clear that affirmative action does not permit or require quotas, reverse discrimination, or favorable treatment of unqualified women or minorities. To ensure that affirmative action programs are fair, the Supreme Court has established a number of standards to guide their implementation: (1) There must be a strong reason for developing an affirmative action program; (2) affirmative action programs must apply only to qualified candidates; and (3) affirmative action programs must be limited and temporary and therefore cannot include "rigid and inflexible quotas."[29]

Discrimination can also be an ethical issue in business when companies use race or other personal factors to discriminate against specific groups of customers. Many companies have been accused of using race to deny service or charge higher prices to certain ethnic groups. For example, four airlines have settled lawsuits alleging discrimination against perceived Arab, Middle Eastern, or Southeast Asian descent passengers. United, American, Continental, and Delta have all denied any violations but agreed to spend as much as $1.5 million to train staff on respecting civil rights.[30]

Sexual Harassment

Sexual harassment is a form of sex discrimination that violates Title VII of the Civil Rights Act of 1964. Title VII applies to employers with 15 or more employees, including state and local governments. To understand the magnitude of this volatile issue, in one year the EEOC received 13,136 charges of sexual harassment, of which over 15 percent were filed by men. In another recent year, the EEOC resolved 13,786 sexual harassment charges and recovered $37.1 million in penalties.[31] **Sexual harassment** can be defined as any repeated, unwanted behavior of a sexual nature perpetrated upon one individual by another. It may be verbal, visual, written, or physical and can occur between people of different genders or those of the same sex. "Workplace display of sexually explicit material—photos, magazines, or posters—may constitute a hostile work environment harassment, even though the private possession, reading, and consensual sharing of such materials is protected under the Constitution."[32]

Even the United Nations, an organization whose mission is to protect human rights globally, has dealt with a series of sexual harassment cases. Many U.N. employees who have made or faced accusations claim that the system is poorly equipped to handle complaints, resulting in unfair, slow, and arbitrary rulings. For example, one employee who claimed she was harassed for years in Gaza saw her superior cleared by one of his colleagues.[33]

To establish sexual harassment, an employee must understand the definition of a **hostile work environment,** for which three criteria must be met: the conduct was unwelcome; the conduct was severe, pervasive, and regarded by the claimant as so hostile or offensive as to alter his or her conditions of employment; and the conduct was such that a reasonable person would find it hostile or offensive. To assert a hostile work environment, an employee need not prove that it seriously affected his or her psychological well-being nor caused an injury; the decisive issue is whether the conduct interfered with the claimant's work performance.[34]

Sexual harassment includes unwanted sexual approaches (including touching, feeling, groping) and/or repeated unpleasant, degrading, or sexist remarks directed toward an employee with the implied suggestion that the target's employment status, promotion, or favorable treatment depend on a positive response and/or cooperation. It can be regarded as a private nuisance, unfair labor practice, or, in some states, a civil wrong (tort) that may be the basis for a lawsuit against the individual who made the advances and against the employer who did not take steps to halt the harassment. The law is primarily concerned with the impact of the behavior and not the intent. An important facet of sexual harassment law is its focus on the victim's reasonable behaviors and expectations.[35] However the definition of reasonable varies from state to state, as does the concept of expectations. In addition, an argument used by some in defense of sexual harassment is the freedom of speech granted by the First Amendment.

An important facet of sexual harassment law is its focus on the victim's reasonable behaviors and expectations.

The key ethical issue within sexual harassment is called dual relationships or unethically intimate relationships. A **dual relationship** is defined as a personal, loving, and/or sexual relationship with someone with whom you share professional responsibilities. Potentially, **unethical dual relationships** are those where the relationship causes either a direct or indirect conflict of interest or a risk of impairment to professional judgment.[36] Another important factor in these cases is intent. If the sexual advances in any form are considered mutual, then consent is created. The problem is that, unless the employee or employer gets something in writing before the romantic action, consent can always be questioned, and when it comes to sexual harassment, the alleged perpetrator must prove mutual consent.

For example, in a case in Illinois, a professor made advances to his office assistant, repeatedly asking her "Do you love me?" and "Would you ever marry a man like me?" He would also ask her for hugs, rub her shoulders, and tickle her. The assistant was troubled by these behaviors, and although she confided her distress to the proper authorities, nothing was done until she went to another institution and filed an official complaint. The university responded by directing the professor to undergo training in proper behavior toward female students and by placing a letter in his personnel file, outlining the actions to be taken and the method for evaluating their effectiveness. In this case, the university believed that there was no duality and the EEOC awarded no monetary damages to the assistant.

Three former female employees sued Florida-based Airguide Corporation and its parent company, Pioneer Metals, Inc., for sexual harassment. The courts awarded each of the three women $1 million, but the penalties for sexual harassment do not stop there. In addition, Airguide and Pioneer Metals must conduct annual training in 19 facilities in Florida and undergo monitoring by the EEOC for three years.[37]

To avoid sexual misconduct or harassment charges a company should, at the minimum, take the following steps:

1. *Establish a statement of policy* naming someone in the company as ultimately responsible for preventing harassment at the company.
2. *Establish a definition of sexual harassment* that includes unwelcome advances, requests for sexual favors, and any other verbal, visual, or physical conduct of a sexual nature; that provides examples of each; and that reminds employees that the list of examples is not all-inclusive.
3. *Establish a nonretaliation policy* that protects complainants and witnesses.
4. *Establish specific procedures for prevention* of such practices at early stages. However, if a company puts these procedures in writing, they are expected by law to train, measure, and ensure that the policies are being enforced.
5. *Establish, enforce, and encourage* victims of sexual harassment to report the behavior to authorized individuals.
6. *Establish a reporting procedure.*
7. *Make sure that the company has timely reporting requirements to the proper authorities.* Usually, there is a time limitation to file the complaint for a formal administrative sexual charge, ranging from six months to a year. However, the failure to meet a shorter complaint period (for example, 60 to 90 days) so that a "rapid response" and remediation may occur and to help to ensure a harassment-free environment could be a company's defense against the charge that it was negligent.

Once these steps have been taken, a training program should identify and describe forms of sexual harassment and give examples, outline the grievance procedure, explain how to use the procedures and discuss the importance of them, discuss the penalty for violation, and train employees for the essential need of a workplace that is free from harassment, offensive conduct, or intimidation. A corporation's training program should cover such items as how to spot sexual harassment; how to investigate complaints including proper documentation; what to do about observed sexual harassment, even when no complaint has been filed; how to keep the work environment as professional and non-hostile as possible; how to teach employees that the consequences can be dismissal; and how to train management to understand follow-up procedures on incidents.

Environmental Issues

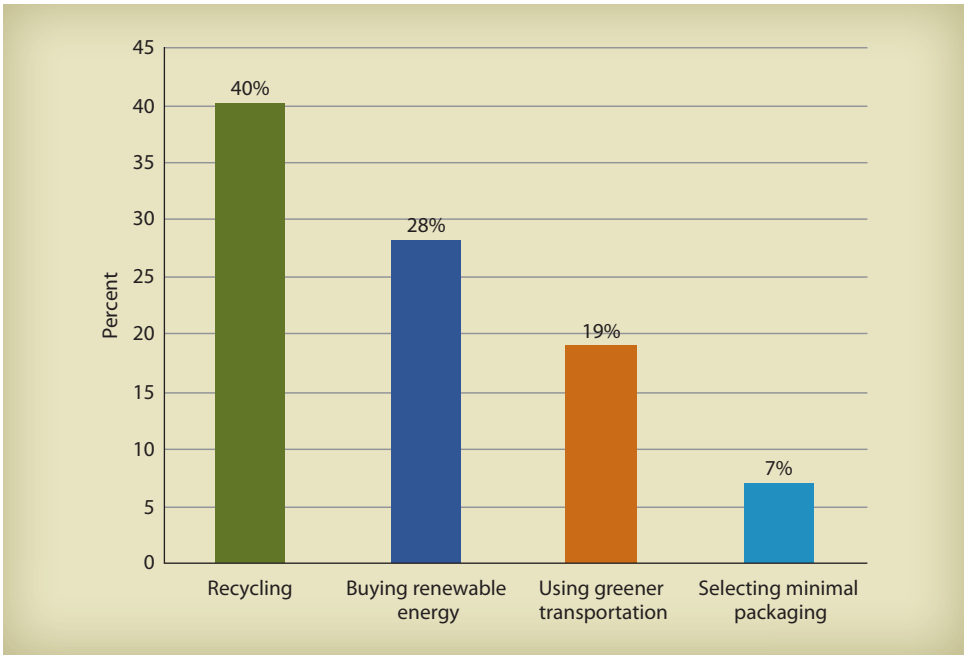
Environmental issues are becoming the significant concerns within the business community. The **Kyoto Protocol,** one example of the world's growing concern about global warming, is an international treaty on climate change committed to reducing emissions of carbon dioxide and five other greenhouse gases and to engaging in emissions trading if member signatories maintain or increase emissions of these gases. The objective is to stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous climate changes. Some current estimates indicate that, if these objectives are not successfully and completely implemented, the predicted global temperature increase could be between 1.4°C to 5.8°C. Possible massive tidal surges and extreme weather patterns are in store for our planet in the future if countries do not restrict specific gases emanating from business activities. The United States is one of the only countries not to sign the protocol.

Water pollution results from the dumping of raw sewage and toxic chemicals into rivers and oceans, from oil and gasoline spills, and from the burial of industrial wastes in the ground where they may filter into underground water supplies. Fertilizers and pesticides used in farming and grounds maintenance also drain into water supplies with each rainfall. When these chemicals reach the oceans, they encourage the growth of algae that use up all the nearby oxygen, thus killing the sea life. According to the Environmental Protection Agency (EPA), more than one-third of the nation's rivers, lakes, and coastal waters are not safe for swimming or fishing as a result of contaminated runoff.

Waste management has flourished in Europe, especially in Germany, and appears to be growing globally. One green issue is plastic; in the United States alone, 30 million plastic bottles are thrown away daily for a total of nearly 11 billion a year. Those that are recycled use large amounts of energy in the recycling process. An even bigger problem for the future is that, as the world becomes more capitalistic, more people will buy more things using plastics that are made from oil and that do not degrade easily. Consumers currently consider recycling to be the most important thing they can do to live "greener" lives, as Figure 3–2 demonstrates. However, more drastic measures will need to be made by businesses and consumers alike to cut back on energy consumption and waste.

Buildings are rarely considered major pollution sources. Yet 33 percent of major U.S. energy use, 33 percent of major greenhouse gas emissions, and 30 percent of raw material use are the result of buildings.[38] Currently, there are two competitive certification groups that authorize schools, houses, and commercial buildings as green. These two rival groups, Green Globes and Leadership in Energy and Environmental Design (LEED), are vying for leadership in government adoption of environmental rules that determine

FIGURE 3–2 Consumers' Favorite Green Practices



Source: "Environmentally Friendly Choices," *USA Today Snapshots*, March 3, 2009, from Green Seal and Enviromedia Social Marketing survey of 1,000 adults by Opinion Research Corp.

whether a building can be called green. There is concern about stakeholder relationships between the two groups. Green Globes is led by a former timber company executive and received much of its seed money from timber and wood products companies. LEED is a nonprofit organization with less ties to business interests. Already two states, Maryland and Arkansas, have adopted Green Globes as an alternative to LEED, giving officials an alternative for government-funded construction. The Clinton Presidential Library in Little Rock as well as the 7 World Trade Center, the first tower rebuilt near Ground Zero in New York, was certified by Green Globes.[39]

Green energy sources are often considered "green" because they are perceived to lower carbon emissions and create less pollution. They include natural energetic processes that can be harnessed with little pollution. Anaerobic digestion or biomass, geothermal, wind, small-scale hydropower, solar, and tidal power fall under this category. Some definitions may also include power derived from the incineration of waste. Some organizations have specifically classified nuclear power as green energy, but environmental organizations indicate the problems with nuclear waste and claim that this energy is neither efficient nor effective in cutting CO2 emissions, excluding it from clean energy. No power source is entirely impact-free. All energy sources require energy and give rise to some degree of pollution from manufacture of the technology.

Companies that do not recognize the profit potentials and ethical ramifications to brand and corporate reputation will pay later. For example, Exxon Mobil's CEO, Rex Tillerson, has encouraged the U.S. Congress to enact a tax on greenhouse gas emissions in order to fight global warming. "My greatest concern is that policy makers will attempt to mandate or ordain solutions that are doomed to fail," Mr. Tillerson said.[40]

Fraud

When an individual engages in deceptive practices to advance his or her own interests over those of his or her organization or some other group, charges of fraud may result. In general, **fraud** is any purposeful communication that deceives, manipulates, or conceals facts in order to create a false impression. Fraud is a crime and convictions may result in fines, imprisonment, or both. Fraud costs U.S. organizations more than $400 billion a year; the average company loses about 6 percent of total revenues to fraud and abuses committed by its own employees.[41] Among the most common fraudulent activities employees report about their coworkers are stealing office supplies or shoplifting, claiming to have worked extra hours, and stealing money or products.[42] Table 3–3 indicates what fraud examiners view as the biggest risk to companies. In recent years, accounting fraud has become a major ethical issue, but as we will see, fraud can also relate to marketing and consumer issues as well.

TABLE 3-3 Greatest Fraud Risk for Companies

Conflicts of interest	56%
Fraudulent financial statements	57%
Billing schemes	22%
Expense and reimbursement schemes	41%
Bribery/economic extortions	35%

Source: "The 2007 Oversight Systems Report on Corporate Fraud," Ethics World, http://www.ethicsworld.org/ethicsandemployees/PDF%20links/Oversight_2007_Fraud_Survey.pdf (accessed March 12, 2009).

Accounting fraud usually involves a corporation's financial reports in which companies provide important information on which investors and others base decisions that may involve millions of dollars. If the documents contain inaccurate information, whether intentionally or not, then lawsuits and criminal penalties may result. For example, trustees of New Century Financial Corporation sued its auditor, KPMG, for "reckless and grossly negligent audits" that hid the company's financial problems and sped its collapse. New Century was one of the early casualties of the subprime mortgage crisis, but was once one of the country's largest mortgage lenders to those with poor credit histories. After it disclosed accounting errors not discovered by KPMG the company collapsed.[43] Scrutiny of financial reporting increased dramatically in the wake of accounting scandals in the early twenty-first century. As a result of the negative publicity surrounding the allegations of accounting fraud at a number of companies, many firms were forced to take a second look at their financial documents. More than a few chose to restate their earnings to avoid being drawn into the scandal.[44] For example, WellCare Health Plans Inc. was forced to restate over three years of its earnings following a Florida Medicare fraud investigation that also led to changes in management and a loss of profits.[45]

The field of accounting has changed dramatically over the last decade. The profession used to have a club-type mentality: Those who became certified public accountants (CPAs) were not concerned about competition. Now CPAs advertise their skills and short-term results in an environment in which competition has increased and overall billable hours have significantly decreased because of technological innovations. Additionally, accountants are now permitted to charge performance-based fees rather than hourly rates, a rule change that encouraged some large accounting firms to promote tax-avoidance strategies for high-income individuals because the firms can charge 10 to 40 percent of the amount of taxes saved.[46]

Pressures on accountants today include time, reduced fees, client requests to alter opinions concerning financial conditions or lower tax payments, and increased competition. Other issues that accountants face daily involve compliance with complex rules and regulations, data overload, contingent fees, and commissions. An accountant's life is filled with rules and data that have to be interpreted correctly, and because of such pressures and the ethical predicaments they spawn, problems within the accounting industry are on the rise.

As a result, accountants must abide by a strict code of ethics that defines their responsibilities to their clients and the public interest. The code also discusses the concepts of integrity, objectivity, independence, and due care. Despite the standards the code provides, the accounting industry has been the source of numerous fraud investigations in recent years. Congress passed the Sarbanes–Oxley Act in 2002 to address many of the issues that could create conflicts of interest for accounting firms auditing public corporations. The law generally prohibits accounting firms from providing both auditing and consulting services to the same firm. Additionally, the law specifies that corporate boards of directors must include outside directors with financial knowledge on the company's audit committee.

Marketing fraud—the process of creating, distributing, promoting, and pricing products—is another business area that generates potential ethical issues. False or misleading marketing communications can destroy customers' trust in a company. Lying, a major ethical issue involving communications, is potentially a significant problem. In both external and internal communications, it causes ethical predicaments because it destroys trust. Misleading marketing can also cost consumers hard-earned money. A U.S. district court passed judgment on Ira Rubin and his company Global Marketing

Group. Rubin allegedly debited millions of dollars from U.S. consumers' bank accounts on behalf of many telemarketing scams dating back to 2003. The judgment involved a halt on all payment processing associated with the case.[47] False or deceptive advertising is a key issue in marketing communications. One set of laws that is common to many countries are laws concerning deceptive advertising—that is, advertisements that are not clearly labeled as advertisements. For example, in the United States, Section 5 of the Federal Trade Commission (FTC) Act addresses deceptive advertising. Abuses in advertising can range from exaggerated claims and concealed facts to outright lying, although improper categorization of advertising claims is the critical point. Courts place false or misleading advertisements into three categories: puffery, implied falsity, and literal falsity. **Puffery** can be defined as exaggerated advertising, blustering, and boasting upon which no reasonable buyer would rely and is not actionable under the Lanham Act. For example, in a Lanham Act suit between two shaving products companies, the defendant advertised that the moisturizing strip on its shaving razor was "six times smoother" than its competitors' strips, while showing a man rubbing his hand down his face. The court rejected the defendant's argument that "six times smoother" implied that only the moisturizing strip on the razor's head was smoother. Instead, the court found that the "six times smoother" advertising claim implied that the consumer would receive a smoother shave from the defendant's razor as a whole, a claim that was false.[48]

Implied falsity means that the message has a tendency to mislead, confuse, or deceive the public. The advertising claims that use implied falsity are those that are literally true but imply another message that is false. In most cases, this can be done only through a time-consuming and expensive consumer survey, whose results are often inconclusive.[49]

The characterization of an advertising claim as **literally false** can be divided into two subcategories: *tests prove* (*establishment claims*), in which the advertisement cites a study or test that establishes the claim; and *bald assertions* (*non-establishment claims*), in which the advertisement makes a claim that cannot be substantiated, as when a commercial states that a certain product is superior to any other on the market. For example, the FTC filed formal complaints against Stock Value 1 Inc. and Comstar Communications Inc. for making unsubstantiated claims that their radiation-protection patches block the electromagnetic energy emitted by cellular telephones. The FTC's complaint charged that the companies "made false statements that their products had been scientifically 'proven' and tested," when in fact that was not the case.[50]

Another form of advertising abuse involves making ambiguous statements in which the words are so weak or general that the viewer, reader, or listener must infer the advertiser's intended message. These "weasel words" are inherently vague and enable the advertiser to deny any intent to deceive. The verb *help* is a good example (as in expressions such as "helps prevent," "helps fight," "helps make you feel").[51] Consumers may view such advertisements as unethical because they fail to communicate all the information needed to make a good purchasing decision or because they deceive the consumer outright.

Labeling issues are even murkier. For example, Netgear Inc. agreed to settle a class action lawsuit that claimed it exaggerated the data-transfer speeds of its wireless equipment. As part of the settlement, the company must pay $700,000 in legal fees, give a 15 percent discount to members of the class action, donate $25,000 of product to charity, and include disclaimers about the data-transfer speed of its products.[52]

Slamming, or changing a customer's phone service without authorization, is an important issue involving labeling that is specific to the telephone industry. AT&T sued

Business Discount Plan (BDP), accusing it of using fraud and deception to routinely "slam" customers to its telecommunication service by suggesting that BDP was affiliated with AT&T. As part of the settlement, BDP had to send letters to consumers telling them that BDP was not affiliated with AT&T.[53] Such misleading behavior creates ethical issues because the communicated messages do not include all the information that consumers need to make good purchasing decisions, frustrating and angering customers who feel that they have been deceived. In addition, they damage the seller's credibility and reputation.

Advertising and direct sales communication can also mislead by concealing the facts within the message. For instance, a salesperson anxious to sell a medical insurance policy might list a large number of illnesses covered by the policy but fail to mention that it does not cover some commonly covered illnesses. Indeed, the fastest-growing area of fraudulent activity is in direct marketing, which employs the telephone and impersonal media to communicate information to customers, who then purchase products via mail, telephone, or the Internet.

Consumer Fraud

Consumer fraud is when consumers attempt to deceive businesses for their own gain. The FTC estimates that more than 25 million consumers annually engage in consumer fraud.[54] Shoplifting, for example, accounts for 35 percent of the losses at the largest U.S. retail chains, although this figure is still far outweighed by the nearly 44 percent of losses perpetrated by store employees, according to the National Retail Security Survey. Together with vendor fraud and administrative error, these losses cost U.S. retailers $36 billion annually and are on the rise. Retail shrinkage, or stealing from stores, accounts for losses averaging around 1.52 percent of total sales and 92 percent of retailers surveyed say that they have been a victim.[55]

Consumer fraud involves intentional deception to derive an unfair economic advantage by an individual or group over an organization.

Consumers engage in many other forms of fraud against businesses, including price tag switching, item switching, lying to obtain age-related and other discounts, and taking advantage of generous return policies by returning used items, especially clothing that has been worn (with the price tags still attached). Such behavior by consumers affects retail stores as well as other consumers who, for example, may unwittingly purchase new clothing that has actually been worn.[56]

Consumer fraud involves intentional deception to derive an unfair economic advantage by an individual or group over an organization. Examples of fraudulent activities include shoplifting, collusion or duplicity, and guile. *Collusion* typically involves an employee who assists the consumer in fraud. For example, a cashier may not ring up all merchandise or may give an unwarranted discount. *Duplicity* may involve a consumer staging an accident in a grocery store and then seeking damages against the store for its lack of attention to safety. A consumer may purchase, wear, and then return an item of clothing for a full refund. In other situations, the consumer may ask for a refund by claiming a defect. *Guile* is associated with a person who is crafty or understands right/wrong behavior but uses tricks to obtain an unfair advantage. The advantage is unfair because the person has the intent to go against the right behavior or end. Although some of these acts warrant legal prosecution, they can be very difficult to prove, and many companies are reluctant

to accuse patrons of a crime when there is no way to verify it. Businesses that operate with the "customer is always right" philosophy have found that some consumers will take advantage of this promise and have therefore modified return policies to curb unfair use.

Financial Misconduct

The failure to understand and manage ethical risks played a significant role in the financial crisis and recession of 2008–2009. While there is a difference between bad business decisions and business misconduct, there is also a thin line between the ethics of using only financial incentives to gauge performance and the use of holistic measures that include ethics, transparency, and responsibility to stakeholders. From CEOs to traders and brokers, lucrative financial incentives existed for performance in the financial industry.

The global recession was caused in part by a failure of the financial industry to take appropriate responsibility for its decision to utilize risky and complex financial instruments. Loopholes in regulations and the failures of regulators were exploited. Corporate cultures were built on rewards for taking risks rather than rewards for creating value for stakeholders. Ethical decisions were based more on what was legal rather than what was the right thing to do. Unfortunately, most stakeholders, including the public, regulators, and the mass media, do not always understand the nature of the financial risks taken on by banks and other institutions to generate profits. The intangible nature of financial products makes it difficult to understand complex financial transactions. Problems in the subprime mortgage markets sound the alarm for the most recent recession.

"The top executives or CEOs are ultimately responsible for the repercussions of their employees' decisions."

Ethics issues emerged early in subprime lending, with loan officers receiving commissions on securing loans from borrowers with no consequences if the borrower defaulted on the loan. "Liar loans" were soon developed to create more sales and higher personal compensation for lenders. Lenders would encourage subprime borrowers to provide false information on their loan applications in order to qualify for and secure the loan. Some appraisers provided inflated home values in order to increase the loan amount. In other instances consumers were asked to falsify their incomes to make the loan more attractive to the lending institution. The opportunity for misconduct was widespread. Top managers, and even CEOs, were complacent about the wrongdoings as long as profits were good. Congress and President Clinton encouraged Fannie Mae and Freddie Mac to support home ownership among low-income people by giving out home mortgages. Throughout the early 2000s, in an economy with rapidly increasing home values, the culture of unethical behavior was not apparent to most people. When home values started to decline and individuals were "upside down" on their loans (owing more than the equity of the home), the failures and unethical behavior of lending and borrowing institutions became more obvious.

The top executives or CEOs are ultimately responsible for the repercussions of their employees' decisions. Top executives at Merrill Lynch awarded $3.6 billion in bonuses shortly before its merger with Bank of America in 2008. A combined $121 million went to four top executives. This was done in spite of the fact that Merrill Lynch had to be rescued by the government to save it from bankruptcy. Two ethics issues are at play. First, paying

out the bonuses at all; and second, rushing their distribution in order to complete the job before Bank of America's takeover. Risk management in the financial industry is a key concern, including paying bonuses to executives who failed in their duties. Unfortunately, at the same time the industry was focused on its own bottom line, regulatory agencies and Congress were not proactive in investigating early cases of financial misconduct and the systemic issues that led to the crisis. The legal and regulatory systems were more focused on individual misconduct rather than systemic ethical failures.

Insider Trading

An insider is any officer, director, or owner of 10 percent or more of a class of a company's securities. There are two types of **insider trading:** illegal and legal. *Illegal insider trading* is the buying or selling of stocks by insiders who possess material that is still not public. The act, which puts insiders in breach of their fiduciary duty, can be committed by anyone who has access to nonpublic material, such as brokers, family, friends, and employees. In addition, someone caught "tipping" an outsider with material nonpublic information can also be found liable. The Securities and Exchange Commission brought a first-ever case alleging insider trading in credit default swaps in New York. The case centers on a small profit earned in the buyout of Dutch Media Company VNU NV. It alleges that a salesperson for Deutsche Bank AG passed on confidential information about VNU to a trader at Millennium Partners, who then allegedly used the information to earn a $1.2 million profit on credit default swaps tied to the value of the company's debt.[57] To determine if an insider gave a tip illegally, the SEC uses the *Dirks test,* which states that if a tipster breaches his or her trust with the company and understands that this was a breach, he or she is liable for insider trading.

Legal insider trading involves legally buying and selling stock in an insider's own company, but not all the time. Insiders are required to report their insider transactions within two business days of the date the transaction occurred. For example, if an insider sold 10,000 shares on Monday, June 12, he or she would have to report this change to the SEC by Wednesday, June 14. To deter insider trading, insiders are prevented from buying and selling their company stock within a six-month period; therefore, insiders buy stock when they feel the company will perform well over the long term.

A major player in the subprime mortgage crisis, Countrywide Financial's former CEO, Angelo Mozilo, was charged with fraud and insider trading. Mozilo was accused of fraudulently deliberately misleading investors about the risks being taken by the company. The SEC also alleges that Mozilo engaged in insider trading when he sold his Countrywide stock for $140 million in profits when he knew that the company's business was deteriorating.[58]

Intellectual Property Rights

Intellectual property rights involve the legal protection of intellectual properties such as music, books, and movies. Laws such as the Copyright Act of 1976, the Digital Millennium Copyright Act, and the Digital Theft Deterrence and Copyright Damages Improvement Act of 1999 were designed to protect the creators of intellectual property. However, with the advance of technology, ethical issues still abound for websites. For example, until it was sued for copyright infringement and subsequently changed its business model, Napster.com allowed individuals to download copyrighted music for personal use without providing compensation to the artists.

A decision by the Federal Copyright Office (FCO) helped lay the groundwork for intellectual property rules in a digital world. The FCO decided to make it illegal for Web users to hack through barriers that copyright holders erect around material released online, allowing only two exceptions. The first exception was for software that blocks users from finding obscene or controversial material on the Web, and the second was for people who want to bypass malfunctioning security features of software or other copyrighted goods they have purchased. This decision reflects the fact that copyright owners are typically being favored in digital copyright issues.[59] There have been many lawsuits related to this issue, and some have had costly results. MP3.com paid Universal Music Group $53.4 million to end its dispute with major record label over copyright infringement.[60]

As China has grown into an economic powerhouse, the market for pirated goods of all types ranging from DVDs to pharmaceuticals, and even cars, has grown into a multibillion dollar industry.[61] China's government has thus far proven weak in protecting intellectual property, and the underground market for such pirated goods—which are sold all over the world—has grown at a rapid pace. While intellectual property rights infringement always poses a threat from companies that risk losing profits and reputation, it can also threaten the health and well-being of consumers. For example, illegally produced medications, when consumed by unknowing consumers, can cause sickness and even death. Research on software piracy has shown that high levels of economic well-being and an advanced technology sector are effective in deterring software piracy.[62] Perhaps as China's economy moves forward piracy will become less of a problem, but in the meantime it poses a major threat.

"There are few legal protections of an employee's right to privacy,"

Privacy Issues

Consumer advocates continue to warn consumers about new threats to their privacy, especially within the health care and Internet industries. As the number of people using the Internet increases, the areas of concern related to its use increase as well.[63] Some **privacy issues** that must be addressed by businesses include the monitoring of employees' use of available technology and consumer privacy. Current research suggests that, even if businesses use price discounts or personalized services, consumers remain suspicious. However, certain consumers are still willing to provide personal information, despite the potential risks.[64]

A challenge for companies today is meeting their business needs while protecting employees' desires for privacy. There are few legal protections of an employee's right to privacy, which allows businesses a great deal of flexibility in establishing policies regarding employees' privacy while they are on company property and using company equipment. The increased use of electronic communications in the workplace and technological advances that permit employee monitoring and surveillance have provided companies with new opportunities to obtain data about employees. From computer monitoring and telephone taping to video surveillance and GPS satellite tracking, employers are using technology to manage their productivity and protect their resources.

To motivate employee compliance, over 25 percent of 596 companies have fired workers for misusing the Internet, 6 percent have fired employees for misusing office telephones, 76 percent monitor their workers' website connections, and 65 percent use software to block connections to inappropriate websites. In addition, 36 percent of those employers track content, keystrokes, and time spent at keyboards and store the data in order

to review it later. Employers are also notifying employees when they are being watched; of the organizations monitoring employees, 80 percent informed their workers.[65]

Because of the increased legal and regulatory investigations, employers have established policies governing personal e-mail use, personal Internet use, personal instant messenger use, personal blogs, and operation of personal websites on company time. Companies are also concerned about inappropriate telephone use, such as 1-900 lines or personal long-distance calls. Hence, some businesses routinely track phone numbers and, in selected job categories, record and review all employees' phone calls. More than half of the companies surveyed use video monitoring to counter theft, violence, and sabotage. The use of video surveillance to track employees' on-the-job performance has also increased, although companies that videotape workers usually notify them of the practice.

Concerns about employee privacy extend to Europe as well. In Finland an executive vice president and several employees of Sonera Corporation were arrested as part of an investigation into whether the wireless telecommunications company violated the privacy of its workers by monitoring their call records, a serious offense in Finland. The investigation was launched after a local newspaper reported that Sonera was tracing employees' phone calls in order to identify who may have leaked information about the company to the media. The company denied the accusation.[66]

Clearly conveying the organization's policy on workplace privacy should reduce the opportunity for employee lawsuits and the resulting costs of such actions. However, if a company fails to monitor employees' use of e-mail and the Internet, the costs can be huge. For example, Chevron Corporation agreed to pay $2.2 million to employees who claimed that unmonitored sexually harassing e-mail created a threatening environment for them.[67] Instituting practices that show respect for employee privacy but that do not abdicate the employer's responsibility should help create a climate of trust that promotes opportunities for resolving employee–employer disputes without lawsuits.

Electronic monitoring allows a company to determine whether productivity is being reduced because employees are spending too much time on personal Web activities. Knowing this can then enable the company to take steps to remedy the situation. Internet filtering companies such as Cyber Patrol, Surfcontrol, Surfwatch, and WebSense provide products that block employee access to websites deemed distracting or objectionable. WebSense launched AfterWork.com, a personal homepage for each employee at a company that allows employees to visit nonwork-related websites during breaks and lunch, as well as before and after work hours.[68] One survey about this subject found that 58 percent of employees considered using company resources for personal Web surfing to be an "extremely serious" or "very serious" business ethics violation.[69]

There are two dimensions to consumer privacy: consumer awareness of information collection and a growing lack of consumer control over how companies use the personal information that they collect. For example, many are not aware that Google Inc. reserves the right to track every time you click on a link from one of its searches.[70] Online purchases and even random Web surfing can be tracked without a consumer's knowledge. A survey by the Progress and Freedom Foundation found that 96 percent of popular commercial websites collect personally identifying information from visitors.[71]

For example, the FTC asked a federal judge to shut down Odysseus Marketing Inc. on the grounds that it secretly installed spyware that could not be removed by the consumers whose computers it infected. The company offered a free software package to make peer-to-peer file sharing anonymous, but consumers ended up downloading a program called Clientman, a spyware program that altered search results, disseminated pop-up

ads, and installed third-party ads without notice to consumers. The company denies any wrongdoing.[72]

A U.S. Department of Commerce study on e-commerce and privacy found that 81 percent of Internet users and 79 percent of consumers who buy products and services over the Web were concerned about online threats to privacy.[73] Another survey found that 38 percent of respondents felt that it is never ethical to track customers' Web activities, and 64 percent said that they do not trust websites that do.[74] These concerns have led some companies to cut back on the amount of information they collect: Of the sites surveyed by the Progress and Freedom Foundation, 84 percent indicated that they are collecting less data than before.[75] However, many consumers have expressed a low level of confidence in their ability to avoid becoming a victim of credit or debit card fraud.

Companies are also working to find ways to improve consumers' trust in their websites. For example, an increasing number of websites display an online seal from BBBOnline, available only to sites that subscribe to certain standards. A similar seal is available through TRUSTe, a nonprofit global initiative that certifies those websites that adhere to its principles. (Visit http://e-businessethics.com for more on Internet privacy.)

THE CHALLENGE OF DETERMINING AN ETHICAL ISSUE IN BUSINESS

Most ethical issues will become visible through stakeholder concerns about an event, activity, or the results of a business decision. The mass media, special interest groups, and individuals, through the use of blogs, podcasts, or other individual-generated media, often generate discussion about the ethicalness of a decision. Another way to determine whether a specific behavior or situation has an ethical component is to ask other individuals in the business how they feel about it and whether they view it as ethically challenging. Trade associations and business self-regulatory groups such as the Better Business Bureau often provide direction for companies in defining ethical issues. Finally, it is important to determine whether the organization has adopted specific policies on the activity. An activity approved of by most members of an organization, if it is also customary in the industry, is probably ethical. An issue, activity, or situation that can withstand open discussion between many stakeholders, both inside and outside the organization, probably does not pose ethical problems.

"Over time, problems can become ethical issues as a result of changing societal values."

However, over time, problems can become ethical issues as a result of changing societal values. For instance, for decades Kraft Foods Inc. has been a staple in almost every home in the United States, with products such as Kraft Macaroni and Cheese, Chips Ahoy! cookies, Lunchables, Kool-Aid, Fruity Pebbles, and Oreos. Nothing was said about such foods until 2004. However, a problem was perceived first by parents, then schools, and then politicians who became aware that the United States has the most obese people in the world, with approximately 40 percent of the population overweight.

The fact is that since 1980 the rate of obesity in children (ages 6 to 11) has more than doubled, and it has tripled in adolescents. Children who are 10 years of age weigh 10 pounds more than they did in the 1960s. As a result, Congress has proposed legislation

relative to obesity and concerning the advertising of unhealthy food products to children. Kraft realized that it now has an ethical situation regarding the advertising of such items as hotdogs, cookies, and cereals with high sugar levels. Some consumer groups might now perceive Kraft's $90 million annual advertising budget, which was primarily directed at children, as unethical. Because ignoring the situation could be potentially disastrous, Kraft instead devised a compromise: It would stop advertising some of its products to children under 12 years of age and instead market healthier foods. As a result of government recommendations, Kraft executives have continually revised their advertising guidelines regarding children and the advertisement of products containing large amounts of sugar, fat, and calories, knowing that their decisions would probably negatively affect their bottom line.[78]

Once stakeholders trigger ethical issue awareness and individuals openly discuss it and ask for guidance and the opinions of others, one enters the ethical decision making process, which we examine in Chapter 5.

SUMMARY

Stakeholders' concerns largely determine whether business actions and decisions are perceived as ethical or unethical. When government, communities, and society become involved, what was merely an ethical issue can quickly become a legal one. Shareholders can unwittingly complicate the issue of conducting business ethically by demanding that managers make decisions to boost short-term earnings to maintain or boost the value of their shares of stock.

A first step toward understanding business ethics is to develop ethical issue awareness; that is, to learn to identify which stakeholder issues contain an ethical component. Characteristics of the job, the corporate or local culture, or the organization of the society in which one does business can all create ethical issues. Recognizing an ethical issue is essential to understanding business ethics and therefore to creating an effective ethics and compliance program that will seek to minimize unethical behavior. In order to do this, people must understand the universal moral constants of honesty, fairness, and integrity, which are accepted by businesspeople everywhere. Without embracing these concepts, running a business becomes very difficult. To be honest is to tell the truth to the best of your ability without hiding anything. Confucius defined several levels of honesty: *Li*, which relates to the superficial desires of a person; *Yi*, which relates to doing business based on reciprocity; and *Ren*, which is based on empathy and understanding others. Confucianism advocates treating inferiors as you would want superiors to treat you, an idea that is later reflected in Kant's Golden Rule. Virtues such as a family's honor and a person's reputation for honesty are of paramount importance.

Fairness is the quality of being just, equitable, and impartial, and it overlaps terms such as *justice, equity, equality*, and *morality*. The three fundamental elements that motivate people to be fair are equality, reciprocity, and optimization. Equality relates to how wealth is distributed between employees, within a company or a country or globally; reciprocity relates to the return of small favors that are approximately equal in value; and integrity relates to a person's character and is made up of two basic parts: a formal relation that one has to oneself and a person's set of terminal, or enduring, values from which he or she does not deviate.

An ethical issue is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several actions that must be evaluated as right or wrong, ethical or unethical, but an ethical dilemma has no right or ethical choice.

Bribery is the practice of offering something (usually money) in order to gain an illicit advantage. A conflict of interest is when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group. Corporate intelligence is the collection and analysis of information on markets, technologies, customers, and competitors, as well as on socioeconomic and external political trends. There are three intelligence models: passive, tactical, and top-management. The tools of corporate intelligence are many. One tool is hacking, which has three categories: system, remote, and physical; another is social engineering in which someone is tricked into revealing valuable corporate information; other techniques include dumpster diving, whacking, and phone eavesdropping.

Another ethical/legal issue is discrimination, which is illegal in the United States when it occurs on the basis of race, color, religion, sex, marital status, sexual orientation, public-assistance status, disability, age, national origin, or veteran status. Additionally, discrimination on the basis of political opinions or affiliation with a union is defined as harassment. Sexual harassment is a form of sex discrimination. To help build workforces that reflect their customer base, many companies have initiated affirmative action programs. Environmental issues such as air, water, and waste are becoming an ethical concern within business. In general, fraud is any purposeful communication that deceives, manipulates, or conceals facts in order to create a false impression. There are several types of fraud: accounting, marketing, and consumer.

An insider is any officer, director, or owner of 10 percent or more of a class of a company's securities. There are two types of insider trading: legal and illegal. Intellectual property rights involve the legal protection of intellectual properties such as music, books, and movies. Consumer advocates continue to warn consumers about new threats to their privacy.

IMPORTANT TERMS FOR REVIEW

honesty
fairness
equality
reciprocity
optimization
integrity
ethical issue
ethical dilemma
abusive or intimidating behavior
lying
conflict of interest
bribery
active bribery
passive bribery
facilitation payment
corporate intelligence
hacking
system hacking
remote hacking
physical hacking
social engineering
shoulder surfing
password guessing
dumpster diving
whacking
phone eavesdropping
discrimination
Equal Employment Opportunity Commission
Age Discrimination in Employment Act
affirmative action program
sexual harassment
hostile work environment
dual relationship
unethical dual relationship
environmental issue
Kyoto Protocol
water pollution
green energy
fraud
accounting fraud
marketing fraud
puffery
implied falsity
literally false
labeling issue
slamming
consumer fraud
insider trading
intellectual property rights
privacy issue

RESOLVING ETHICAL BUSINESS CHALLENGES*

Joseph Freberg had been with Alcon for 18 months. He had begun his career right out of college with a firm in the Southeast called Cala Industrial, which specialized in air compressors. Because of his work with Cala, he had been lured away to Alcon, in Omaha, as a sales manager. Joseph's first six months had been hard. Working with older salespeople, trying to get a handle on his people's sales territories and settling into the corporate culture of a new firm took 16-hour days, six days a week. During those six months, he also bought a house, and his fiancé, Ellen, furnished it, deciding almost everything from the color of the rugs to the style of the curtains.

Ellen had taken a brokerage job with Trout Brothers and seemed to be working even more hours than Joseph. But the long days were paying off. Ellen was now starting to handle some large accounts and was being noticed by the "right" crowd in the wealthier Omaha areas.

Costs for the new home had exceeded their anticipated spending limit, and the plans for their wedding seemed to be getting larger and larger. In addition, Ellen was commuting from her apartment to the new home and then to her job, and the commute killed her car. As a result, she decided to lease something that exuded success.

"Ellen, don't you think a Mercedes is a little out of our range? What are the payments?" inquired Joseph.

"Don't worry, darling. When my clients see me in this—as well as when we start entertaining at the new house once we're married—the payments on the car will seem small compared with the money I'll be making," Ellen mused as she ran her fingers through Joseph's hair and gave him a peck on the cheek.

By the time of their wedding and honeymoon, Joseph and Ellen's bank statement looked like a bullfighter's cape—red. "Don't worry, Joseph, everything will turn out okay. You've got a good job. I've got a good job. We're young and have drive. Things will straighten out after a while," said Ellen as she eyed a Rolex in a store window.

After the wedding, things did settle down—to a hectic pace, given their two careers and their two sets of parents 1,000 miles away in either direction. Joseph had realized that Alcon was a paternal type of organization, with good benefits and tremendous growth potential. He had identified whom to be friends with and whom to stay away from in the company. His salespeople seemed to tolerate him, sometimes calling him "Little Joe" or "Joey" because of his age, and his salespeople were producing—slowly climbing up the sales ladder to the number-one spot in the company.

While doing some regular checkup work on sales personnel, Joseph found out that Carl had been giving kickbacks to some of his buyers. Carl's sales volume accounted for a substantial amount of the company's existing clientele sales, and he had been a

trainer for the company for several years. Carl also happened to be the vice president's son-in-law. Joseph started to check on the other reps more closely and discovered that, although Carl seemed to be the biggest offender, 3 of his 10 people were doing the same thing. The next day, Joseph looked up Alcon's policy handbook and found this statement: "Our company stands for doing the right thing at all times and giving our customers the best product for the best prices." There was no specific mention of kickbacks, but everyone knew that kickbacks ultimately reduce fair competition, which eventually leads to reduced quality and increased prices for customers.

By talking to a few of the old-timers at Alcon, Joseph learned that there had been sporadic enforcement of the "no kickback" policy. It seemed that when times were good it became unacceptable and when times were bad it slipped into the acceptable range. And then there was his boss, Kathryn, the vice president. Joseph knew that Kathryn had a tendency to shoot the bearer of bad news. He remembered a story that he had heard about a sales manager coming in to see Kathryn to explain an error in a bid that one of his salespeople had made. Kathryn called in the entire sales staff and fired the salesperson on the spot. Then, smiling, she told the sales manager: "This was your second mistake, so I hope that you can get a good recommendation from personnel. You have two weeks to find employment elsewhere." From then on, the office staff had a nickname for Kathryn—Jaws.

Trying to solve the problem that he was facing, Joseph broached the subject of kickbacks at his monthly meeting with Carl. Carl responded, "You've been in this business long enough to know that this happens all the time. I see nothing wrong with this practice if it increases sales. Besides, I take the money out of my commission. You know that right now I'm trying to pay off some big medical bills. I've also gotten tacit clearance from above, but I wouldn't mention that if I were you." Joseph knew that the chain-of-command structure in the company made it very dangerous to go directly to a vice president with this type of information.

As Joseph was pondering whether to do nothing, bring the matter into the open and state that it was wrong and that such practices were against policy, or talk to Kathryn about the situation, his cell phone rang. It was Ellen. "Honey, guess what just happened. Kathryn, your boss, has decided to use me as her new broker. Isn't that fantastic!"

What should Joseph do?

QUESTIONS • EXERCISES

1. What are Joseph's ethical problems?
2. Assume that you are Joseph and discuss your options.
3. What other information do you feel you need before making your decision?
4. Discuss in which business areas the ethical problems lie.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Business can be considered a game people play like basketball or boxing.	**Yes**	**No**
2. Key ethical issues in an organization relate to fraud, discrimination, honesty and fairness, conflicts of interest, and technology.	**Yes**	**No**
3. Only 10 percent of employees observe abusive behavior in the workplace.	**Yes**	**No**
4. Fraud occurs when a false impression exists, which conceals facts.	**Yes**	**No**
5. Putting one's own interests ahead of the organization is the most commonly observed type of misconduct.	**Yes**	**No**

ANSWERS **1. No**. People are not economically self-sufficient and cannot withdraw from the game of business. **2. Yes**. See pages 62–83 regarding these key ethical issues and their implications for the organization. **3. No**. According to Table 3-1, 21 percent of employees observe abusive behavior in the workplace. **4. No**. Fraud must be purposeful, rather than accidental, and exists when deception and manipulation of facts are concealed to create a false impression that causes harm. **5. Yes**. The most observed form of misconduct in Table 3-1 is putting one's own interests ahead of the company.

CHAPTER 4

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The Institutionalization of Business Ethics

CHAPTER OBJECTIVES

- To distinguish between the voluntary and mandated boundaries of ethical conduct
- To provide specific mandated requirements for legal compliance in specific subject matter areas related to competition, consumers, safety, and the environment
- To specifically address the requirements of the Sarbanes–Oxley legislation and implementation by the Securities and Exchange Commission
- To provide an overview of regulatory efforts to provide incentives for ethical behavior
- To provide an overview of the Federal Sentencing Guidelines for Organizations recommendations and incentives for developing an ethical corporate culture
- To provide an overview of voluntary boundaries and the relationship to social responsibility

CHAPTER OUTLINE

Managing Ethical Risk Through Mandated and Voluntary Programs

Mandated Requirements for Legal Compliance

Laws Regulating Competition

Laws Protecting Consumers

Laws Promoting Equity and Safety

Laws Protecting the Environment

Gatekeepers and Stakeholders

Accountants

Risk Assessment

The Sarbanes–Oxley Act

Public Company Accounting Oversight Board

Conflicts of Interest: Auditor and Analyst Independence

Enhanced Financial Disclosures

Whistle-Blower Protection

Corporate and Criminal Fraud Accountability

Cost of Compliance

Laws That Encourage Ethical Conduct

Federal Sentencing Guidelines for Organizations

Highly Appropriate Core Practices

Philanthropic Contributions

Strategic Philanthropy

AN ETHICAL DILEMMA*

Myron had just graduated from West Coast University with both chemistry–pharmacy and business degrees and was excited to work for Producto International (PI). He loved having the opportunity to discover medicinal products around the world. His wife, Quan, was also enthusiastic about her job as an import–export agent for a subsidiary of PI.

Producto International was the industry leader, with headquarters in Paris. Worldwide, hundreds of small firms were competing with PI; however, only six had equivalent magnitude. These six had cornered 75 percent of world sales. So many interrelationships had developed that competition had become "managed." However, this did not constitute any illegal form of monopolistic behavior as defined by the European Union.

Myron's first assignment was in India and concerned exporting betel nuts to South and perhaps North America. It is estimated that more than 20 million people chew betel nuts in India alone. The betel nut is one of the world's most popular plants, and its leaf is used as a paper for rolling tobacco. The betel nut is also mashed or powdered with other ingredients and rolled up in a leaf and sold as candy. Myron quickly found that regular use of the betel nut, in time, stains the mouth, gums, and teeth a deep red, which in Asia is a positive quality. As Myron was learning more about the betel nut, he came across the following report from the People's Republic of China: "Studies show that the chewing of the spiced betel nut can lead to oral cancer. According to research, 88 percent of China's oral cancer patients are betel nut chewers. Also, people who chew betel nuts and smoke are 90 times more likely to develop oral cancer than nonusers." Myron found that the betel nut primarily affects the central nervous system. It increases respiration while decreasing the workload on the heart (a mild high). Myron also found that demand for it was starting to emerge in the United States as well as in other developed countries.

While Myron was working on the betel nut, David, Myron's boss, also wanted him to work on introducing khat (pronounced "cot") into Asia. Khat is a natural stimulant from a plant grown in East Africa and southern Arabia. Fresh khat leaves, which typically are chewed like tobacco, produce a mild cocaine- or amphetamine-like euphoria. However, the effect is much less intense than that produced by either of those substances, with no reports of a rush sensation or paranoia, for example. Chewing khat produces a strong

aroma and generates intense thirst. Casual users claim that khat lifts spirits, sharpens thinking, and, when its effects wear off, generates mild lapses into depression similar to those observed among cocaine users. The body appears to have a physical intolerance to khat due in part to limitations in how much can be ingested by chewing. As a result, reports suggest that there are no physical symptoms accompanying withdrawal. Advocates of khat use claim that it eases symptoms of diabetes, asthma, and disorders of the stomach and the intestinal tract. Opponents claim that khat damages health, suppresses appetite, and prevents sleep. In the United States, khat has been classified as a schedule IV substance by the Drug Enforcement Agency (DEA): freshly picked khat leaves (that is, within 48 hours of harvest) are classified as a schedule I narcotic, the most restrictive category used by the DEA.

After doing his research, Myron delivered his report to David and said, "I really think that, given the right marketing to some of the big pharmaceutical companies, we should have two huge revenue makers."

"That's great, Myron, but the pharmaceutical market is only secondary to our primary market—the two billion consumers to whom we can introduce these products."

"What do you mean, David?" Myron asked.

"I mean these products are grown legally around the world, and the countries that we are targeting have no restrictions on these substances," David explained. "Why not tailor the delivery of the product by country? For example, we find out which flavors people want the betel nut in, in North and South America or the Middle East. The packaging will have to change by country as well as branding. Pricing strategies will need to be developed relative to our branding decisions, and of course quantity usages will have to be calculated. For example, single, multiple, and super value sizes need to be explored. The same can be done for khat. Because of your research and your business background, I'm putting you on the marketing team for both. Of course, this means that you're going to have to be promoted and at least for a while live in Hong Kong. I know Quan will be excited. In fact, I told her the news this morning that she would be working on the same project in Hong Kong. Producto International tries to be sensitive to the dual-career family problems that can occur. Plus you'll be closer to relatives. I told Quan that with living allowances and all of the other things that go with international placement, you two should almost triple your salaries! You don't have to thank me, Myron. You've worked hard on these projects, and now you deserve to have some of the benefits."

Myron went back to his office to think about his and Quan's future. He had heard of another employee who had rejected a similar offer, and that person's career had languished at PI. Eventually, that individual left the industry, never to be heard from again.

QUESTIONS • EXERCISES

1. Identify the social responsibility issues in this scenario.
2. Discuss the advantages and disadvantages of each decision that Myron could make.
3. Discuss the issue of marketing products that are legal but have addictive properties associated with them.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

To understand the institutionalization of business ethics it is important to understand the voluntary and legally mandated dimensions of organizational practices. In addition, there are core practices sometimes called best practices that most responsible firms—trying to achieve acceptable conduct—embrace and

implement. The effective organizational practice of business ethics requires all three dimensions (legal, voluntary, and core practices) to be integrated into an ethics and compliance program. This creates an ethical culture that can effectively manage the risks of misconduct. Institutionalization relates to legal and societal forces that provide both rewards and punishment to organizations based on the stakeholder evaluations of specific conduct. Institutionalization in business ethics relates to established laws, customs, and expected organizational programs that are considered normative in establishing reputation. This means that deviations from expected conduct often are considered ethical issues and therefore concern stakeholders. Institutions provide requirements, structure, and societal expectations to reward and sanction ethical decision making.

In this chapter, we examine the boundaries of ethical conduct and focus on the voluntary, core practices, and mandated requirements for legal compliance—three important areas in developing an ethical culture. In particular, we concentrate on compliance in specific areas related to competition, consumers, safety, and the environment. We also consider the requirements of the Sarbanes–Oxley legislation and its implementation by the Securities and Exchange Commission (SEC) and how its implementation has affected companies. This chapter gives an overview of legislative and administrative actions taken to help the public maintain confidence in the financial system. We also provide an overview of the Federal Sentencing Guidelines for Organizations (FSGO) and give recommendations and incentives for developing an ethical corporate culture. The FSGO, the Sarbanes–Oxley Act, industry trade associations, and societal expectations support core practices. Finally, we examine philanthropic contributions and how strategic philanthropy can be an important core competency to manage stakeholder relationships.

MANAGING ETHICAL RISK THROUGH MANDATED AND VOLUNTARY PROGRAMS

Table 4–1 provides an overview of the three dimensions of institutionalization. **Voluntary practices** include the beliefs, values, and voluntary contractual obligations of a business. All businesses engage in some level of commitment to voluntary activities to benefit both internal and external stakeholders. Google, Inc. works hard to give its employees a positive work environment through its benefits package. In addition to being a famously great place to work, Google offices offer such health and wellness-boosting amenities as swimming pools, gyms, volleyball courts, ping-pong tables and dance classes, the company even allows employees to bring their dogs to work.[1] Most firms engage in **philanthropy**—giving back to communities and causes.

Core practices are documented best practices, often encouraged by legal and regulatory forces as well as industry trade associations. The **Better Business Bureau** is a leading self-regulatory body that provides directions for managing customer disputes and reviews advertising cases. These practices are appropriate and common practices that help ensure compliance with legal requirements and societal expectations. Although these practices are not enforced, there are consequences for not engaging in these practices when there is misconduct. For example, the Federal Sentencing Guidelines for Organizations (FSGO) suggest that the governing authority (board of directors) be

TABLE 4–1 Voluntary Boundary, Core Practices, and Mandated Boundaries of Ethical Decisions

Voluntary boundary	**A management-initiated boundary of conduct (beliefs, values, voluntary policies, and voluntary contractual obligations)**
Core practice	**A highly appropriate and common practice that helps ensure compliance with legal requirements, industry self-regulation, and societal expectations**
Mandated boundary	**An externally imposed boundary of conduct (laws, rules, regulations, and other requirements)**

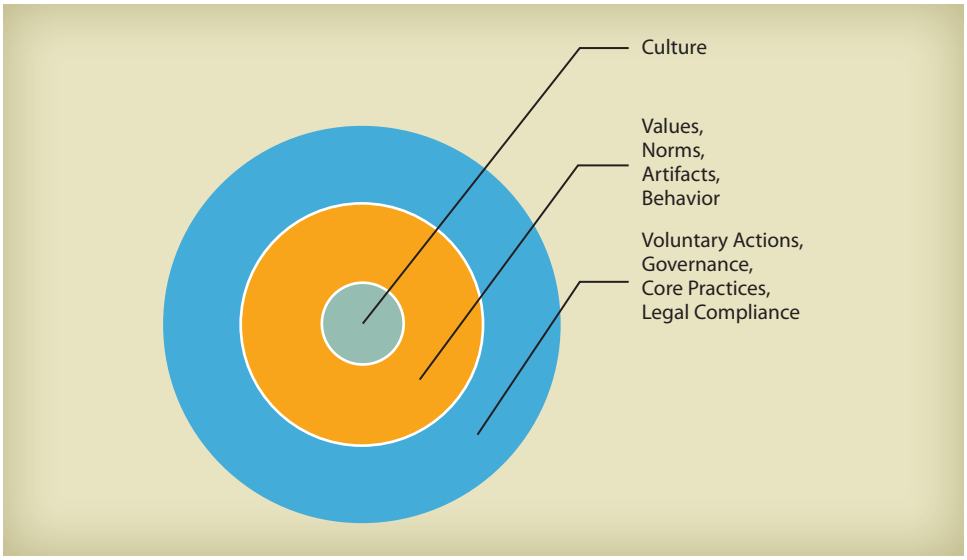
Source: Adapted from the "Open Compliance Ethics Group (OCEG) Foundation Guidelines," v1.0, Steering Committee Update, December 2005, Phoenix, AZ.

responsible for and assess an organization's ethical and compliance activities. There is no required reporting of investigations by government regulatory bodies, but there are incentives to the firm that effectively implement this recommendation. If misconduct occurs, there may be opportunities to avoid serious punishment. On the other hand, if there has been no effort by the board to oversee ethics and compliance, this could increase and compound the level of punishment. In this way, the government in institutionalizing core practices provides organizations the opportunity to take their own approach and only takes action if there are violations. **Mandated boundaries** are the externally imposed boundaries of conduct, such as laws, rules, regulations, and other requirements. Antitrust and consumer protection laws create boundaries that must be respected by companies.

There is a need to maintain an ethical culture, and to manage stakeholder expectations for appropriate conduct in an organization. This is achieved through corporate governance compliance, risk management, and voluntary activities. The development of these drivers of an ethical culture has been institutionally supported by government initiatives and the demands of stakeholders. The compliance element represents areas that must conform to existing legal and regulatory requirements. Established laws and regulatory decisions leave limited flexibility to organizations in adhering to these standards. Corporate governance (as discussed in Chapter 2) is structured by a governing authority providing oversight as well as checks and balances to make sure that the organization meets its goals and objectives for ethical performance. Risk management analyzes the probability or chance that misconduct could occur based on the nature of the business and the exposure to risky events. Voluntary activities often represent the values and responsibilities that firms accept in contributing to stakeholder needs and expectations.

Figure 4–1 depicts the key elements of an organizational culture. The elements include values, norms, artifacts, and behavior. An ethical culture creates an environment in which to structure behavior that is then evaluated by stakeholders. Values are broad and are viewed as long-term enduring beliefs about issues such as integrity, trust, openness, diversity, and individual respect and responsibility. Norms dictate and clarify desirable behaviors through principles, rules, policies, and procedures. For example, norms could provide guiding principles for antibribery issues, sustainability, and conflicts of interest. Artifacts are visible, tangible external symbols of values and norms. Websites, codes of ethics, rituals, language, and physical settings are artifacts. These three elements have different impacts on behaviors. For example, norms prescribe specific behaviors in certain situations. Organizational decisions on such issues as governance, core practices, and legal compliance help shape the ethical culture.

FIGURE 4–1 Elements of an Ethical Culture

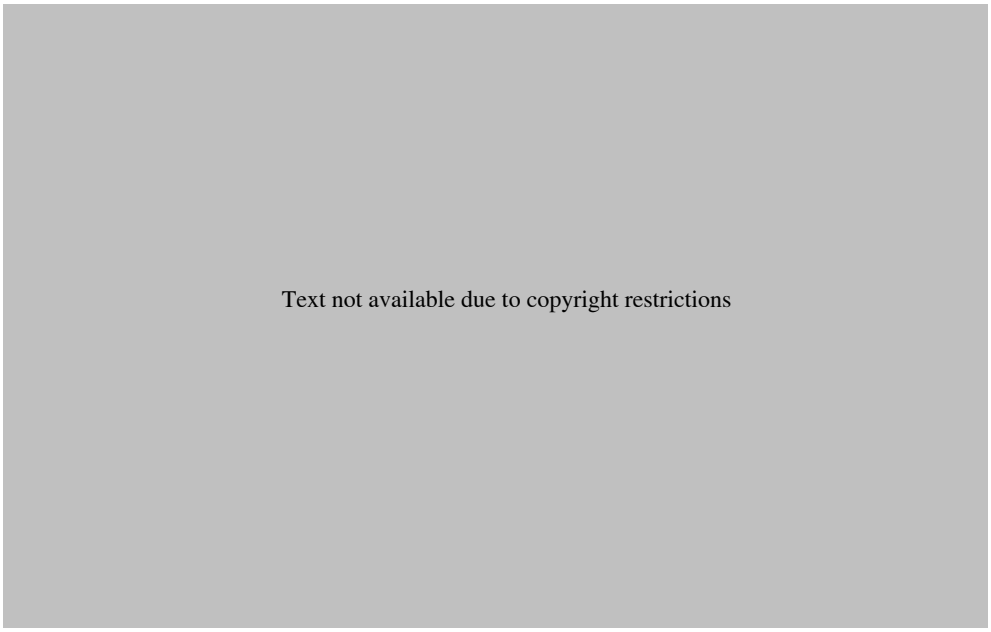


MANDATED REQUIREMENTS FOR LEGAL COMPLIANCE

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Laws regulating business conduct are passed because certain stakeholders believe that business cannot be trusted to do what is right in certain areas, such as consumer safety and environmental protection. Because public policy is dynamic and often changes in response to business abuses and consumer demands for safety and equality, many laws have been passed to resolve specific problems and issues. But the opinions of society, as expressed in legislation, can change over time, and different courts or state legislatures may take diverging views. For example, the thrust of most business legislation can be summed up as follows: Any practice is permitted that does not substantially lessen or reduce competition or harm consumers or society. Courts differ, however, in their interpretations of what constitutes a "substantial" reduction of competition. Laws can help businesspeople determine what society believes at a certain time, but what is legally wrong today may be perceived as acceptable tomorrow, and vice versa. After generations of fame for its top-secret bank accounts, Swiss banks have been forced to disclose information about some of their clients. The rules are changing, however, and countries like Switzerland, Liechtenstein, and Luxembourg now must share information on potential tax dodgers with government agencies like the Internal Revenue Service. One bank alone, UBS, may harbor the secret bank accounts of 52,000 American tax dodgers.[2] However, personal views on legal and illegal activity in this area vary tremendously and explain why accounting firms struggle to advise.[3] Instructions to employees to "just obey the law" are meaningless without effective training and experience in dealing with specific legal risk areas.

Laws are categorized as either civil or criminal. **Civil law** defines the rights and duties of individuals and organizations (including businesses). **Criminal law** not only prohibits specific actions—such as fraud, theft, or securities trading violations—but also imposes fines or imprisonment as punishment for breaking the law. The primary difference between criminal and civil law is that the state or nation enforces criminal laws, whereas individuals (generally, in court) enforce civil laws. Criminal and civil laws are derived from four sources: the U.S. Constitution (constitutional law), precedents established by judges (common law), federal and state laws or statutes (statutory law), and federal and state administrative agencies (administrative law). Federal administrative agencies established by Congress control and influence business by enforcing laws and regulations to encourage competition and to protect consumers, workers, and the environment. State laws and regulatory agencies also exist to achieve these objectives. Amid the fallout from the subprime mortgage and Wall Street financial sector crises, the Securities and Exchange Commission CEO, Mary Schapiro, moved quickly to try to fill in regulatory gaps to prevent further financial crises and bank failures.[4]

The primary method of resolving conflicts and serious business ethics disputes is through lawsuits in which one individual or organization uses civil laws to take another individual or organization to court. To avoid lawsuits and to maintain the standards necessary to reduce risk and create an ethical culture, it is necessary to have both legal and organizational standards enforced. When violations of organizational standards occur, the National Business Ethics Survey (NBES) notes that many employees do not feel that their company has a strong ethics program. In fact, Figure 4–2 demonstrates that only 25 percent of companies in the United States have a well-implemented ethics program. A full 30 percent of companies do not have any ethics program at all to speak of, a serious



problem in this age of misconduct and ethical violations. It is important for a company to have a functioning program in place long before an ethical disaster strikes.

The role of laws is not so much to distinguish what is ethical or unethical as to determine the appropriateness of specific activities or situations. In other words, laws establish the basic ground rules for responsible business activities. Most of the laws and regulations that govern business activities fall into one of five groups: (1) regulation of competition, (2) protection of consumers, (3) promotion of equity and safety, (4) protection of the natural environment, and (5) incentives to encourage organizational compliance programs to deter misconduct, which we examine later.

Laws Regulating Competition

The issues surrounding the impact of competition on business's social responsibility arise from the rivalry among businesses for customers and profits. When businesses compete unfairly, legal and social responsibility issues can result. Intense competition sometimes makes managers feel that their company's very survival is threatened. In these situations, managers may begin to see unacceptable alternatives as acceptable, and they may begin engaging in questionable practices to ensure the survival of their organizations. Both Intel and Microsoft have been hit with fines amounting to billions of dollars for alleged antitrust activity in Europe, where the companies have been accused of engaging in behavior that prevents smaller companies from competing. The European Union is famous for being tough on companies suspected of antitrust cases, although being aware of antitrust laws is important for all large corporations around the world.

Size frequently gives some companies an advantage over others. For example, large firms can often generate economies of scale (for example, by forcing their suppliers to lower their prices) that allow them to put smaller firms out of business. Consequently, small companies and even whole communities may resist the efforts of firms like Wal-Mart, Home Depot, and Best Buy to open stores in their vicinity. These firms' sheer size enables them to operate at such low costs that small, local firms often cannot compete. Some companies' competitive strategies may focus on weakening or destroying a competitor, which can harm competition and ultimately reduce consumer choice. When the Chinese government mandated that all computers must be equipped with web-filtering software, lawyers and academics promptly challenged the law. They claimed that the software could be used to filter other content as well, such as political content the government deems unfavorable. They also worried that the measure was anticompetitive because it would favor two companies selected by the government in a nontransparent way to produce the software.[5] Other examples of anticompetitive strategies include sustained price cuts, discriminatory pricing, and price wars. The primary objective of U.S. antitrust laws is to distinguish competitive strategies that enhance consumer welfare from those that reduce it. The difficulty of this task lies in determining whether the intent of a company's pricing policy is to weaken or even destroy a competitor.[6] President Obama has promised to be tough on antitrust violations, and followed through by reversing a Bush-era policy that made it more difficult for the government to pursue antitrust violations. The Bush administration brought an historically low number of antitrust cases to trial.[7] President Obama plans to follow Europe's model for antitrust cases, which marks a return to a historic norm after eight years of Bush's noninterventionism.[8] Intense competition may also lead companies to resort to corporate espionage. Corporate espionage is the act of illegally taking information from a corporation through computer hacking, theft, intimidation, sorting through trash, and through impersonation of

organizational members. Estimates show corporate espionage may cost companies nearly $50 billion annually. Unauthorized information collected includes patents in development, intellectual property, pricing strategies, customer information, unique manufacturing and technological operations, as well as marketing plans, research and development, and future plans for market and customer expansion.[9] Determining an accurate amount for losses is difficult because most companies do not report such losses for fear that the publicity will harm their stock price or encourage further break-ins. Espionage may be carried out by outsiders or by employees—executives, programmers, network or computer auditors, engineers, or janitors who have legitimate reasons to access facilities, data, computers or networks. They may use a variety of techniques for obtaining valuable information such as dumpster diving, whacking, and hacking as discussed in Chapter 3.

Laws have been passed to prevent the establishment of monopolies, inequitable pricing practices, and other practices that reduce or restrict competition among businesses. These laws are sometimes called **procompetitive legislation** because they were enacted to encourage competition and prevent activities that restrain trade (Table 4–2). The Sherman Antitrust Act of 1890, for example, prohibits organizations from holding monopolies in their industry, and the Robinson–Patman Act of 1936 bans price discrimination between retailers and wholesalers.

In law, however, there are always exceptions. Under the McCarran–Ferguson Act of 1944, for example, Congress exempted the insurance industry from the Sherman Antitrust Act and other antitrust laws. Insurance companies were allowed to join together and set insurance premiums at specific industry-wide levels. However, this legal "permission" could still be viewed as irresponsible and unethical if it neutralizes competition and if prices no longer reflect the true costs of insurance protection. This illustrates the point that what is legal is not always considered ethical by some interest groups. Even Major League Baseball has an antitrust exemption dating back to 1922. MLB is the only major sport that has such a sweeping antitrust exemption, although the major effect it has on the game these days is that sports teams cannot relocate without MLB's permission.[10]

Laws Protecting Consumers

Laws that protect consumers require businesses to provide accurate information about products and services and to follow safety standards (Table 4–3). The first **consumer protection law** was passed in 1906, partly in response to a novel by Upton Sinclair. *The Jungle* describes, among other things, the atrocities and unsanitary conditions of the meatpacking industry in turn-of-the-century Chicago. The outraged public response to this book and other exposés of the industry resulted in the passage of the Pure Food and Drug Act. Likewise, Ralph Nader had a tremendous impact on consumer protection laws with his book *Unsafe at Any Speed*. His critique and attack of General Motors' Corvair had far-reaching effects on autos and other consumer products. Other consumer protection laws emerged from similar processes.

Large groups of people with specific vulnerabilities have been granted special levels of legal protection relative to the general population. For example, the legal status of children and the elderly, defined according to age-related criteria, has received greater attention. American society has responded to research and documentation showing that young consumers and senior citizens encounter difficulties in the acquisition, consumption, and disposition of products. Special legal protection provided to vulnerable consumers is considered to be in the public interest.[11] For example, the Children's Online

TABLE 4–2 Laws Regulating Competition

Sherman Antitrust Act, 1890	Prohibits monopolies.
Clayton Act, 1914	Prohibits price discrimination, exclusive dealing, and other efforts to restrict competition.
Federal Trade Commission Act, 1914	Created the Federal Trade Commission (FTC) to help enforce antitrust laws.
Robinson–Patman Act, 1936	Bans price discrimination between retailers and wholesalers.
Wheeler–Lea Act, 1938	Prohibits unfair and deceptive acts regardless of whether competition is injured.
McCarran–Ferguson Act, 1944	Exempts the insurance industry from antitrust laws.
Lanham Act, 1946	Protects and regulates brand names, brand marks, trade names, and trademarks.
Celler–Kefauver Act, 1950	Prohibits one corporation from controlling another where the effect is to lessen competition.
Consumer Goods Pricing Act, 1975	Prohibits price maintenance agreements among manufacturers and resellers in interstate commerce.
FTC Improvement Act, 1975	Gives the FTC more power to prohibit unfair industry practices.
Antitrust Improvements Act, 1976	Strengthens earlier antitrust laws—Justice Department has more investigative authority.
Trademark Counterfeiting Act, 1980	Provides penalties for individuals dealing in counterfeit goods.
Trademark Law Revision Act, 1988	Amends the Lanham Act to allow brands not yet introduced to be protected through patent and trademark registration.
Federal Trademark Dilution Act, 1995	Gives trademark owners the right to protect trademarks and requires them to relinquish those that match or parallel existing trademarks.
Digital Millennium Copyright Act, 1998	Refines copyright laws to protect digital versions of copyrighted materials, including music and movies.

Privacy Protection Act (COPPA) requires commercial Internet sites to carry privacy policy statements, obtain parental consent before soliciting information from children under the age of 13, and provide an opportunity to remove any information provided by children using such sites. Critics of COPPA argue that children age 13 and older should not be treated as adults on the Web. In a study of children ages 10 to 17, nearly half indicated that they would give their name, address, and other demographic information in exchange for a gift worth $100 or more. Internet safety among children is another major topic of concern. Research has shown that filtering and age verification are not effective in making the Internet safer—businesses, regulators, and parents are all trying to find answers in how to protect children from dangers ranging from online predators to pornography.[12]

TABLE 4–3 Laws Protecting Consumers

Pure Food and Drug Act, 1906	Prohibits adulteration and mislabeling of foods and drugs sold in interstate commerce.
Federal Hazardous Substances Labeling Act, 1960	Controls the labeling of hazardous substances for household use.
Truth in Lending Act, 1968	Requires full disclosure of credit terms to purchasers.
Consumer Product Safety Act, 1972	Created the Consumer Product Safety Commission to establish safety standards and regulations for consumer products.
Fair Credit Billing Act, 1974	Requires accurate, up-to-date consumer credit records.
Energy Policy and Conservation Act, 1975	Requires auto dealers to have "gas mileage guides" in their showrooms.
Consumer Goods Pricing Act, 1975	Prohibits price maintenance agreements.
Consumer Leasing Act, 1976	Requires accurate disclosure of leasing terms to consumers.
Fair Debt Collection Practices Act, 1978	Defines permissible debt collection practices.
Toy Safety Act, 1984	Gives the government the power to recall dangerous toys quickly.
Nutritional Labeling and Education Act, 1990	Prohibits exaggerated health claims and requires all processed foods to have labels showing nutritional information.
Telephone Consumer Protection Act, 1991	Establishes procedures for avoiding unwanted telephone solicitations.
Children's Online Privacy Protection Act, 1998	Requires the FTC to formulate rules for collecting online information from children under age 13.
Do Not Call Implementation Act, 2003	Directs the FCC and the FTC to coordinate so that their rules are consistent regarding telemarketing call practices including the Do Not Call Registry and other lists, as well as call abandonment.

Seniors are another highly vulnerable demographic. New laws have taken aim at financial scams on seniors, such as free lunch seminars. The state of Arkansas has taken the forefront on this issue, conducting police sweeps of suspected scams, increasing fines, and amending laws to imposed increased penalties for those who prey on the elderly. Older people are the most vulnerable group when it comes to financial scams, as they rely on their savings for retirement security.[13]

The role of the FTC's Bureau of Consumer Protection is to protect consumers against unfair, deceptive, or fraudulent practices. The bureau, which enforces a variety of consumer protection laws, is divided into five divisions. The Division of Enforcement monitors compliance with and investigates violations of laws, including unfulfilled holiday delivery promises by online shopping sites, employment opportunities fraud, scholarship scams, misleading advertising for health care products, high-tech and telemarketing fraud, data security, and financial practices.

TABLE 4–4 Laws Promoting Equity and Safety

Equal Pay Act of 1963	Prohibits discrimination in pay on the basis of sex.
Equal Pay Act of 1963 (amended)	Prohibits sex-based discrimination in the rate of pay to men and women working in the same or similar jobs.
Title VII of the Civil Rights Act of 1964 (amended in 1972)	Prohibits discrimination in employment on the basis of race, color, sex, religion, or national origin.
Age Discrimination in Employment Act, 1967	Prohibits discrimination in employment against persons between the ages of 40 and 70.
Occupational Safety and Health Act, 1970	Designed to ensure healthful and safe working conditions for all employees.
Title IX of Education Amendments of 1972	Prohibits discrimination based on sex in education programs or activities that receive federal financial assistance.
Vocational Rehabilitation Act, 1973	Prohibits discrimination in employment because of physical or mental handicaps.
Vietnam Era Veterans Readjustment Act, 1974	Prohibits discrimination against disabled veterans and Vietnam War veterans.
Pension Reform Act, 1974	Designed to prevent abuses in employee retirement, profit-sharing, thrift, and savings plans.
Equal Credit Opportunity Act, 1974	Prohibits discrimination in credit on the basis of sex or marital status.
Age Discrimination Act, 1975	Prohibits discrimination on age in federally assisted programs.
Pregnancy Discrimination Act, 1978	Prohibits discrimination on the basis of pregnancy, childbirth, or related medical conditions.
Immigration Reform and Control Act, 1986	Prohibits employers from knowingly hiring a person who is an unauthorized alien.
Americans with Disabilities Act, 1990	Prohibits discrimination against people with disabilities and requires that they be given the same opportunities as people without disabilities.
Civil Rights Act of 1991	Provides monetary damages in cases of intentional employment discrimination.

Laws Promoting Equity and Safety

Laws promoting equity in the workplace were passed during the 1960s and 1970s to protect the rights of minorities, women, older persons, and persons with disabilities; other legislation has sought to protect the safety of all workers (Table 4–4). Of these laws, probably the most important to business is Title VII of the Civil Rights Act, originally passed in 1964 and amended several times since. Title VII specifically prohibits discrimination in employment on the basis of race, sex, religion, color, or national origin. The Civil Rights Act also created the Equal Employment Opportunity Commission (EEOC) to help enforce the provisions of Title VII. Among other things, the EEOC helps businesses design affirmative action

programs. These programs aim to increase job opportunities for women and minorities by analyzing the present pool of employees, identifying areas where women and minorities are underrepresented, and establishing specific hiring and promotion goals, along with target dates for meeting those goals.

Other legislation addresses more specific employment practices. The Equal Pay Act of 1963 mandates that women and men who do equal work must receive equal pay. Wage differences are allowed only if they can be attributed to seniority, performance, or qualifications. The Americans with Disabilities Act of 1990 prohibits discrimination against people with disabilities. Despite these laws, inequities in the workplace still exist. According to the U.S. Women's Bureau and National Committee on Pay Equity, women earn 77.8 percent of what men earn.[14] The disparity in wages is even higher for African American, Hispanic, and older women.

Congress has also passed laws that seek to improve safety in the workplace. By far the most significant of these is the Occupational Safety and Health Act of 1970, which mandates that employers provide safe and healthy working conditions for all workers. The **Occupational Safety and Health Administration** (OSHA), which enforces the act, makes regular surprise inspections to ensure that businesses maintain safe working environments.

Even with the passage and enforcement of safety laws, many employees still work in unhealthy or dangerous environments. Safety experts suspect that companies underreport industrial accidents to avoid state and federal inspection and regulation. The current emphasis on increased productivity has been cited as the main reason for the growing number of such accidents. Competitive pressures are also believed to lie behind the increases in manufacturing injuries. Greater turnover in organizations due to downsizing means that employees may have more responsibilities and less experience in their current positions, thus increasing the potential for accidents. The airline industry has become a prime example of tough economic times resulting in overworked, under-trained employees. Many pilots receive low compensation, poor health benefits, and are forced to work long hours—all factors that may have played a part in a tragic crash in Buffalo, New York, in February 2009 that killed all 49 people on board and one person on the ground. Even esteemed Captain Sully Sullenberger, who safely landed a plane on the Hudson River in January 2009 after colliding with some geese, confessed that his pay had been cut 40 percent. Because the industry cannot pay for the best and the brightest, such important factors as experience and skill are less important when hiring new pilots.[15]

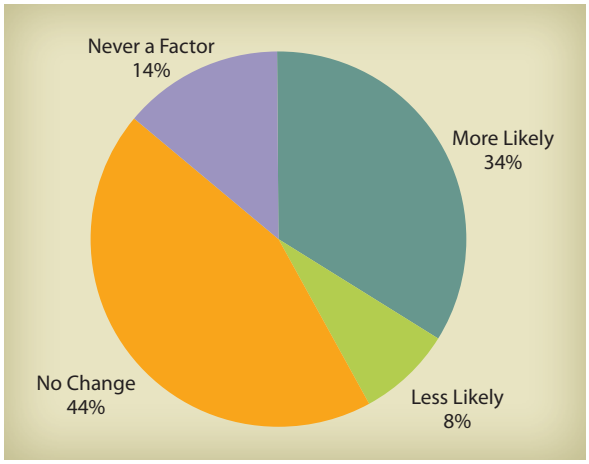
Laws Protecting the Environment

Environmental protection laws have been enacted largely in response to concerns over business's impact on the environment, which began to emerge in the 1960s. **Sustainability** has become a buzzword in recent years, yet many people may not even think about what it means. According to the UN's World Commission on the Environment and Development, sustainable means "meeting the present needs without compromising future generations to meet their own needs."[16] The environment and sustainability are more important topics than ever. Thirty-five percent of people say that they are more interested in environmental issues and expect companies to be more environmentally responsible than they used to be.[17] Consumer interest in sustainability is so great that many firms have even made being green a competitive issue. For example, General Electric and Siemens, two large technology companies, are fighting via their advertisements and reports for title of greenest company. GE has an Ecomagination report that allows consumers to see all the green measures it has

taken. Siemens, on the other hand, claims that it has a much larger environmental report yet has been annoyed by the lack of attention it has received for its actions.[18]

Many people have questioned the cost–benefit analyses often used in making business decisions. Such analyses try to take into account all factors in a situation, represent them with dollar figures, calculate the costs and benefits of the proposed action, and determine whether an action's benefits outweigh its costs. The problem, however, is that it is difficult to arrive at an accurate monetary valuation of environmental damage or physical pain and injury. In addition, people outside the business world often perceive such analyses as inhumane. Figure 4–3 indicates that most consumers view environmental responsibility to be important, even during a recession. In addition, 70 percent of Americans now say that they pay attention to companies' stances toward the environment, even if they cannot afford to buy their products or services.[19]

FIGURE 4–3 Shopping for Environmentally Friendly Products in a Recession



Source: 2009 Cone Consumer Environmental Survey of 1,087 adults, January 29–30.

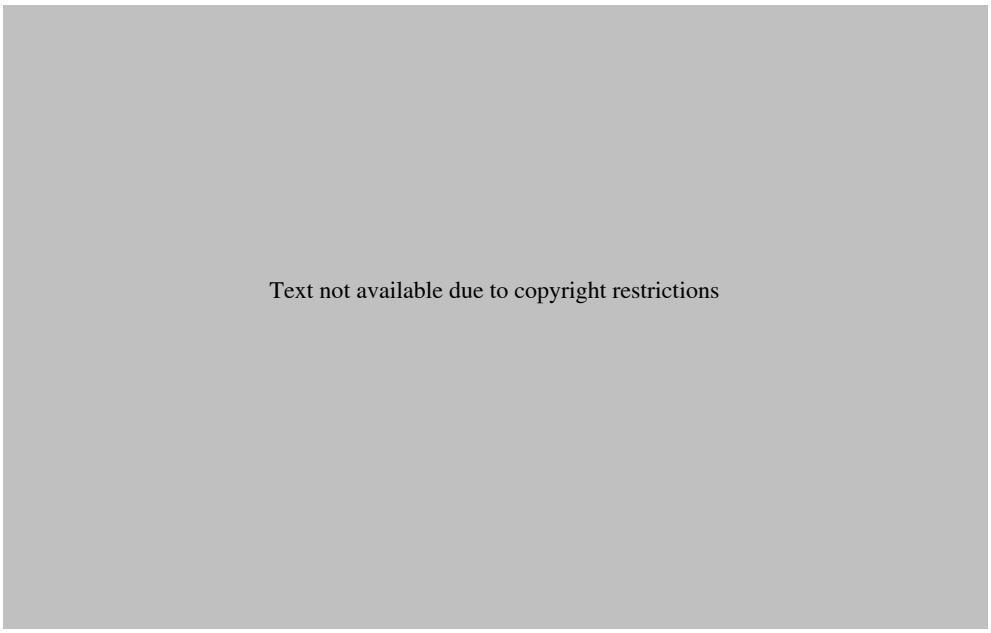
The **Environmental Protection Agency** (EPA) was created in 1970 to coordinate environmental agencies involved in enforcing the nation's environmental laws. The major area of environmental concern relates to air, water, and land pollution. Large corporations are being encouraged to establish pollution-control mechanisms and other policies favorable to the environment. Otherwise, these companies could deplete resources and damage the health and welfare of society by focusing only on their own economic interests. For example, 3M voluntarily stopped making Scotchguard, a successful product for 40 years with $300 million in sales, after tests showed that it did not decompose in the environment.[20]

Increases in toxic waste in the air and water, as well as noise pollution, have prompted the passage of a number of laws (Table 4–5). Many environmental protection laws have resulted in the elimination or modification of goods and services. For instance, leaded gasoline was phased out during the 1990s by the EPA because catalytic converters, which reduce pollution caused by automobile emissions and are required by law on most vehicles, do not work properly with leaded gasoline. Increased Corporate Average Fuel Economy (or CAFE) standards are forcing companies to figure out ways for their cars to get better gas mileage. For many carmakers, a major part of this strategy involves increased production and sales of hybrid vehicles, as well as improving electric car and hydrogen fuel-cell technology.

The harmful effects of toxic waste on water life and on leisure industries such as resorts and fishing have raised concerns about proper disposal of these wastes. Few disposal sites meet EPA standards, so businesses must decide what to do with their waste until disposal sites become available. Some firms have solved this problem by illegal or unethical measures: dumping toxic wastes along highways, improperly burying drums containing toxic chemicals, and discarding hazardous waste at sea. For example, a five-year investigation found that ships owned by Royal Caribbean Cruises Ltd. used "secret bypass pipes" to dump waste oil and hazardous materials overboard, often at night. Justice Department officials accused the company of dumping to save the expense of properly disposing of waste at the same time that the cruise line was promoting itself as environmentally

TABLE 4–5 Laws Protecting the Environment

Clean Air Act, 1970	Established air-quality standards; requires approved state plans for implementation of the standards.
National Environmental Policy Act, 1970	Established broad policy goals for all federal agencies; created the Council on Environmental Quality as a monitoring agency.
Coastal Zone Management Act, 1972	Provides financial resources to the states to protect coastal zones from overpopulation.
Federal Water Pollution Control Act, 1972	Designed to prevent, reduce, or eliminate water pollution.
Noise Pollution Control Act, 1972	Designed to control the noise emission of certain manufactured items.
Federal Insecticide, Fungicide and Rodenticide Act, 1972	Provides federal control of pesticide distribution, sale, and use.
Endangered Species Act, 1973	Provides a program for the conservation of threatened and endangered plants and animals and the habitats in which they are found
Safe Drinking Water Act, 1974	Established to protect the quality of drinking water in the United States; focused on all waters actually or potentially designed for drinking use, whether from aboveground or underground sources; established safe standards of purity and required all owners or operators of public water systems to comply with primary (health-related) standards.
Toxic Substances Control Act, 1976	Requires testing and restricts use of certain chemical substances, to protect human health and the environment.
Resource Conservation and Recovery Act, 1976	Gives the EPA authority to control hazardous waste from the "cradle to grave"; includes the generation, transportation, treatment, storage, and disposal of hazardous waste, as well as a framework for the management of nonhazardous waste.
Comprehensive Environmental Response, Compensation, and Liability Act, 1980	Created a tax on chemical and petroleum industries and provides broad federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment.
Emergency Planning and Community Right-to-Know Act, 1986	The national legislation on community safety, designed to help local communities protect public health, safety, and the environment from chemical hazards.
Oil Pollution Act, 1990	Streamlined and strengthened the EPA's ability to prevent and respond to catastrophic oil spills; a trust fund financed by a tax on oil is available to clean up spills when the responsible party is incapable or unwilling to do so.
Pollution Prevention Act, 1990	Focuses industry, government, and public attention on reducing the amount of pollution through cost-effective changes in production, operation, and raw materials use.
Food Quality Protection Act, 1996	Amended the Federal Insecticide, Fungicide and Rodenticide Act and the Federal Food Drug and Cosmetic Act; the requirements included a new safety standard—reasonable certainty of no harm—that must be applied to all pesticides used on foods.



friendly. The company ultimately pleaded guilty to 21 felony counts, paid $27 million in fines, spent as much as $90,000 per vessel to install new oily water-treatment systems and placed an environmental officer on board each vessel.[21] Congress regularly evaluates legislation to increase the penalties for disposing of toxic wastes in this way. Disposal issues remain controversial because, although everyone acknowledges that the wastes must go somewhere, no community wants them dumped in its own backyard.

One solid-waste problem is the result of rapid innovations in computer hardware, which render machines obsolete after just 18 months. Today, hundreds of millions of computers have reached obsolescence, and tens of millions of these are expected to end up in landfills. Cell phones are another problem, with billions destined for landfills. Computers and cell phones both contain such toxic substances as lead, mercury, and polyvinyl chloride, which can leach into the soil and contaminate groundwater when disposed of improperly. While electronics recycling is not widespread, it has become increasingly available, as Figure 4–4 shows. Websites like electronicsrecycling.org help consumers find locations to recycle their phones and computers. The Environmental Protection Agency hosts its own electronics recycling program, which collects around 67 million pounds of electronics a year. Stores like Staples and Best Buy offer limited recycling programs, and companies like Dell and Samsung are all seeking to extend the availability of recycling for their products.[22]

GATEKEEPERS AND STAKEHOLDERS

Trust is the glue that holds businesses and their stakeholders together. Trust creates confidence and helps to forge relationships of reliance between businesses and stakeholders. Trust also allows businesses to depend upon one another as they make transactions or exchange value. Ethics helps create the foundational trust between two parties in a

transaction. There are many people who must trust and be trusted to make business work properly. Sometimes these parties are referred to as *gatekeepers*. Gatekeepers not only include accountants, who are essential to certifying the accuracy of financial information, but also lawyers, financial rating agencies, and even financial reporting services. All of these groups are critical in providing information that allows stakeholders to gain an understanding of the financial position of an organization. Most of these gatekeepers operate with professional codes of ethics and face legal consequences, or even disbarment, if they fail to operate within agreed-upon principles of conduct. Therefore, there is a strong need for gatekeepers to retain ethical standards and independence using standard methods and procedures that can be audited by other gatekeepers, the regulatory system, and investors.

Accountants

Accountants measure and disclose financial information, with an assurance of accuracy, to the public. Managers, investors, tax authorities, and other stakeholders who make resource allocation decisions are all groups who use the information provided by accountants. Accountants assume certain basic principles about their clients. One assumption is that the corporation is an entity that is separate and distinct from its owners, and that it will continue to operate as such in the future. Another assumption is that a stable monetary system (such as the dollar) is in place and that all necessary information concerning the business is available and presented in an understandable manner. Accountants have their own set of rules, one of which is that, if there is a choice between equally acceptable accounting methods, they should use the one that is least likely to overstate or misdirect. During the 2008–2009 financial meltdown, many people lost trust in accountants and auditors because a few made unscrupulous decisions.

> *Gatekeepers such as lawyers, financial rating agencies, and even financial reporting services must have high ethical standards.*

Some accountants have not been adhering to their responsibilities to stakeholders. For example, Arthur Andersen was once a standard bearer for integrity. But at Andersen, growth became the priority, and its emphasis on recruiting and retaining big clients came at the expense of quality and independent audits. The company linked its consulting business in a joint cooperative relationship with its audit arm, which compromised its auditors' independence, a quality crucial to the execution of a credible audit. The firm's focus on growth generated a fundamental change in its corporate culture, one in which obtaining high-profit consulting business was regarded as more important than providing objective auditing services. This situation presents a conflict of interest, and posed a problem when partners had to decide how to treat questionable accounting practices discovered at some of Andersen's largest clients. Ultimately, Arthur Andersen was dissolved because of its ties to the Enron scandal. Gatekeepers such as lawyers, financial rating agencies, and even financial reporting services must have high ethical standards. These groups must be trusted by all stakeholders, and most operate with professional codes of ethics.

Risk Assessment

Another critical gatekeeper group in the financial meltdown was risk assessors of financial products. The top three companies in the world that independently assess financial risks are Standard & Poor's, Moody's, and Fitch. They assess risk and express it through letters ranging from "AAA," which is the highest grade, to "C," which is junk. Different rating

services use the same letter grades, but use various combinations of upper- and lowercase letters to differentiate themselves.

As early as 2003, financial analysts and the three global rating firms suspected that there were some major problems with the way their models were assessing risk. In 2005, Standard & Poor's realized that its algorithm for estimating the risks associated with debt packages was flawed. As a result, it asked for comments on improving its equations. In 2006–2007 many governmental regulators and others started to realize what the rating agencies had known for years: Their ratings were not very accurate. One report stated that the high ratings given to debt were based on inadequate historical data and companies were ratings shopping between companies so as to obtain the best rating possible. It was found that investment banks were among some of the worst offenders, paying for ratings and therefore causing conflicts of interest. The amount of revenue these three companies annually receive is approximately $5 billion.

Further investigations uncovered many disturbing problems. First, Moody's, S&P's, and Fitch had all violated a code of conduct that required analysts to consider only credit factors, not "'the potential impact on Moody's, or an issuer, an investor or other market participant.'" Also, these companies had become overwhelmed by an increase in the volume and sophistication of the securities they were asked to review. Finally, analysts, faced with less time to perform the due diligence expected of them, began to cut corners.

SEC Chairman Mary Schapiro believes that the SEC must take more drastic measures to implement oversight for credit-rating firms—a group that was largely blamed for not catching risky activity in the financial sector sooner. Part of the problem, as Schapiro sees it, is that credit rating firms are paid by the securities that they rank. This creates a conflict of interest problem, and can affect the reliability of the ratings.[23] No organization is exempt from criticism over how transparent it is. While large financial firms have received most of the fury over risk taking and executive pay, even nonprofits are now being scrutinized more carefully.[24]

THE SARBANES–OXLEY ACT

In 2002, largely in response to widespread corporate accounting scandals, Congress passed the Sarbanes–Oxley Act to establish a system of federal oversight of corporate accounting practices. In addition to making fraudulent financial reporting a criminal offense and strengthening penalties for corporate fraud, the law requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reporting to investors and other stakeholders.

Supported by both Republicans and Democrats, the Sarbanes–Oxley Act was enacted to restore stakeholder confidence after accounting fraud at Enron, WorldCom, and hundreds of other companies resulted in investors and employees losing much of their savings. During the resulting investigations, the public learned that hundreds of corporations had not reported their financial results accurately. Many stakeholders came to believe that accounting firms, lawyers, top executives, and boards of directors had developed a culture of deception to ensure investor approval and gain competitive advantage. Many boards failed to provide appropriate oversight of the decisions of their companies' top officers. At Adelphia Communications, for example, the Rigas family amassed $3.1 billion in off-balance-sheet loans backed by the company. Dennis Kozlowski, CEO of Tyco, was accused of improperly using corporate funds for personal use as well as fraudulent accounting practices.[25] At Kmart, CEO Charles Conaway allegedly hired unqualified executives and consultants for excessive fees. Kmart's board also approved $24 million in loans to various executives, just a month before the retailer filed

for Chapter 11 bankruptcy protection. Conaway and the other executives have since left the company or were fired. Loans of this type are now illegal under the Sarbanes–Oxley Act.[26]

As a result of public outrage over the accounting scandals, the Sarbanes–Oxley Act garnered nearly unanimous support not only in Congress but also by government regulatory agencies, the president, and the general public. When President George W. Bush signed the Sarbanes–Oxley Act into law, he emphasized the need for new standards of ethical behavior in business, particularly among the top managers and boards of directors responsible for overseeing business decisions and activities.

At the heart of the Sarbanes–Oxley Act is the **Public Company Accounting Oversight Board,** which monitors accounting firms that audit public corporations and establishes standards and rules for auditors in accounting firms. The law gave the board investigatory and disciplinary power over auditors and securities analysts who issue reports about corporate performance and health. The law attempts to eliminate conflicts of interest by prohibiting accounting firms from providing both auditing and consulting services to the same client companies without special permission from the client firm's audit committee; it also places limits on the length of time lead auditors can serve a particular client.Table 4–6 summarizes the significant provisions of the law.

TABLE 4–6 Major Provisions of the Sarbanes–Oxley Act

1.	**Requires the establishment of a Public Company Accounting Oversight Board in charge of regulations administered by the SEC.**
2.	**Requires CEOs and CFOs to certify that their companies' financial statements are true and without misleading statements.**
3.	**Requires that corporate board of directors' audit committees consist of independent members who have no material interests in the company.**
4.	**Prohibits corporations from making or offering loans to officers and board members.**
5.	**Requires codes of ethics for senior financial officers; code must be registered with the SEC.**
6.	**Prohibits accounting firms from providing both auditing and consulting services to the same client without the approval of the client firm's audit committee.**
7.	**Requires company attorneys to report wrongdoing to top managers and, if necessary, to the board of directors; if managers and directors fail to respond to reports of wrongdoing, the attorney should stop representing the company.**
8.	**Mandates "whistle-blower protection" for persons who disclose wrongdoing to authorities.**
9.	**Requires financial securities analysts to certify that their recommendations are based on objective reports.**
10.	**Requires mutual fund managers to disclose how they vote shareholder proxies, giving investors information about how their shares influence decisions.**
11.	**Establishes a ten-year penalty for mail/wire fraud.**
12.	**Prohibits the two senior auditors from working on a corporation's account for more than five years; other auditors are prohibited from working on an account for more than seven years. In other words, accounting firms must rotate individual auditors from one account to another from time to time.**

TABLE 4–7 Benefits of the Sarbanes–Oxley Act

1.	**Greater accountability of top managers and boards of directors to employees, investors, communities, and society**
2.	**Renewed investor confidence**
3.	**Clear explanations by CEOs as to why their compensation package is in the best interest of the company; the loss of some traditional senior-management perks such as company loans; greater disclosures by executives about their own stock trades**
4.	**Greater protection of employee retirement plans**
5.	**Improved information from stock analysts and rating agencies**
6.	**Greater penalties for and accountability of senior managers, auditors, and board members**

The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles. For instance, the law requires top managers to certify that their firms' financial reports are complete and accurate, making CEOs and CFOs personally accountable for the credibility and accuracy of their companies' financial statements. Similar provisions are required of corporate boards of directors, especially audit committees, and senior financial officers are now subject to a code of ethics that addresses their specific areas of risk. Additionally, the law modifies the attorney–client relationship to require lawyers to report wrongdoing to top managers and/or the board of directors. It also provides protection for "whistle-blowing" employees who might report illegal activity to authorities. These provisions provide internal controls to make managers aware of and responsible for legal and ethical problems. Table 4–7 summarizes the benefits of the legislation.

On the other hand, the Sarbanes–Oxley Act has raised a number of concerns. The complex law may impose burdensome requirements on executives; the rules and regulations already run to thousands of pages. Some people also believe that the law will not be sufficient to stop those executives who want to lie, steal, manipulate, or deceive. They believe that a deep commitment to managerial integrity, rather than additional rules and regulations, are the key to solving the current crisis in business.[27] Additionally, the new act has caused many firms to restate their financial reports to avoid penalties. Big public companies spent thousands of hours and an average of $4.4 million each annually to make sure that someone was looking over the shoulder of key accounting personnel at every step of every business process, according to Financial Executives International. Section 404 is a core provision of the 2002 corporate reform law. The number of companies that disclosed serious chinks in their internal accounting controls jumped to more than 586 in 2005 compared to 313 in 2004.[28]

Public Company Accounting Oversight Board

The Sarbanes–Oxley Act establishes an oversight board to oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies. Their duties include (1) registration of public accounting firms; (2) establishment of auditing, quality control, ethics, independence, and other standards relating to preparation of audit reports; (3) inspection of accounting firms; (4) investigations, disciplinary proceedings,

and imposition of sanctions; and (5) enforcement of compliance with accounting rules of the board, professional standards, and securities laws relating to the preparation and issuance of audit reports and obligations and liabilities of accountants.

The board reports to the SEC on an annual basis that includes any new established rules and any final disciplinary rulings. The board works with designated professional groups of accountants and other standard-setting advisory groups in establishing auditing, quality control, ethics, and independence rules.

Auditor and Analyst Independence

The Sarbanes–Oxley Act also seeks to eliminate conflicts of interest among auditors, security analysts, brokers, and dealers and the public companies they serve in order to ensure enhanced financial disclosures of public companies' true condition. To accomplish auditor independence, Section 201 of the act no longer allows registered public accounting firms to provide both non-audit and audit services to a public company. National securities exchanges and registered securities associations have already adopted similar conflict-of-interest rules for security analysts, brokers, and dealers, who recommend equities in research reports. The face of Wall Street is experiencing major changes. In early 2003, 10 of the nation's largest securities firms agreed to pay a record $1.4 billion to settle government charges involving abuse of investors during the stock market bubble of the late 1990s. Wall Street firms routinely issued overly optimistic stock research to investors in order to gain favor with corporate clients and win their lucrative investment-banking business.

Enhanced Financial Disclosures

With independence, the Sarbanes–Oxley Act is better able to ensure compliance with the enhanced financial disclosures of public companies' true condition. For example, registered public accounting firms are now required to identify all material correcting adjustments to reflect accurate financial statements. Also, all material off-balance-sheet transactions and other relationships with unconsolidated entities that affect current or future financial conditions of a public company must be disclosed in each annual and quarterly financial report. In addition, public companies must also report "on a rapid and current basis" material changes in the financial condition or operations.

Whistle-Blower Protection

Employees of public companies and accounting firms, in general, are also accountable to report unethical behavior. The Sarbanes–Oxley Act intends to motivate employees through whistle-blower protection that would prohibit the employer from taking certain actions against employees who lawfully disclose private employer information to, among others, parties in a judicial proceeding involving a fraud claim. Whistle-blowers are also granted a remedy of special damages and attorneys' fees. Two years after the act, the SEC received approximately 40,000 whistle-blowing reports per month, compared with 6,400 per month in 2001.[29] With only 11,000 publicly-traded companies in the United States, it seems that even though 75 percent of the whistle-blowing reports have no validity, there are still more whistle-blowing reports every month than the number of companies listed.[30]

Also, any act of retaliation that harms informants, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer

any truthful information relating to the commission or possible commission of any federal offense, will be fined and/or imprisoned for 10 years.

Corporate and Criminal Fraud Accountability

Title VIII of the Sarbanes–Oxley Act, Corporate and Criminal Fraud Accountability, makes the knowing destruction or creation of documents to "impede, obstruct or influence" any existing or contemplated federal investigation a felony. The White-Collar Crime Penalty Enhancements Act of 2002 increased the maximum penalty for mail and wire fraud from 5 to 10 years in prison. It also makes record tampering or otherwise impeding an official a crime. If necessary, the SEC could freeze extraordinary payments to directors, officers, partners, controlling persons, and agents of employees. The U.S. Sentencing Commission reviews sentencing guidelines for securities and accounting fraud.

The act may not prevent future Enron-type businesses from occurring. However, the act's uniqueness from past legislation is its perspective to mandate accountability from the many players in the "game of business," creating more explicit rules in playing fair. The act creates a foundation to strongly discourage wrongdoing and sets ethical standards of what's expected of American business.

Cost of Compliance

The national cost of compliance of the Sarbanes–Oxley Act is estimated at $1 million per $1.7 billion in revenues.

The national cost of compliance of the Sarbanes–Oxley Act is estimated at $1 million per $1.7 billion in revenues.[31] These costs come from internal costs, external costs, and auditor fees. In a survey by Financial Executives International, nearly all the respondents (94 percent) said that the costs of compliance exceeded the benefits.[32] This act has increased external auditing costs for mid- to large-size companies between 52 and 81 percent. The section that has caused the most cost for companies has been compliance with Section 404. Section 404 has three central issues: It requires that (1) management create reliable internal financial controls, (2) that management attest to the reliability of those controls and the accuracy of financial statements that result from those controls, and (3) that an independent auditor further attests to the statements made by management. Section 404 requires companies to document both the results of financial transactions and the processes they have used to generate them. A company may have thousands of processes that may work, but they have never been written down. Writing down the processes is time consuming and costly.[33] Also, because the cost of compliance is so high for many small companies, some publicly-traded companies are even considering delisting themselves from the U.S. Stock Exchange. Companies based outside the United States have also been weighing the costs of compliance versus the savings of deregistration. Sweden-based Electrolux was among the first to delist from NASDAQ after the Sarbanes–Oxley Act was passed. Many new non-U.S. companies may be avoiding the U.S. market altogether. New listings with the SEC from companies outside the United States have dropped to almost zero since the act passed in 2002.[34] After years of complaints from firms, in spring 2009 the Supreme Court agreed to hear arguments over the constitutionality of

Sarbanes–Oxley, which has gained new critics as it failed to detect wrongdoing that led to the subprime mortgage crisis and the meltdown on Wall Street in 2008–2009.[35]

However, there are some cases where companies are benefiting from the act's implementation. Apart from the obvious increase in books and materials to help people comply with the act, there is also a growing business for people teaching and implementing ethics programs and hotlines for organizations. Companies such as Global Compliance and EthicsPoint have grown rapidly as companies seek to learn ethics, and a vast new industry of consultants and suppliers has emerged.[36] Other benefits and savings have come in the form of increased efficiency as companies such as Pitney Bowes Inc. find that they can meld various units such as combining four accounts receivable offices into one, saving more than $500,000 a year. At Genentech Inc., simply having detailed reports on financial controls sped up installation, by several months, of a new computer system that consolidates financial data, which meant that it was running months ahead of schedule. The new system allows managers to analyze data from customers rather than just collecting it. Cisco spent $50 million and 240,000 hours on its first-year audit of internal controls. The mind-numbing effort revealed opportunities to streamline steps for ordering products and services, making it easier for customers to do business with Cisco. It forced them to make sure that sales and support were integrated when a customer called, resulting in one-stop shopping for its customers. Other companies have been able to streamline steps for ordering products and services, making it easier for customers to do business with them.[37]

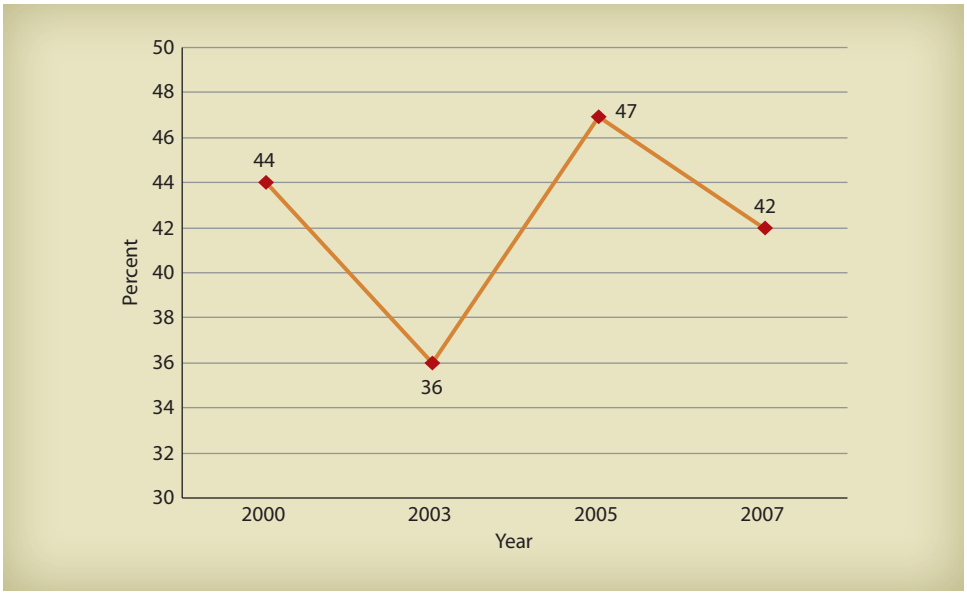
LAWS THAT ENCOURAGE ETHICAL CONDUCT

Violations of the law usually begin when businesspeople stretch the limits of ethical standards, as defined by company or industry codes of conduct, and then choose to engage in schemes that knowingly or unwittingly violate the law. In recent years, new laws and regulations have been passed to discourage such decisions—and to foster programs designed to improve business ethics and social responsibility (Table 4–8). The most important of these are the Federal Sentencing Guidelines for Organizations (FSGO) and the Sarbanes–Oxley Act. One of the goals of both acts is to require employees to

TABLE 4–8 Institutionalization of Ethics through the U.S. Sentencing Guidelines for Organizations

1991	***Law:*** **U.S. Sentencing Guidelines for Organizations created for federal prosecutions of organizations. These guidelines provide for just punishment, adequate deterrence, and incentives for organizations to prevent, detect, and report misconduct. Organizations need to have an effective ethics and compliance program to receive incentives in the case of misconduct.**
2004	***Amendments:*** **The definition of an effective ethics program now includes the development of an ethical organizational culture. Executives and board members must assume the responsibility of identifying areas of risk, provide ethics training, create reporting mechanisms, and designate an individual to oversee ethics programs.**
2007–2008	***Additional definition of a compliance and ethics program:*** **Firms should focus on due diligence to detect and prevent misconduct and to promote an organizational culture that encourages ethical conduct. More details are provided encouraging the assessment of risk and appropriate steps to design, implement, and modify ethics programs and training to include all employees, top management, and the board or governing authority. These modifications continue to reinforce the importance of an ethical culture in preventing misconduct.**

FIGURE 4–5 Percentage of Employees Who Still DO NOT Report Observed Misconduct



Source: 2007 National Business Ethics Survey, p. 17.

report observed misconduct. The development of reporting systems has advanced with most companies having some method for employees to report observed misconduct. While reported misconduct is up, a sizable percentage of employees still do not report misconduct, as Figure 4–5 shows.

FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS

As mentioned in Chapter 1, Congress passed the FSGO in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance. These guidelines, which were developed by the U.S. Sentencing Commission, apply to all felonies and class A misdemeanors committed by employees in association with their work. As an incentive, organizations that have demonstrated due diligence in developing effective compliance programs that discourage unethical and illegal conduct may be subject to reduced organizational penalties if an employee commits a crime.[38] Overall, the government philosophy is that legal violations can be prevented through organizational values and a commitment to ethical conduct.

The commission delineated seven steps that companies must implement to demonstrate due diligence:

1. A firm must develop and disseminate a code of conduct that communicates required standards and identifies key risk areas for the organization.

2. High-ranking personnel in the organization who are known to abide by the legal and ethical standards of the industry (such as an ethics officer, vice president of human resources, general counsel, and so forth) must have oversight over the program.
3. No one with a known propensity to engage in misconduct should be put in a position of authority.
4. A communications system for disseminating standards and procedures (ethics training) must also be put into place.
5. Organizational communications should include a way for employees to report misconduct without fearing retaliation, such as an anonymous toll-free hotline or an ombudsman. Monitoring and auditing systems designed to detect misconduct are also required.
6. If misconduct is detected, then the firm must take appropriate and fair disciplinary action. Individuals both directly and indirectly responsible for the offense should be disciplined. In addition, the sanctions should be appropriate for the offense.
7. After misconduct has been discovered, the organization must take steps to prevent similar offenses in the future. This usually involves making modifications to the ethical compliance program, additional employee training, and issuing communications about specific types of conduct.

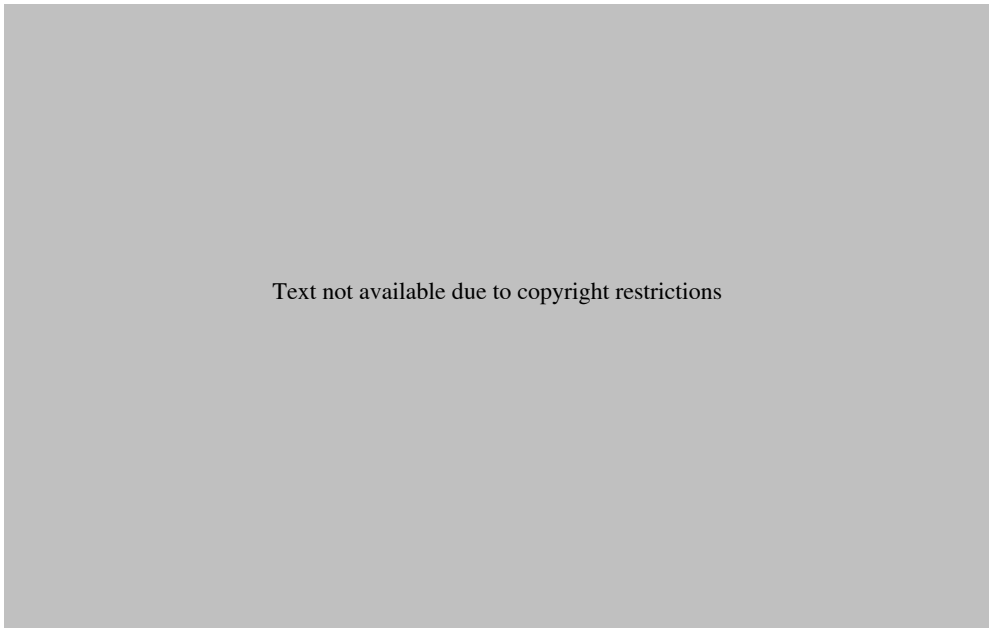
The government expects these seven steps for compliance programs to undergo continuous improvement and refinement.[39]

These steps are based on the commission's determination to emphasize compliance programs and to provide guidance for both organizations and courts regarding program effectiveness. Organizations have flexibility about the type of program they develop; the seven steps are not a checklist requiring that legal procedures be followed to gain certification of an effective program. Organizations implement the guidelines through effective core practices that are appropriate for their firms. The program must be capable of reducing the opportunity that employees have to engage in misconduct.

A 2004 amendment to the FSGO requires that a business's governing authority be well informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm's leadership, usually the board of directors. The board must ensure that there is a high-ranking manager accountable for the day-to-day operational oversight of the ethics program. The board must provide for adequate authority, resources, and access to the board or an appropriate subcommittee of the board. The board must ensure that there are confidential mechanisms available so that the organization's employees and agents may report or seek guidance about potential or actual misconduct without fear of retaliation. Finally, the board is required to oversee the discovery of risks and to design, implement, and modify approaches to deal with those risks. Figure 4–6 provides an overview from NBES about how prepared employees are to respond to various ethical and legal risks. Over three-quarters of employees who encounter risk feel adequately prepared to respond. If board members do not understand the nature, purpose, and methods available to implement an ethics program, the firm is at risk of inadequate oversight in the event of ethical misconduct that escalates into a scandal.[40]

A 2005 Supreme Court decision held that the sentences for violations of law were not mandatory but should serve only as recommendations for judges to use in their decisions. Some legal and business experts believe that this decision might weaken

the implementation of the FSGO, but most sentences have remained in the same range as before the Supreme Court decision. The guidelines remain an important consideration in developing an effective ethics and compliance program. An Open Compliance Group Benchmarking survey provided some insights into effective core practices, as illustrated in Table 4-9.



The 2007–2008 amendments to the FSGO extend the ethics training of individuals to members of the board or governing authority, high-level personnel, employees, and the organizations' agents. This applies not only oversight but mandatory training to all levels of the organization. Merely distributing a code of ethics does not meet the training requirements. The 2007 and 2008 amendments now require most governmental contractors to provide ethics and compliance training. As new FSGO amendments are implemented, more explicit responsibility is being placed on organizations to improve and expand ethics and compliance provisions to include all employees and board members.

The Department of Justice, through the Thompson Memo (Larry Thompson, deputy attorney general, 2003 memo to U.S. Attorneys), advanced general principles to consider in cases involving corporate wrongdoing. This memo makes it clear that ethics and compliance programs are important to detect the types of misconduct most likely to occur in a particular corporation's line of business. Without an effective ethics and compliance program to detect ethical and legal lapses, the firm should not be treated leniently. Also, the prosecutor generally has wide latitude in determining when, whom, and whether to prosecute violations of federal law. U.S. Attorneys are directed that charging for even minor misconduct may be appropriate when the wrongdoing was pervasive by a large number of employees in a particular role—for example, sales staff, procurement officers—or was condoned by upper management. Without an effective program to identify an isolated rogue employee involved in misconduct, serious consequences can be associated with regulatory issues, enforcement, and sentencing.[41] Therefore, there is general agreement both from laws and administrative policy that an effective ethics and compliance program is necessary to prevent conduct and reduce the legal consequences.

HIGHLY APPROPRIATE CORE PRACTICES

The FSGO and the Sarbanes–Oxley Act provide incentives for developing core practices that help ensure ethical and legal compliance. Core practices move the emphasis from a focus on individuals' moral capability to developing structurally sound organization core practices and developing structural integrity for both financial performance and nonfinancial performance. Although the Sarbanes–Oxley Act provides standards for financial performance, most ethical issues relate to nonfinancial issues such as marketing, human resource management, and customer relationships. Abusive behavior, lying, and conflict of interest are still the top three ethical issues.

The Integrity Institute has developed an integrated model to standardize the measurement of nonfinancial performance. Methodologies have been developed to assess communications, compensation, social responsibility, corporate culture, leadership, risk, and stakeholder perceptions, as well as more subjective aspects of earnings, corporate governance, technology, and other important nonfinancial areas. The model exists to establish a standard that can predict sustainability and success of an organization. The Integrity Institute uses the measurement to an established standard as the basis of certification of integrity.[42]

The majority of executives and board members want to measure nonfinancial performance, but no standards currently exist. The Open Compliance Ethics Group (oceg .org) has developed benchmarking studies available to organizations to conduct self-assessments to develop ethics program elements. Developing organizational systems and processes is a requirement of the regulatory environment, but organizations are given considerable freedom in developing ethics and compliance programs. Core practices do

exist and can be identified in every industry. Trade associations' self-regulatory groups and research studies often provide insights about the expected best core practices. The most important is for each firm to assess its legal and ethical risk areas and then develop structures to prevent, detect, and quickly correct any misconduct.

Consider McDonald's approach to answering critics about nutritional guidance. It announced a move to provide nutritional information on its product packaging worldwide. McDonald's was the first in its industry to post nutritional information on food packaging. McDonald's has been seeking to build trust and loyalty among consumers, something that the company proclaims is highly important to it. McDonald's also introduced a "Balanced Lifestyles" initiative for kids, which involved offering healthier menu options, promoting physical activity, and providing more nutritional information to its customers about its products. In 2004 it withdrew its supersize meals after a damaging portrayal of the company in the film *Super Size Me*. The product sizes available at McDonald's are small, medium, and large, but upgrading to a bigger-portion size remains cheap.[43]

Philanthropic Contributions

Philanthropic issues are another dimension of voluntary social responsibility and relate to a business's contributions to stakeholders. Philanthropy provides four major benefits to society:

1. Philanthropy improves the quality of life and helps make communities places where people want to do business, raise families, and enjoy life. Thus, improving the quality of life in a community makes it easier to attract and retain employees and customers.
2. Philanthropy reduces government involvement by providing assistance to stakeholders.
3. Philanthropy develops employee leadership skills. Many firms, for example, use campaigns by the United Way and other community service organizations as leadership- and skill-building exercises for their employees.
4. Philanthropy helps create an ethical culture and the values that can act as a buffer to organizational misconduct.[44]

> *Philanthropy helps create an ethical culture*

The most common way that businesses demonstrate philanthropy is through donations to local and national charitable organizations. Consistently a large philanthropic donor, Wells Fargo & Company contributes around $100 million annually in community grants for nonprofits and schools, contributes $45 million and 100,000 volunteers to Habitat for Humanity and other housing nonprofits, purchases green energy, has a website devoted to financial education, and its employees have donated hundreds of thousands of hours to charities around the nation.[45] Indeed, many companies have become concerned about the quality of education in the United States after realizing that the current pool of prospective employees lacks many basic work skills. Recognizing that today's students are tomorrow's employees and customers, firms such as Kroger, Campbell Soup Company, Eastman Kodak, American Express, Apple Computer, Xerox, and Coca-Cola have donated money, equipment, and employee time to help improve schools in their communities and throughout the nation.

The Wal-Mart Foundation, the charitable giving branch of Wal-Mart Inc., donated $378 million in 2009 to charities and communities across the globe, making it the largest corporate cash contributor in the nation, according to the Chronicle of Philanthropy. *Forbes Magazine* recognized Wal-Mart as the most generous company in the nation overall.[46] The money supported a variety of causes such as child development, education, the environment, and disaster relief. Wal-Mart feels that it can make the greatest impact on communities by supporting issues and causes that are important to its customers and associates in their own neighborhoods. Wal-Mart relies on its own associates to know which organizations are the most important to their hometowns, and it empowers them to determine how money will be spent in their communities. Wal-Mart is particularly focused on education, workforce development, sustainability, and health and wellness. By supporting communities at the local level, it encourages customer loyalty and goodwill.[47]

Strategic Philanthropy

Tying philanthropic giving to overall strategy and objectives is also known as strategic philanthropy. **Strategic philanthropy** is the synergistic and mutually beneficial use of an organization's core competencies and resources to deal with key stakeholders so as to bring about organizational and societal benefits. For example, last year Bisto, a staple of Britain's meal tables since 1908 with its instant gravy, launched a new marketing campaign. The focus was on families trying to eat one meal together a week. Bisto called it "ahh nights" based on its longtime marketing slogan of "ahh . . . Bisto." Families eat fewer and fewer meals together; this has been identified by social policy experts as playing a key role in a wide range of social problems such as teenage drug abuse, sexual promiscuity, teenage pregnancy, crime, antisocial behavior, truancy, and poor academic performance. Bisto used the new marketing slogan to extol the virtues of eating together as a family while explicitly recognizing the challenges of doing this in the modern world. It used a website, www.aahnight.co.uk, to make it easy for families to have a meal together at least once a week. It used three steps: (1) Download a contract that families can sign and stick on the refrigerator; (2) invite family or friends by e-mail; (3) make a delicious meal with recipes provided using—you guessed it—Bisto.[48]

Home Depot directs much of the money it spends on philanthropy to affordable housing, at-risk youth, the environment, and disaster recovery. In 2008 the company supported thousands of nonprofit organizations with over $50 million in contributions. The company also posts a Social Responsibility Report on its website. Home Depot works with more than 350 affiliates of Habitat for Humanity. In March 2008, Home Depot and Habitat for Humanity announced a five-year $30 million initiative to provide funding for creating at least 5,000 energy-efficient homes. Home Depot also supports YouthBuildUSA, a nonprofit organization that provides training and skill development for young people. After the 9/11 terrorist attacks in 2001, the company set up three command centers to help coordinate relief supplies such as dust masks, gloves, batteries, and tools to victims and rescue workers. After hurricanes Katrina, Rita, and Wilma, Home Depot, the Home Depot Foundation, their suppliers, and The Home Fund contributed $9.3 million in cash and materials to support recovery. Home Depot also donated $500,000 supporting the American Red Cross tsunami relief efforts in South East Asia. More recently, Home Depot donated $300,000 to the American Red Cross for disaster relief for people who suffer from hurricanes. Separately, Home Depot's Home Fund donated $500,000 to 650 associates who had suffered through Hurricane Gustav in 2008.[49]

SUMMARY

To understand the institutionalization of business ethics, it is important to understand the voluntary and legally mandated dimensions of organizational practices. Core practices are documented best practices, often encouraged by legal and regulatory forces as well as industry trade associations. The effective organizational practice of business ethics requires all three dimensions to be integrated into an ethics and compliance program. This creates an ethical culture that can effectively manage the risks of misconduct. Institutionalization in business ethics relates to established laws, customs, and expected organizational programs that are considered normative in establishing reputation. Institutions provide requirements, structure, and societal expectations to reward and sanction ethical decision making. In this way, society is institutionalizing core practices and providing organizations the opportunity to take their own approach, only taking action if there are violations.

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Civil and criminal laws regulating business conduct are passed because society—including consumers, interest groups, competitors, and legislators—believes that business must comply with society's standards. Such laws regulate competition, protect consumers, promote safety and equity in the workplace, protect the environment, and provide incentives for preventing misconduct.

In 2002, largely in response to widespread corporate accounting scandals, Congress passed the Sarbanes–Oxley Act to establish a system of federal oversight of corporate accounting practices. In addition to making fraudulent financial reporting a criminal offense and strengthening penalties for corporate fraud, the law requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reporting to investors and other stakeholders. The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles. For instance, the law requires top managers to certify that their firms' financial reports are complete and accurate, making CEOs and CFOs personally accountable for the credibility and accuracy of their companies' financial statements. The act establishes an oversight board to oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies.

Congress passed the Federal Sentencing Guidelines for Organizations (FSGO) in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance. These guidelines, which were developed by the U.S. Sentencing Commission, apply to all felonies and class A misdemeanors committed by employees in association with their work. As an incentive, organizations that have demonstrated due diligence in developing effective compliance programs that discourage unethical and illegal conduct may be subject to reduced organizational penalties if an employee commits a crime.[50] Overall, the government philosophy is that legal violations can be prevented through organizational values and a commitment to ethical conduct. A 2004 amendment to the FSGO requires that a business's governing authority be well-informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm's leadership, usually the board of directors. The board must ensure that there is a high-ranking manager accountable for the day-to-day operational oversight of the ethics program. The board must provide for adequate authority, resources, and access to the board or an appropriate subcommittee of

the board. The board must ensure that there are confidential mechanisms available so that the organization's employees and agents may report or seek guidance about potential or actual misconduct without fear of retaliation.

The FSGO and the Sarbanes–Oxley Act provide incentives for developing core practices that help ensure ethical and legal compliance. Core practices move the emphasis from a focus on the individual's moral capability to developing structurally sound organization core practices and developing structural integrity for both financial performance and nonfinancial performance. The Integrity Institute has developed an integrated model to standardize the measurement of nonfinancial performance. Methodologies have been developed to assess communications, compensation, social responsibility, corporate culture, leadership, risk, and stakeholder perceptions, as well as more subjective aspects of earnings, corporate governance, technology, and other important nonfinancial areas.

Philanthropic issues touch on businesses' social responsibility insofar as businesses contribute to the local community and to society. Philanthropy provides four major benefits to society: improving the quality of life, reducing government involvement, developing staff leadership skills, and building staff morale. Companies contribute significant amounts of money to education, the arts, environmental causes, and the disadvantaged by supporting local and national charitable organizations. Strategic philanthropy involves linking core business competencies to societal and community needs.

IMPORTANT TERMS FOR REVIEW

voluntary practices
philanthropy
core practices
Better Business Bureau
mandated boundaries
civil law
criminal law
procompetitive legislation
consumer protection law
Occupational Safety and Health Administration
sustainability
Environmental Protection Agency
Public Company Accounting Oversight Board
strategic philanthropy

RESOLVING ETHICAL BUSINESS CHALLENGES*

Albert Chen was sweating profusely in his Jaguar on the expressway as he thought about his options and the fact that Christmas and the Chinese New Year were at hand. He and his wife, Mary, who were on their way to meet Albert's parents at New York's John F. Kennedy International Airport, seemed to be looking up from an abyss, with no daylight to be seen. Several visits and phone calls from various people had engulfed both him and Mary.

He had graduated with honors in finance and had married Mary in his senior year. They had both obtained prestigious brokerage jobs in the New York area, and both had been working killer hours to develop their accounts. Listening to other brokers, both had learned that there were some added expenses to their professions. For example,

they were told that brokers need to "look" and "act" successful. So Albert and Mary bought the appropriate clothes and cars, joined the right clubs, and ate at the right restaurants with the right people. They also took the advice of others, which was to identify the "players" of large corporations at parties and take mental notes. "You'd be surprised at what information you hear with a little alcohol in these people," said one broker. Both started using this strategy, and five months later their clients began to see significant profits in their portfolios.

Their good luck even came from strange places. For example, Albert had an uncle whose work as a janitor gave him access to many law offices that had information on a number of companies, especially those about to file for bankruptcy. Mary and Albert were able to use information provided by this uncle to benefit their clients' portfolios. The uncle even had some of his friends use Albert. To Albert's surprise, his uncle's friends often had nest eggs in excess of $200,000. Because some of these friends were quite elderly, Albert was given permission to buy and sell nonrisky stocks at will.

Because both of them were earning good salaries, the Chens soon managed to invest in the market themselves, and their investments included stock in the company for which Mary's father worked. After eighteen months, Albert decided to jump ship and start working for Jarvis, Sunni, Lamar & Morten (JSL&M). JSL&M's reputation was that of a fast mover in the business. "We go up to the line and then measure how wide the line is so that we know how far we can go into it," was a common remark at the brokerage firm.

About six months ago, Mary's father, who was with a major health care company, commented that the management team was running the company into the ground. "If only someone could buy the company and put in a good management team," he mused. After the conversation, Mary investigated the company and discovered that the stock was grossly undervalued. She made a few phone calls and found a company that was interested in doing a hostile takeover. Mary also learned from her father that if a new management were acceptable to the union, the union would do everything in its power to oust the old management—by striking, if necessary—and welcome the new one. As things started to materialize, Mary told several of her best clients, who in turn did very well on the stock. This increased her status in the firm, which kept drawing bigger clients.

Albert soon became a player in initial public stock offerings (IPOs) of new companies. Occasionally, when Albert saw a very hot IPO, he would talk to some of his best venture-capital friends, who then bought the IPOs and gained some very good returns. This strategy helped attract some larger players in the market. By this point in his young career, Albert had made a great many friends.

One of those friends was Barry, who worked on the stock floor. As they were talking, Barry mentioned that if Albert wanted to, he, as a favor, when placing orders to buy shares, would occasionally put Albert's or Mary's trade before the client order.

The first sign of trouble came when Mary told Albert about what was happening at her office. "I'm getting e-mail from some of the brokers with off-color jokes and even some nude photos of women and men. I just don't care for it."

"So what are you doing about it?" Albert asked.

"Well, I've just started not even opening my messages if they come from these people," Mary replied.

"What about messages that request that you send them on? What do you do with those?" queried Albert.

"I just e-mail them along without looking at them," was her response.

"This isn't good, Mary. A couple of analysts were just fired for doing that at a big firm last week," said Albert.

Several weeks later the people who were sending Mary the obnoxious messages were fired. Mary was also asked to see the head of her division. When she came to his office, he said, "Please shut the door, Mary. I have some bad news. I know that you weren't involved with what was happening with the e-mail scandal; however, you did forward messages that contained such material. As a result, I have no alternative but to give you your two weeks' notice. I know this is unfair, but I have my orders. Because of this mess, the SEC wants to check all your trades for the last eight months. It seems to be a formality, but it will take time, and as you well know, the chances of going to another firm with that hanging over your head are slim. I'm sorry that it's only two months until the holidays." That night Mary fell into a depression.

To exacerbate the situation, Albert's parents were flying in from the People's Republic of China. They were not happy with Albert's marriage to a non-Chinese woman, but they had consoled themselves that Mary had a good job. They had also said that if things should go badly for them in New York, they could always come to the parents' retirement home in Taiwan. However, the idea of leaving the United States, attempting to learn Mandarin, and raising children in an unfamiliar culture did not appeal to Mary.

Albert was also having some problems. Because their income was cut in half, Albert tried to make up for the loss by trading in some high-risk markets, such as commodities and precious metals. However, many of these investments turned sour, and he found himself buying and selling more and more to pull his own portfolio, as well as those of his clients, into the black. He was getting worried because some of his uncle's friends' portfolios were losing significant value. Other matters, however, were causing him even more anxiety. The previous week Barry had called him, asking for some inside information on several companies that he was working with for an IPO. Albert knew that this could be construed as insider information and had said no.

Today, Barry called again and said, "Look, Al, I've been doing you favors for a while. I need to score big because of the holidays. You probably don't know, but what I've been doing for you could be construed as spinning, which is not looked upon favorably. I'm not asking for the IPO information—I'm demanding it. Is that clear enough for you, Al? E-mail it over by tomorrow morning." Then Barry hung up.

An hour later Albert's supervisor came in and said, "Al, I need a favor from you. I want you to buy some stock for a few friends and me. When it goes to $112, I want you to sell it. We'll pay the taxes and give you a little bonus for Christmas as well. I want you to buy tomorrow as soon as the market opens. Here are the account numbers for the transaction. I must run. See you tomorrow."

QUESTIONS • EXERCISES

1. Identify the ethical and legal issues of which Albert needs to be aware.
2. Discuss the advantages and disadvantages of each decision that Albert could make and has made.
3. Identify the pressures that have brought about these issues.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Voluntary practices include documented best practices **Yes** **No**
2. The primary method for resolving business ethics disputes is through the criminal court system. **Yes** **No**
3. The FSGO provides an incentive for organizations to conscientiously develop and implement ethics programs. **Yes** **No**
4. The Sarbanes–Oxley Act encourages CEOs and CFOs to report their financial statements accurately. **Yes** **No**
5. Strategic philanthropy represents a new direction in corporate giving that maximizes the benefit to societal or community needs and relates to business objectives. **Yes** **No**

ANSWERS **1. No.** Core practices are documented best practices. **2. No.** Lawsuits and civil litigation are the primary way in which business ethics disputes are resolved. **3. Yes.** Well-designed ethics and compliance programs can minimize legal liability when organizational misconduct is detected. **4. No.** The Sarbanes–Oxley Act *requires* CEOs and CFOs to accurately report their financial statements to a federal oversight committee; they must sign the document and are held personally liable for any inaccuracies. **5. Yes.** Strategic philanthropy helps both society and the organization.

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PART 3

The Decision Making Process

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CHAPTER 5

Ethical Decision Making and Ethical Leadership

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CHAPTER OBJECTIVES

- To provide a comprehensive framework for ethical decision making in business
- To examine the intensity of ethical issues as an important element influencing the ethical decision making process
- To introduce individual factors that may influence ethical decision making in business
- To introduce organizational factors that may influence ethical decision making in business
- To explore the role of opportunity in ethical decision making in business
- To explain how knowledge about the ethical decision making framework can be used to improve ethical leadership
- To provide leadership styles and habits that promote an ethical culture

CHAPTER OUTLINE

A Framework for Ethical Decision Making in Business

Ethical-Issue Intensity

Individual Factors

Organizational Factors

Opportunity

Business Ethics Evaluations and Intentions

Using the Ethical Decision Making Framework to Improve Ethical Decisions

The Role of Leadership in a Corporate Culture

Leadership Styles Influence Ethical Decisions

Habits of Strong Ethical Leaders

Ethical Leaders Have Strong Personal Character

Ethical Leaders Have a Passion to Do Right

Ethical Leaders Are Proactive

Ethical Leaders Consider Stakeholders' Interests

Ethical Leaders Are Role Models for the Organization's Values

Ethical Leaders Are Transparent and Actively Involved in Organizational Decision Making

Ethical Leaders Are Competent Managers Who Take a Holistic View of the Firm's Ethical Culture

AN ETHICAL DILEMMA*

Bill Church was in a bind. A recent graduate of a prestigious business school, he had taken a job in the auditing division of Greenspan & Company, a fast-growing leader in the accounting industry. Greenspan relocated Bill, his wife, and their 1-year-old daughter from the Midwest to the East Coast. On arriving, they bought their first home and a second car. Bill was told that the company had big plans for him. Thus, he did not worry about being financially overextended.

Several months into the job, Bill found that he was working late into the night to complete his auditing assignments. He realized that the company did not want its clients billed for excessive hours and that he needed to become more efficient if he wanted to move up in the company. He asked one of his friends, Ann, how she managed to be so efficient in auditing client records.

Ann quietly explained: "Bill, there are times when being efficient isn't enough. You need to do what is required to get ahead. The partners just want results—they don't care how you get them."

"I don't understand," said Bill.

"Look," Ann explained, "I had the same problem you have a few years ago, but Mr. Reed [the manager of the auditing department] explained that everyone 'eats time' so that the group shows top results and looks good. And when the group looks good, everyone in it looks good. No one cares if a little time gets lost in the shuffle."

Bill realized that "eating time" meant not reporting all the hours required to complete a project. He also remembered one of Reed's classic catch phrases, "results, results, results." He thanked Ann for her input and went back to work. Bill thought of going over Reed's head and asking for advice from the division manager, but he had met her only once and did not know anything about her.

QUESTIONS • EXERCISES

1. What should Bill do?
2. Describe the process through which Bill might attempt to resolve his dilemma.
3. Consider the impact of this company's approach on young accountants. How could working long hours be an ethical problem?

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

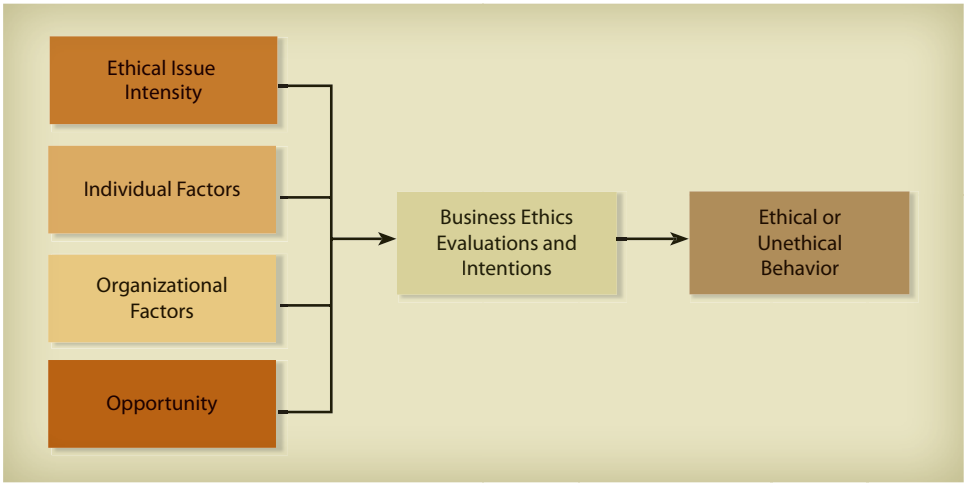
To improve ethical decision making in business, one must first understand how individuals make ethical decisions in an organizational environment. Too often it is assumed that individuals in organizations make ethical decisions in the same way that they make ethical decisions at home, in their family, or in their personal lives. Within the context of an organizational work group, however, few individuals have the freedom to decide ethical issues independent of organizational pressures.

This chapter summarizes our current knowledge of ethical decision making in business and provides insights into ethical decision making in organizations. Although it is impossible to describe exactly how any one individual or work group might make ethical decisions, we can offer generalizations about average or typical behavior patterns within organizations. These generalizations are based on many studies and at least six ethical decision models that have been widely accepted by academics and practitioners.[1] Based on these models, we present a framework for understanding ethical decision making in the context of business organizations. In addition to business, this framework integrates concepts from philosophy, psychology, sociology, and organizational behavior. This framework should be helpful in understanding organizational ethics and developing ethical programs.

A FRAMEWORK FOR ETHICAL DECISION MAKING IN BUSINESS

As Figure 5–1 shows, our model of the ethical decision making process in business includes ethical issue intensity, individual factors, and organizational factors such as corporate culture and opportunity. All of these interrelated factors influence the evaluations of and intentions behind the decisions that produce ethical or unethical behavior. This model does not describe how to make ethical decisions, but it does help one to understand the factors and processes related to ethical decision making.

FIGURE 5–1 Framework for Understanding Ethical Decision Making in Business



Ethical Issue Intensity

The first step in ethical decision making is to recognize that an ethical issue requires an individual or work group to choose among several actions that various stakeholders inside or outside the firm will ultimately evaluate as right or wrong. The intensity of an ethical issue relates to its perceived importance to the decision maker.[2] **Ethical issue intensity**, then, can be defined as the relevance or importance of an ethical issue in the eyes of the individual, work group, and/or organization. It is personal and temporal in character to accommodate values, beliefs, needs, perceptions, the special characteristics of the situation, and the personal pressures prevailing at a particular place and time.[3] Senior employees and those with administrative authority contribute significantly to intensity because they typically dictate an organization's stance on ethical issues. In fact, under current law, managers can be held liable for the unethical and illegal actions of subordinates. In the United States, the Federal Sentencing Guidelines for Organizations have a liability formula that judges those who are in positions of authority in regard to their action or inaction regarding the unethical and illegal activities of those around them. For example, many of the Enron employees and managers who were aware of the firm's use of off-balance-sheet partnerships—which turned out to be the major cause of the energy firm's collapse—were advised that these partnerships were legal, so they did not perceive them as an ethical issue. Although such partnerships were in fact legal at that time, the way that some Enron officials designed them and the methods they used to provide collateral (that is, Enron stock) created a scheme that brought about the collapse of the company.[4] Thus, ethical issue intensity involves individuals' cognitive state of concern about an issue, whether or not they have knowledge that an issue is unethical, which indicates their involvement in making choices.

Ethical issue intensity reflects the ethical sensitivity of the individual or work group that faces the ethical decision making process. Research suggests that individuals are subject to six "spheres of influence" when confronted with ethical choices—the workplace, family, religion, legal system, community, and profession—and that the level of importance of each of these influences will vary depending on how important the decision maker perceives the issue to be.[5] Additionally, the individual's sense of the situation's moral intensity increases the individual's perceptiveness regarding ethical problems, which in turn reduces his or her intention to act unethically.[6] **Moral intensity** relates to a person's perception of social pressure and the harm the decision will have on others.[7] All other factors in Figure 5–1, including individual factors, organizational factors, and intentions, determine why different individuals perceive ethical issues differently. Unless individuals in an organization share common concerns about ethical issues, the stage is set for ethical conflict. The perception of ethical issue intensity can be influenced by management's use of rewards and punishments, corporate policies, and corporate values to sensitize employees. In other words, managers can affect the degree to which employees perceive the importance of an ethical issue through positive and/or negative incentives.[8]

For some employees, ethical issues may not reach the critical awareness level if managers fail to identify and educate employees about specific problem areas. Subprime lenders, such as Countrywide Finance, failed to educate brokers about the damages of misrepresenting financial data to help individuals secure loans. Organizations that consist of employees with diverse values and backgrounds must train them in the way the firm wants specific ethical issues handled. Identifying the ethical issues and risks that employees might encounter is a significant step toward developing their ability to make ethical decisions. Many ethical issues are identified by industry groups or through general

information available to a firm. Companies must assess areas of ethical and legal risk that are in reality ethical issues. Issues that are communicated as being high in ethical importance could trigger increases in employees' ethical issue intensity. The perceived importance of an ethical issue has been found to have a strong influence on both employees' ethical judgment and their behavioral intention. In other words, the more likely individuals are to perceive an ethical issue as important, the less likely they are to engage in questionable or unethical behavior.[9] Therefore, ethical issue intensity should be considered a key factor in the ethical decision making process.

Individual Factors

When people need to resolve ethical issues in their daily lives, they often base their decisions on their own values and principles of right or wrong. They generally learn these values and principles through the socialization process with family members, social groups, and religion and in their formal education. The actions of specific individuals in scandal-plagued companies such as AIG, Countrywide Financial, Fannie Mae, and Freddie Mac often raise questions about those individuals' personal character and integrity. They appear to operate in their own self-interest or in total disregard of the law and interests of society. Fannie Mae has become one of the high-profile figures in the 2008–2009 financial meltdown. It is a stockholder-owned corporation created to purchase and securitize mortgages, and was a key figure in the subprime mortgage debacle.[10] Many people granted mortgages by Fannie Mae were not strong candidates to receive mortgages, and their homes have since been foreclosed. Civil charges had already been filed against Fannie Mae's CEO, CFO, and the former controller, who allegedly manipulated earnings to increase their bonuses. CEO Daniel Mudd was also investigated for lying to investors about earnings. Bad decisions and managerial misconduct clearly contributed to the company's downfall.[11]

> *The more likely individuals are to perceive an ethical issue as important, the less likely they are to engage in questionable or unethical behavior.*

In the workplace, personal ethical issues typically involve honesty, conflicts of interest, discrimination, nepotism, and theft of organizational resources. For example, many individuals use the company computer system for several hours of work time a day for personal reasons. Most employees limit the use of their work time for personal use, and most companies probably overlook these as reasonable. Some employees, however, use times in excess of 30 minutes for personal Internet communications, which companies are likely to view as an excessive use of company time for personal reasons. The decision to use company time for personal affairs is an example of an ethical decision. It illustrates the fine line between what may be acceptable or unacceptable in a business environment. It also reflects how well an individual will assume responsibilities in the work environment. Often this decision will depend on company policy and the corporate environment.

The way the public perceives individual ethics generally varies according to the profession in question. Telemarketers, car salespersons, advertising practitioners, stockbrokers, and real estate brokers are often perceived as having the lowest ethics. Research regarding individual factors that affect ethical awareness, judgment, intent, and behavior include gender, education, work experience, nationality, age, and locus of control.

Extensive research has been done regarding the link between **gender** and ethical decision making. The research shows that in many aspects there are no differences between men and women, but when differences are found, women are generally more ethical than men.[12] By "more ethical," we mean that women seem to be more sensitive to

ethical scenarios and less tolerant of unethical actions. In a study on gender and intentions for fraudulent financial reporting, females reported higher intentions to report them than male participants.[13] As more and more women work in managerial positions, these findings may become increasingly significant.

Education, the number of years spent in pursuit of academic knowledge, is also a significant factor in the ethical decision making process. The important thing to remember about education is that it does not reflect experience. Work experience is defined as the number of years within a specific job, occupation, and/or industry. Generally, the more education or work experience that one has, the better he or she is at ethical decision making. The type of education has little or no effect on ethics. For example, it doesn't matter if you are a business student or a liberal arts student—you are pretty much the same in terms of ethical decision making. Current research, however, shows that students are less ethical than businesspeople, which is likely because businesspeople have been exposed to more ethically challenging situations than students.[14]

Nationality is the legal relationship between a person and the country in which he or she is born. Within the twenty-first century, nationality is being redefined by regional economic integration such as the European Union (EU). When European students are asked their nationality, they are less likely to state where they were born than where they currently live. The same thing is happening in the United States, as someone born in Florida who lives in New York might consider him- or herself to be a New Yorker. Research about nationality and ethics appears to be significant in that it affects ethical decision making; however, the true effect is somewhat hard to interpret.[15] Because of cultural differences, it is impossible to state that ethical decision making in an organizational context will differ significantly. The reality of today is that multinational companies look for businesspeople who can make decisions regardless of nationality. Perhaps in twenty years, nationality will no longer be an issue in that the multinational's culture will replace the national status as the most significant factor in ethical decision making.

Age is another individual factor that has been researched within business ethics. Several decades ago, we believed that age was positively correlated with ethical decision making. In other words, the older you are, the more ethical you are. However, recent research suggests that there is probably a more complex relationship between ethics and age.[16] We do believe that older employees with more experience have greater knowledge to deal with complex industry-specific ethical issues.

Locus of control relates to individual differences in relation to a generalized belief about how one is affected by internal versus external events or reinforcements. In other words, the concept relates to where people view themselves in relation to power. Those who believe in **external control** (that is, externals) see themselves as going with the flow because that's all they can do. They believe that the events in their lives are due to uncontrollable forces. They consider that what they want to achieve depends on luck, chance, and powerful people in their company. In addition, they believe that the probability of being able to control their lives by their own actions and efforts is low. Conversely, those who believe in **internal control** (that is, internals) believe that they control the events in their lives by their own effort and skill, viewing themselves as masters of their destinies and trusting in their capacity to influence their environment.

Current research suggests that we still can't be sure how significant locus of control is in terms of ethical decision making. One study that found a relationship between locus of control and ethical decision making concluded that internals were positively related whereas externals were negative.[17] In other words, those who believe that their fate is in the hands of others were more ethical than those who believed that they formed their own destiny.

Organizational Factors

Although people can and do make individual ethical choices in business situations, no one operates in a vacuum. Indeed, research has established that in the workplace the organization's values often have greater influence on decisions than a person's own values.[18] Ethical choices in business are most often made jointly, in work groups and committees, or in conversations and discussions with coworkers. Employees approach ethical issues on the basis of what they have learned not only from their own backgrounds but also from others in the organization. The outcome of this learning process depends on the strength of each person's personal values, the opportunities he or she has to behave unethically, and the exposure he or she has to others who behave ethically or unethically. Although people outside the organization, such as family members and friends, also influence decision makers, an organization's culture and structure operate through the relationships of its members to influence their ethical decisions.

"The more ethical employees perceive an organization's culture to be, the less likely they are to make unethical decisions."

A **corporate culture** can be defined as a set of values, norms, and artifacts, including ways of solving problems that members (employees) of an organization share. As time passes, stakeholders come to view the company or organization as a living organism, with a mind and will of its own. The Walt Disney Company, for example, requires all new employees to take a course in the traditions and history of Disneyland and Walt Disney, including the ethical dimensions of the company. The corporate culture at American Express Company stresses that employees help customers out of difficult situations whenever possible. This attitude is reinforced through numerous company legends of employees who have gone above and beyond the call of duty to help customers. This strong tradition of customer loyalty thus might encourage an American Express employee to take unorthodox steps to help a customer who encounters a problem while traveling overseas. Employees learn that they can take some risks in helping customers. Such strong traditions and values have become a driving force in many companies, including McDonald's, IBM, Procter & Gamble, Southwest Airlines, and Hershey Foods.

An important component of corporate, or organizational, culture is the company's ethical culture. Whereas corporate culture involves values and norms that prescribe a wide range of behavior for organizational members, the **ethical culture** reflects whether the firm also has an ethical conscience. Ethical culture is a function of many factors, including corporate policies on ethics, top management's leadership on ethical issues, the influence of coworkers, and the opportunity for unethical behavior. Within the organization as a whole, subclimates can develop within individual departments or work groups, but they are influenced by the strength of the firm's overall ethical culture, as well as the function of the department and the stakeholders it serves.[19]

The more ethical employees perceive an organization's culture to be, the less likely they are to make unethical decisions. Corporate culture and ethical culture are closely associated with the idea that significant others within the organization help determine ethical decisions within that organization. Research also indicates that the ethical values embodied in an organization's culture are positively related to employees' commitment to the firm and their sense that they fit into the company. These findings suggest that companies should develop and promote ethical values to enhance employees' experiences in the workplace.[20]

Those who have influence in a work group, including peers, managers, coworkers, and subordinates, are referred to as **significant others**. They help workers on a daily basis with unfamiliar tasks and provide advice and information in both formal and informal ways.

Coworkers, for instance, can offer help in the comments they make in discussions over lunch or when the boss is away. Likewise, a manager may provide directives about certain types of activities that employees perform on the job. Indeed, an employee's supervisor can play a central role in helping employees develop and fit in socially in the workplace.[21] Numerous studies conducted over the years confirm that significant others within an organization may have more impact on a worker's decisions on a daily basis than any other factor.[22]

Obedience to authority is another aspect of the influence that significant others can exercise. Obedience to authority helps to explain why many employees resolve business ethics issues by simply following the directives of a superior. In organizations that emphasize respect for superiors, for example, employees may feel that they are expected to carry out orders by a supervisor even if those orders are contrary to the employees' sense of right and wrong. Later, if the employee's decision is judged to have been wrong, he or she is likely to say, "I was only carrying out orders" or "My boss told me to do it this way." In addition, the type of industry and the size of the organization have also been researched and found to be relevant factors; the bigger the company, the more potential for unethical activities.[23]

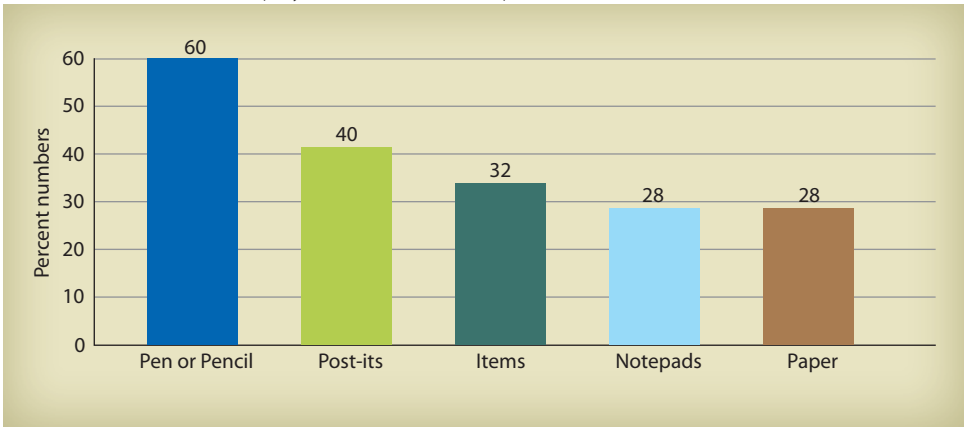
Opportunity

Opportunity describes the conditions in an organization that limit or permit ethical or unethical behavior. Opportunity results from conditions that either provide rewards, whether internal or external, or fail to erect barriers against unethical behavior. Examples of internal rewards include feelings of goodness and personal worth generated by performing altruistic acts. External rewards refer to what an individual expects to receive from others in the social environment. Rewards are external to the individual to the degree that they bring social approval, status, and esteem.

An example of a condition that fails to erect barriers against unethical behavior is a company policy that does not punish employees who accept large gifts from clients. The absence of punishment essentially provides an opportunity for unethical behavior because it allows individuals to engage in such behavior without fear of consequences. The prospect of a reward for unethical behavior can also create an opportunity for questionable decisions. For example, a salesperson who is given public recognition and a large bonus for making a valuable sale that he or she obtained through unethical tactics will probably be motivated to use such tactics in the future, even if such behavior goes against the salesperson's personal value system. If 10 percent of employees report observing others at the workplace abusing drugs or alcohol, then the opportunity to engage in these activities exists if there is a failure to report and respond to this conduct.[24]

Opportunity relates to individuals' **immediate job context**—where they work, whom they work with, and the nature of the work. The immediate job context includes the motivational "carrots and sticks" that superiors use to influence employee behavior. Pay raises, bonuses, and public recognition act as carrots, or positive reinforcements, whereas demotions, firings, reprimands, and pay penalties act as sticks, the negative reinforcements. The United States Chamber of Commerce reports that 75 percent of employees steal from their workplaces, and most do so repeatedly.[25] As Figure 5–2 shows, many employees pilfer office-supply rooms for matters unrelated to the job. It is possible that the opportunity is provided, and in some cases, there are no concerns if employees take pens, Post-its, envelopes, notepads, and paper. Respondents to the survey by Vault.com indicated that 25 percent felt that no one cared if they took office supplies, 34 percent said that they never

FIGURE 5–2 Items that Employees Pilfer in the Workplace



Source: "Top Items Employees Pilfer," the most popular items employees take from office-supply rooms for matters unrelated to the job. Vault's office survey of 1,152 respondents. In Snapshots, *USA Today*, March 29, 2006, B1.

got caught, and 1 percent said that they were caught and got in trouble. If there is no policy against this practice, one concern is that employees will not learn where to draw the line and will get into the habit of taking even more expensive items for personal use.

The opportunity that employees have for unethical behavior in an organization can be eliminated through formal codes, policies, and rules that are adequately enforced by management. For example, financial companies—such as banks, savings and loan associations, and securities companies—have developed elaborate sets of rules and procedures to avoid the opportunity for individual employees to manipulate or take advantage of their trusted position. In banks, one such rule requires most employees to take a vacation and stay out of the bank a certain number of days every year so that they cannot be physically present to cover up embezzlement or other diversion of funds. This rule prevents the opportunity for inappropriate conduct. Even after audits by prestigious accounting firm PricewaterhouseCoopers, the founder and chairman of one of India's largest technology companies, Satyam Computer Services Ltd., admitted he invented financial results, including a fictitious cash balance of more than $1 billion. He was able to overstate profits and understate liabilities. This was allowed to happen, even though Satyam had independent directors, including a Harvard business school professor, on its board. The question is: How did the CEO manage to blatantly manipulate financial information without anyone catching on? There had to be loopholes in the oversight of the company's accounting, audits, and corporate governance that allowed this fraud. In addition, government regulation of financial reporting allowed the opportunity for misconduct. To avoid situations like this in the future, there must be checks and balances that create transparency.[26]

Opportunity also comes from knowledge. Major misconduct observed among employees in the workplace include lying to employees, customers, vendors, or the public or withholding needed information from them.[27] A person who has an information base, expertise, or information about the competition has the opportunity to exploit this knowledge. An individual can be a source of information because he or she is familiar with the organization. Individuals who have been employed by one organization for many years become "gatekeepers" of its culture and often have the opportunity to make decisions related to unwritten traditions and rules. They help socialize newer employees to abide

by the rules and norms of the company's internal and external ways of doing business, as well as understanding when the opportunity exists to cross the line. They may function as mentors or supervise managers in training. Like drill sergeants in the army, these trainers mold the new recruits into what the company wants. This can contribute to either ethical or unethical conduct.

The opportunity for unethical behavior cannot be eliminated without aggressive enforcement of codes and rules. A national jewelry store–chain president explained to us how he dealt with a jewelry buyer in one of his stores who had taken a bribe from a supplier. There was an explicit company policy against taking incentive payments in order to deal with a specific supplier. When the president of the firm learned that one of his buyers had taken a bribe, he immediately traveled to that buyer's office and terminated his employment. He then traveled to the supplier (manufacturer) selling jewelry to his stores and terminated his relationship with the firm. The message was clear: Taking a bribe is unacceptable for the store's buyers, and salespeople from supplying companies could cost their firm significant sales by offering bribes. This type of policy enforcement illustrates how the opportunity to commit unethical acts can be eliminated.

Business Ethics Evaluations and Intentions

Ethical dilemmas involve problem-solving situations in which decision rules are often vague or in conflict. The results of an ethical decision are often uncertain; no one can always tell us whether we have made the right decision. There are no magic formulas, nor is there computer software that ethical dilemmas can be plugged into for a solution. Even if they mean well, most businesspeople will make ethical mistakes. Thus, there is no substitute for critical thinking and the ability to take responsibility for our own decisions.

An individual's intentions and the final decision regarding what action he or she will take are the last steps in the ethical decision making process. When the individual's intentions and behavior are inconsistent with his or her ethical judgment, the person may feel guilty. For example, when an advertising account executive is asked by her client to create an advertisement that she perceives as misleading, she has two alternatives: to comply or to refuse. If she refuses, she stands to lose business from that client and possibly her job. Other factors—such as pressure from the client, the need to keep her job to pay her debts and living expenses, and the possibility of a raise if she develops the advertisement successfully—may influence her resolution of this ethical dilemma. Because of these other factors, she may decide to act unethically and develop the advertisement even though she believes it to be inaccurate. Because her actions are inconsistent with her ethical judgment, she will probably feel guilty about her decision.

Guilt or uneasiness is the first sign that an unethical decision has occurred. The next step is changing one's behavior to reduce such feelings. This change can reflect a person's values shifting to fit the decision or the person changing his or her decision type the next time a similar situation occurs. Finally, one can eliminate some of the situational factors by quitting. For those who begin the value shift, the following are the usual justifications that will reduce and finally eliminate guilt:

1. I need the paycheck and can't afford to quit right now.
2. Those around me are doing it so why shouldn't I? They believe it's okay.
3. If I don't do this, I might not be able to get a good reference from my boss or company when I leave.

4. This is not such a big deal, given the potential benefits.
5. Business is business with a different set of rules.
6. If not me, someone else would do it and get rewarded.

The road to success depends on how the businessperson defines *success*. The success concept drives intentions and behavior in business either implicitly or explicitly. Money, security, family, power, wealth, and personal or group gratification are all types of success measures that people use. The list described is not comprehensive, and in the next chapter, you will understand more about how success can be defined. Another concept that affects behavior is the probability of rewards and punishments. That too will be explained further in Chapter 6.

USING THE ETHICAL DECISION MAKING FRAMEWORK TO IMPROVE ETHICAL DECISIONS

The ethical decision making framework presented in this chapter cannot tell you if a business decision is ethical or unethical. It bears repeating that it is impossible to tell you what is right or wrong; instead, we are attempting to prepare you to make informed ethical decisions. Although this chapter does not moralize by telling you what to do in a specific situation, it does provide an overview of typical decision making processes and factors that influence ethical decisions. The framework is not a guide for how to make decisions but is intended to provide you with insights and knowledge about typical ethical decision making processes in business organizations.

Because it is impossible to agree on normative judgments about what is ethical, business ethics scholars developing descriptive models have instead focused on regularities in decision making and the various phenomena that interact in a dynamic environment to produce predictable behavioral patterns. Furthermore, it is unlikely that an organization's ethical problems will be solved strictly by having a thorough knowledge about how ethical decisions are made. By its very nature, business ethics involves value judgments and collective agreement about acceptable patterns of behavior.

We propose that gaining an understanding of typical ethical decision making in business organizations will reveal several ways that such decision making could be improved. With more knowledge about how the decision process works, you will be better prepared to analyze critical ethical dilemmas and to provide ethical leadership regardless of your role in the organization. One important conclusion that should be taken from our framework is that ethical decision making within an organization does not rely strictly on the personal values and morals of individuals. Knowledge of moral philosophies or principles must be balanced with business knowledge and understanding of the complexities of the dilemma requiring a decision. For example, a manager who embraces honesty, fairness, and equity has to understand the diverse risks associated with a complex financial instrument such as options or derivatives. Business competence must exist, along with personal accountability, in ethical decisions. Organizations take on a

culture of their own, with managers and coworkers exerting a significant influence on ethical decisions.

THE ROLE OF LEADERSHIP IN A CORPORATE CULTURE

Top managers provide a blueprint for what a firm's corporate culture should be.[28] If these leaders fail to express desired behaviors and goals, a corporate culture will evolve on its own but will still reflect the values and norms of the company. **Leadership,** the ability or authority to guide and direct others toward achievement of a goal, has a significant impact on ethical decision making because leaders have the power to motivate others and enforce the organization's norms and policies as well as their own viewpoints. Leaders are key to influencing an organization's corporate culture and ethical posture. However, one poll found that less than half (47 percent) of employees in large (2,500 employees or more) organizations think that the senior leadership in their firm is highly ethical.[29]

Although we often think of CEOs and other top managers as the most important leaders in an organization, the corporate governance reforms discussed in Chapter 4 make it clear that a firm's board of directors is also an important leadership component. Indeed, directors have a legal obligation to manage companies "for the best interests of the corporation." To determine what is in the best interest of the firm, directors can consider the effects that a decision may have on not only shareholders and employees but also other important stakeholders.[30] Therefore, when we discuss leadership, we include the corporate directors as well as top executives.

In the long run, if stakeholders are not reasonably satisfied with a company's leader, he or she will not retain a leadership position. A leader must have not only his or her followers' respect but also provide a standard of ethical conduct to them. Former chairman of Korean electronics giant Samsung Group, Lee Kun-hee, resigned in disgraced after 20 years on the Samsung board after being accused of evading $128 million in taxes. His son and heir to the company, Lee Jae-yong, also resigned from the board. This was only the final in a long string of corruption charges against Lee. He was also convicted of bribery 10 years ago. Since his resignation, the company has sought to improve its image.[31] Table 5–1 summarizes the steps executives should take to demonstrate that they understand the importance of ethics in doing business.

TABLE 5–1 The Managerial Role in Developing Ethics Program Leadership

1. Organizational commitment from board of directors and top management
2. Organizational resources for ethics initiatives
3. Determine ethical risks and develop contingency plans
4. Develop an effective ethics program to address risks and maintain compliance with ethical standards
5. Provide oversight for implementation and audits of ethical programs
6. Communicate with stakeholders to establish shared commitment and values for ethical conduct.

LEADERSHIP STYLES INFLUENCE ETHICAL DECISIONS

Leadership styles influence many aspects of organizational behavior, including employees' acceptance of and adherence to organizational norms and values. Styles that focus on building strong organizational values among employees contribute to shared standards of conduct. They also influence the organization's transmittal and monitoring of values, norms, and codes of ethics.[32] In short, the leadership style of an organization influences how its employees act. For example, the management philosophy of Mike Armstrong, former CEO of AT&T, is characterized by the observations of its lab's chief, David Nagel: "Most bosses hate conflict. Mike is delighted when he sees us getting at each other." Armstrong has been characterized as scary, demanding, a taskmaster, and a maniac—in an affectionate way. The fast-paced, intensely competitive telecommunications industry requires a "nontraditional" leadership style to achieve success.[33] Studying a firm's leadership styles and attitudes can also help pinpoint where future ethical issues may arise. Even for actions that may be against the law, employees often look to their organizational leaders to determine how to resolve the issue.

"The ethical leadership concept is not only for CEOs, boards of directors, and managers but can also be fellow employees."

Although we often think of CEOs and other top managers as the most important leaders in an organization, a firm's board of directors is also a required leadership and an oversight component. The ethical leadership concept is not only for CEOs, boards of directors, and managers but can also be fellow employees. Ethical leadership by the CEO requires an understanding of the firm's vision and values, as well as the challenges of responsibility and the risk in achieving organizational objectives. Lapses in ethical leadership can occur even in people who possess strong ethical character, especially if they view the organization's ethical culture as being outside the realm of decision making that exists in the home, family, and community. This phenomenon has been observed in countless cases of so-called good community citizens engaging in unethical business activities. For example, Robin Szeliga, former CFO of Qwest, who pleaded guilty for insider trading, was an excellent community leader, even serving on a college of business advisory board.

Ethical leaders need both knowledge and experience to make decisions. Strong ethical leaders must have the right kind of moral integrity. Such integrity must be transparent or, in other words, do in private as if it were always public. This type of integrity relates to values and is discussed in later chapters. They must be proactive and ready to leave the organization if its corporate governance system makes it impossible to make the right choice. Such right choices are complex by definition. The ethical leader must choose a balance of all involved today as well as in the future. Such a person must be concerned with shareholders as well as the lowest-paid employee. Experience shows that no leader can always be right or judged ethical by stakeholders in every case. The acknowledgment of this may be perceived as a weakness, but in reality it supports integrity and increases the debate exchange of views on ethics and openness.

Six leadership styles that are based on emotional intelligence—the ability to manage ourselves and our relationships effectively—have been identified by Daniel Goleman.[34]

1. The coercive leader demands instantaneous obedience and focuses on achievement, initiative, and self-control. Although this style can be very effective during times of

crisis or during a turnaround, it otherwise creates a negative climate for organizational performance.

2. The authoritative leader—considered to be one of the most effective styles—inspires employees to follow a vision, facilitates change, and creates a strongly positive performance climate.

3. The affiliative leader values people, their emotions, and their needs and relies on friendship and trust to promote flexibility, innovation, and risk taking.

4. The democratic leader relies on participation and teamwork to reach collaborative decisions. This style focuses on communication and creates a positive climate for achieving results.

5. The pacesetting leader can create a negative climate because of the high standards that he or she sets. This style works best for attaining quick results from highly motivated individuals who value achievement and take the initiative.

6. The coaching leader builds a positive climate by developing skills to foster long-term success, delegating responsibility, and skillfully issuing challenging assignments.

The most successful leaders do not rely on one style but alter their techniques based on the characteristics of the situation. Different styles can be effective in developing an ethical culture depending on the leader's assessment of risks and desire to achieve a positive climate for organizational performance.

Another way to consider leadership styles is to classify them as transactional or transformational. **Transactional leaders** attempt to create employee satisfaction through negotiating, or "bartering," for desired behaviors or levels of performance. **Transformational leaders** strive to raise employees' level of commitment and to foster trust and motivation.[35] Both transformational and transactional leaders can positively influence the corporate culture.

Transformational leaders communicate a sense of mission, stimulate new ways of thinking, and enhance as well as generate new learning experiences. They consider employee needs and aspirations in conjunction with organizational needs. They also build commitment and respect for values that provide agreement on how to deal with ethical issues.

Thus, transformational leaders strive to promote activities and behavior through a shared vision and common learning experience. As a result, they have a stronger influence on coworker support for ethical decisions and building an ethical culture than do transactional leaders. Transformational ethical leadership is best suited for organizations that have higher levels of ethical commitment among employees and strong stakeholder support for an ethical culture. A number of industry trade associations—including the American Institute of Certified Public Accountants, Defense Industry Initiative on Business Ethics and Conduct, Ethics and Compliance Officer Association, and Mortgage Bankers Association of America—are helping companies provide transformational leadership.[36]

In contrast, transactional leaders focus on ensuring that required conduct and procedures are implemented. Their negotiations to achieve desired outcomes result in a dynamic relationship with subordinates in which reactions, conflict, and crisis influence the relationship more than ethical concerns. Transactional leaders produce employees who achieve a negotiated level of performance, including compliance with ethical and legal standards. As long as employees and leaders both find this exchange mutually rewarding, the relationship is likely to be successful. However, transactional leadership is best suited for rapidly changing situations, including those that require responses to

ethical problems or issues. When Eric Pillmore took over as senior vice president of corporate governance at Tyco, after a major scandal involving CEO Dennis Kozlowski, the company needed transitional leadership. To turn the company around, many ethics and corporate governance decisions needed to be made quickly. The company also needed cross-functional leadership, improved accountability, and empowered leaders in order to improve corporate culture. Pillmore helped install a new ethics program that changed leadership policies and allowed him direct communications with the board in order to help implement the leadership transition.[37]

HABITS OF STRONG ETHICAL LEADERS

Archie Carroll, a University of Georgia business professor, crafted "7 Habits of Highly Moral Leaders" based on the idea of Stephen Covey's *The 7 Habits of Highly Effective People.*[38] We have adapted Carroll's "7 Habits of Highly Moral Leaders"[39] to create our own "Seven Habits of Strong Ethical Leaders" (Table 5–2). In particular, we believe that ethical leadership is based on holistic thinking that embraces the complex and challenging issues that companies face on a daily basis. Ethical leaders need both knowledge and experience to make the right decision. Strong ethical leaders have both the courage and the most complete information to make decisions that will be the best in the long run. Strong ethical leaders must stick to their principles and, if necessary, be ready to leave the organization if its corporate governance system is so flawed that it is impossible to make the right choice.

Many corporate founders—such as Sam Walton, Bill Gates, Milton Hershey, Michael Dell, and Steve Jobs, as well as Ben Cohen and Jerry Greenfield—left their ethical stamp on their companies. Their conduct set the tone, making them role models for desired conduct in the early growth of their respective corporations. In the case of Milton Hershey, his legacy endures, and Hershey Foods continues to be a role model for ethical corporate culture. In the case of Sam Walton, Wal-Mart embarked on a course of rapid growth after his death and became involved in numerous conflicts with various stakeholder groups, especially employees, regulators, competitors, and communities. Despite the ethical foundation left by Sam Walton, Wal-Mart, as well as most large corporations, deals with hundreds of reported ethical lapses every month.[40]

TABLE 5–2 Seven Habits of Strong Ethical Leaders

1. **Ethical leaders have strong personal character.**
2. **Ethical leaders have a passion to do right.**
3. **Ethical leaders are proactive.**
4. **Ethical leaders consider stakeholders' interests.**
5. **Ethical leaders are role models for the organization's values.**
6. **Ethical leaders are transparent and actively involved in organizational decision making.**
7. **Ethical leaders are competent managers who take a holistic view of the firm's ethical culture.**

Ethical Leaders Have Strong Personal Character

There is general agreement that ethical leadership is highly unlikely without a strong personal character. The question is how to teach or develop a moral person in a corporate environment. Thomas I. White, a leading authority on character development, believes the focus should be on "ethical reasoning" rather than on being a "moral person." According to White, the ability to resolve the complex ethical dilemmas encountered in a corporate culture requires intellectual skills.[41] For example, when Lawrence S. Benjamin took over as president of U.S. Food Service after a major ethical disaster, he initiated an ethics and compliance program to promote transparency and to teach employees how to make difficult ethical choices. A fundamental problem in traditional character development is that specific values and virtues are used to teach a belief or philosophy. This approach may be inappropriate for a business environment where cultural diversity and privacy must be respected. On the other hand, teaching individuals who want to do the right thing regarding corporate values and ethical codes, and equipping them with the intellectual skills to address the complexities of ethical issues, is the correct approach.

Ethical Leaders Have a Passion to Do Right

The passion to do right is "the glue that holds ethical concepts together." Some leaders develop this trait early in life, whereas others develop it over time through experience, reason, or spiritual growth. They often cite familiar arguments for doing right—to keep society from disintegrating, to alleviate human suffering, to advance human prosperity, to resolve conflicts of interest fairly and logically, to praise the good and punish the guilty, or just because something "is the right thing to do."[42] Having a passion to do right indicates a personal characteristic of not only recognizing the importance of ethical behavior but also the willingness to face challenges and make tough choices. Courageous leadership requires making and defending the right decision. Consider the crisis faced by Harry Kraemer, the CEO of Baxter International, after 53 dialysis patients died during treatment. "We have this situation. The financial people will assess the potential financial impact. The legal people will do the same. But at the end of the day, if we think it's a problem that a Baxter product was involved in the deaths of 53 people, then those other issues become pretty easy. If we don't do the right thing, then we won't be around to address those other issues."[43]

Ethical Leaders Are Proactive

Ethical leaders do not hang around waiting for ethical problems to arise. They anticipate, plan, and act proactively to avoid potential ethical crises.[44] One way to be proactive is to take a leadership role in developing effective programs that provide employees with guidance and support for making more ethical choices even in the face of considerable pressure to do otherwise. Ethical leaders who are proactive understand social needs and apply or even develop "the best practices" of ethical leadership that exist in their industry. One of *Fortune* magazine's Best Companies to Work For in 2009, office furniture maker Herman Miller is also known for its highly ethical culture. *Fortune* also has ranked it the Most Admired Company in its industry for the past 20 years. Its strong ethical culture has placed Herman Miller at the top of the Human Rights Campaign's Corporate Equality Index for years. Additionally, the company ranks as one of the safest, coolest, and most ethical companies in its industry.[45] Strong leadership is key in maintaining such impressive credentials over the long term.

Ethical Leaders Consider Stakeholders' Interests

Ethical leaders consider the interests of and implications for all stakeholders, not just those that have an economic impact on the firm. This requires acknowledging and monitoring the concerns of all legitimate stakeholders, actively communicating and cooperating with them, employing processes that are respectful of them, recognizing interdependencies among them, avoiding activities that would harm their human rights, and recognizing the potential conflicts between leaders' "own role as corporate stakeholders and their legal and moral responsibilities for the interests of other stakeholders."[46]

Ethical leaders have the responsibility to balance stakeholder interests to ensure that the organization maximizes its role as a responsible corporate citizen. In addition to being one of the world's most admired companies, according to *Fortune* magazine, Xerox has taken significant strides toward reducing its environmental impact, increasing social responsibility, and improving diversity. Xerox is the largest document management and technology company in the world with sales of over $17.6 billion annually, and as such a large company it produces a lot of waste every day. Xerox is aware of its carbon footprint and has produced such innovations as erasable paper to be used in testing machines so that the company does not throw away so much paper each day. The company also aims to be carbon neutral and tries to source its paper from sustainable sources.[47] The company also recently celebrated some significant diversity milestones. In 2009 Ursula Burns became the first African American female to be the CEO of a major American company, and Xerox was the first major company in history to have a female-to-female CEO sucession.[48] The company also extends its commitment to diversity to suppliers as well, because its own research has found that minority and women-owned businesses often have higher standards.[49]

Ethical Leaders Are Role Models for the Organization's Values

If leaders do not actively serve as role models for the organization's core values, then those values become nothing more than lip service. According to behavioral scientist Brent Smith, as role models, leaders are the primary influence on individual ethical behavior. Leaders whose decisions and actions are contrary to the firm's values send a signal that the firm's values are trivial or irrelevant.[50] Firms such as Countrywide Financial articulated core values that were only used as window dressing. On the other hand, when leaders model the firm's core values at every turn, the results can be powerful.

Consider Whole Foods, the world's largest organic and natural grocer. Ever since its conception in Austin, Texas, in 1980, Whole Foods has demonstrated a commitment to social responsibility and strong core values. (See Table 5–3) In addition to providing consumers with fresh, healthy foods, Whole Foods cares for its employees by creating a transparent and friendly work environment. The company encourages a sense of teamwork through imposing a salary cap for top executives. The company also works to support growers and the environment through sourcing from sustainable growers and such efforts as recycling and reducing energy whenever possible. Whole Foods donates a minimum of 5 percent of profits to local communities in which it operates. Especially in a time of repeated food contamination scares, many people are drawn to grocers like Whole Foods because of its high quality standards, educational initiatives, and close relationships with many of its suppliers.[51]

TABLE 5–3 Whole Food's Core Values

• **Selling the highest quality natural and organic products**
• **Satisfying and delighting our customers**
• **Supporting team member happiness and excellence**
• **Creating wealth through profits and growth**
• **Caring about our communities and our environment**
• **Creating ongoing win-win partnerships with our suppliers**
• **Promoting the health of our stakeholders through healthy eating education.**

Source: "Our Core Values," Whole Foods Markets, www.wholefoodsmarket.com/company/corevalues.php (accessed June 5, 2009).

Ethical Leaders Are Transparent and Actively Involved in Organizational Decision Making

Being transparent fosters openness, freedom to express ideas, and the ability to question conduct, and it encourages stakeholders to learn about and comment on what a firm is doing. Transparent leaders will not be effective unless they are personally involved in the key decisions that have ethical ramifications. Transformational leaders are collaborative, which opens the door for transparency through interpersonal exchange. Earlier we said that transformational leaders instill commitment and respect for values that provide guidance on how to deal with ethical issues. Herb Baum, former CEO of the Dial Corporation, says, "In today's business environment, if you're a leader—or want to be—and you aren't contributing to a values-based business culture that encourages your entire organization to operate with integrity, your company is as vulnerable as a baby chick in a pit of rattlesnakes." Baum's three remarkably simple principles of transparency are (1) tell the whole truth, (2) build a values-based culture, and (3) hire "people people."[52]

Ethical Leaders Are Competent Managers Who Take a Holistic View of the Firm's Ethical Culture

Ethical leaders can see a holistic view of their organization and therefore view ethics as a strategic component of decision making, much like marketing, information systems, production, and so on. Although his company is called Waste Management, CEO David P. Steiner is as committed to renewable energy as just about anyone working for a multibillion dollar business. Steiner was selected as one of the 100 Most Influential People in Business Ethics by the Ethisphere Institute in 2007, and his company, Waste Management, was chosen as one of the World's Most Ethical Companies in 2008.[53] Steiner likes to point out that Waste Management produces more renewable energy than the entire U.S. solar industry. In fact, nearly half of the company's revenues come from "green" services.[54] Steiner's personal commitment to social responsibility and sustainability has dramatically changed a company that was previously known primarily as a garbage collection service.

The challenge of being an effective leader is illustrated in Table 5–4. Most senior executives believe that it is much more challenging to be a leader in today's business environment compared to five years ago. Leadership continues to be one of the most important drivers of ethical conduct in organizations.

TABLE 5–4 Leadership Is More Challenging in Today's Business Environment

Do you think it is more or less challenging to be a company leader in today's business environment compared with five years ago?	
More challenging	89%
No change	9%
Less challenging	1%
Don't know	1%

Source: Robert Half Management Resources poll of 150 senior executives at companies with revenue of $1 billion to $40 billion. In *USA Today,* March 6, 2006, B1.

SUMMARY

The key components of the ethical decision making framework include ethical issue intensity, individual factors, organizational factors, and opportunity. These factors are interrelated and influence business ethics evaluations and intentions, which result in ethical or unethical behavior.

The first step in ethical decision making is to recognize that an ethical issue requires that an individual or work group choose among several actions that will ultimately be evaluated as ethical or unethical by various stakeholders. Ethical issue intensity is the perceived relevance or importance of an ethical issue to the individual or work group. It reflects the ethical sensitivity of the individual or work group that triggers the ethical decision process. Other factors in our ethical decision making framework influence this sensitivity, thus determining why different individuals often perceive ethical issues differently.

Individual factors such as gender, education, nationality, age, and locus of control can affect the ethical decision making process, with some factors being more important than others. Organizational factors such as an organization's values often have greater influence on an individual's decisions than that person's own values. In addition, decisions in business are most often made jointly, in work groups and committees, or in conversations and discussions with coworkers. Corporate cultures and structures operate through the individual relationships of the organization's members to influence those members' ethical decisions. A corporate culture can be defined as a set of values, beliefs, goals, norms, and ways of solving problems that members (employees) of an organization share. Corporate culture involves norms that prescribe a wide range of behavior for the organization's members. The ethical culture of an organization indicates whether it has an ethical conscience. Significant others—including peers, managers, coworkers, and subordinates—who influence the work group have more daily impact on an employee's decisions than any other factor in the decision making framework. Obedience to authority may explain why many business ethics issues are resolved simply by following the directives of a superior.

Ethical opportunity results from conditions that either provide rewards, whether internal or external, or limit barriers to ethical or unethical behavior. Included in opportunity is a person's immediate job context, which includes the motivational techniques superiors use to influence employee behavior. The opportunity employees have for unethical behavior in an organization can be eliminated through formal codes, policies, and rules that are adequately enforced by management.

The ethical decision making framework is not a guide for making decisions. It is intended to provide insights and knowledge about typical ethical decision making processes in business organizations. Ethical decision making within organizations does not rely strictly on the personal values and morals of employees. Organizations have a culture of their own, which when combined with corporate governance mechanisms may significantly influence business ethics.

Leadership styles and habits promote an organizational ethical climate. Leadership styles include coercive, authoritative, affiliative, democratic, and coaching elements. Transactional leaders negotiate or barter with employees. Transformational leaders strive for a shared vision and common learning experience. Strong ethical leaders have a strong personal character, have a passion to do the right thing, are proactive, focus on stakeholders' interests, are role models for the organization's values, make transparent decisions, and take a holistic view of the firm's ethical culture.

IMPORTANT TERMS FOR REVIEW

ethical issue intensity
moral intensity
gender
education
nationality
locus of control
external control
internal control
corporate culture
ethical culture
significant other
obedience to authority
opportunity
immediate job context
leadership
transactional leader
transformational leader

RESOLVING ETHICAL BUSINESS CHALLENGES*

Peter had been a human resource (HR) manager for 18 years and vice president for 2 more years for Zyedego Corporation, a small company in New Orleans. In the last decade, there have been many changes to what potential/actual employees can be asked and what constitutes fair and equitable treatment. Frankly, the situation Peter was in was partly his own fault.

The first issue began with Hurricane Katrina. In its wake, Zyedego employees had been working around the clock to get the company up and running again. The company had been calling all employees (if they could locate them) to get them to return to work. Gwyn, one of Peter's HR managers, was planning on rehiring Dana Gonzales but found out that Dana was pregnant. Because of the "rough" condition of the workplace, Gwyn was concerned for Dana's safety. Gwyn felt that if Dana were rehired, employees' hourly wages should be decreased by 25 percent because the company had experienced setbacks during the hurricane and had to work with a reduced

budget. In addition, Gwyn had some concerns over Dana's citizenship because her passport appeared to be questionable. The flooding destroyed the original documents, and although Gwyn requested new documents, Dana had been slow in providing them. Gwyn had asked some difficult questions, and Dana stated that if not rehired she would go to a competitor and expected the company to pay severance of two weeks' wages for the time she was out of work during the hurricane. Another issue is the hiring of truck drivers. Zyedego hires many truck drivers and routinely requests driving records as part of the preemployment process. Several of the potential new hires have past DWI records. All have stated that they would never do it again, have maintained a clean record for at least five years, and understand the consequences of another infraction. Gwyn has hired some drivers with infractions to secure the necessary number of drivers needed for the company. However, Gwyn has some concerns over whether she is exposing the company to unnecessary risk because of the increased potential for accidents or repeat DWI violation. From Peter, Gwyn needs guidance related to continuing these hiring practices.

However, Zyedego has even deeper problems, which is what concerns Peter. The problem really started when Peter was still an HR manager, and involves one "family." Guy Martin started working for Zyedego 20 years ago. He was married with two children, and had a mortgage. A little over a year ago, Guy separated from his wife, and they divorced only to remarry six months later. When Guy was hired, Peter had made sure that Guy's son, who has asthma, would be covered by health insurance. Peter also helped out the family several times when money was tight and provided Guy with overtime work. But tragedy struck the Martins when Guy was killed in the hurricane. Police and rescue workers hunted for his body, but it was never found. Because Martha, Guy's wife, was a stay-at-home mother, their only income had been from Zyedego. The company's death benefits provide only 50 percent of the deceased's pension for a surviving spouse. Also, because the body had not been found, there was the legal question of death. Usually, it takes seven years before one can claim any type of insurance or death-benefit payments, as well as medical insurance, for the family. Even with Social Security benefits, Martha would probably lose the house and could be forced to seek employment.

Zyedego had sustained substantial losses since the hurricane. Insurance companies were extremely slow concerning payments to all the small businesses, arguing about wind versus water damage. Impeding the process of obtaining benefits was the lack of many documents destroyed in the storm.

The storm really began for Peter late last week when he met with the insurance company about medical reimbursements, death benefits, and the pension plans. Darrell Lambert was the chief adjuster for Zyedego's insurance and pension provider.

"Here's another case that we will not cover," said Darrell as he flipped the file to Peter. "We can't help the Martins for a variety of reasons. There is no body, which means no payment until after a judge declares him legally dead. That will take at least a year. While that is being settled, Mrs. Martin and her family will not be eligible for medical coverage unless Zyedego is going to pay their amount. Finally, and I know this may sound heartless, but Mrs. Martin will only get a maximum of half of Mr. Martin's pension."

"But he was killed on the job!" exclaimed Peter.

"Did you require him to work that day? Did he punch in or out? Is there any record that he was called in from Zyedego to help? The answer is no to all of the above. He helped because he felt obligated to Zyedego. But I am not Zyedego, and I do not have any obligation to the Martins," Darrell said with a smile.

"Peter," exclaimed Darrell, "I know that Zyedego is under intense financial pressure, but we are too. You have approximately 100 families that we will have to pay something to. You and I can spend the next 12 months going over every case, bit-by-bit, item-by-item, but if that's what you want, Zyedego will go into bankruptcy. We don't want that to happen. But we also are not going to pay for everything that you claim you are due. Our lawyers will stall the system until you go broke, and your 100 families will get nothing. Well, maybe something in five to seven years. What I am

proposing is a way for you to stay in business and for my company to reduce its financial payouts. Remember, we have hundreds of small businesses like you to deal with."

Darrell then calmly said, "My proposal is that you look over these files and reduce your total reimbursements to us by 40 percent. To help you out, I'll start with this case [Martin's]. You decide whether we pay out 40 percent or nothing. Tomorrow at 9:00 a.m., I want you to have 25 cases, including this one, pared down by 40 percent. If not, well, I'm sure my superiors have informed your superiors about this arrangement by now. You should be getting a call within the hour. So, I'll see you here at 9:00," and Darrell walked out the door.

Several hours later, Peter received a phone call from upper management about the deal he was to implement to save the company.

QUESTIONS • EXERCISES

1. What are the legal and ethical risks associated with the decision about hiring truck drivers at Zyedego?
2. What should Peter recommend to Gwyn about Dana's case?
3. Do you think Peter is too emotionally attached to the Martin case to make an objective decision?

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. The first step in ethical decision making is to understand the individual factors that influence the process.	**Yes**	**No**
2. Opportunity describes the conditions within an organization that limit or permit ethical or unethical behavior.	**Yes**	**No**
3. Transactional leaders negotiate compliance and ethics.	**Yes**	**No**
4. The most significant influence on ethical behavior in an organization is the opportunity to engage in (un)ethical behavior.	**Yes**	**No**
5. Obedience to authority relates to the influence of corporate culture.	**Yes**	**No**

Answers **1. No.** The first step is to become more aware that an ethical issue exists and to consider its relevance to the individual or work group. **2. Yes.** Opportunity results from conditions that provide rewards or fail to erect barriers against unethical behavior. **3. Yes.** Transactional leaders barter or negotiate with employees. **4. No.** Significant others have more impact on ethical decisions within an organization. **5. No.** Obedience to authority relates to the influence of significant others and supervisors.

CHAPTER 6

Individual Factors: Moral Philosophies and Values

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CHAPTER OBJECTIVES

- **To understand how moral philosophies and values influence individual and group ethical decision making in business**
- **To compare and contrast the teleological, deontological, virtue, and justice perspectives of moral philosophy**
- **To discuss the impact of philosophies on business ethics**
- **To recognize the stages of cognitive moral development and its shortcomings**
- **To introduce white-collar crime as it relates to moral philosophies, values, and corporate culture**

CHAPTER OUTLINE

Moral Philosophy Defined

Moral Philosophies

Goodness—Instrumental and Intrinsic

Teleology

Deontology

Relativist Perspective

Virtue Ethics

Justice

Applying Moral Philosophy to Ethical Decision Making

Cognitive Moral Development

White-Collar Crime

The Role of Individual Factors in Business Ethics

AN ETHICAL DILEMMA*

One of the problems that Lael Matthews has had to deal with in trying to climb the corporate ladder is the "glass ceiling" faced by minorities and women. In her current position, she must decide which of three managers to promote, a decision that, as her superior has informed her, could have serious repercussions for her future. The following people are the candidates.

Liz is a 34-year-old African American, divorced with one child, who graduated in the lower half of her college class at Northwest State. She has been with the company for four years and in the industry for eight years, with mediocre performance ratings but a high energy level. She has had some difficulties in managing her staff. In addition, her child has had various medical problems, so higher pay would be helpful. If promoted, Liz would be the first African American female manager at this level. Although Lael has known Liz only a short time, they seem to have hit it off; in fact, Lael once babysat Liz's daughter, Janeen, in an emergency. The downside to promoting Liz, though, might be a perception that Lael is playing favorites.

Roy is a 57-year-old Caucasian, married with three children, who graduated from a private university in the top half of his class. Roy has been with the company for 20 years and in the industry for 30, and he has always been a steady performer, with mostly average ratings. The reason why Roy has been passed over before was his refusal to relocate, but that is no longer a problem. Roy's energy level is average to low; however, he has produced many of the company's top sales performers in the past. This promotion would be his last before retirement, and many in the company feel that he has earned it. In fact, one senior manager stopped Lael in the hall and said, "You know, Lael, Roy has been with us for a long time. He has done many good things for the company, sacrificing not only himself but also his family. I really hope that you can see your way to promoting him. It would be a favor to me that I wouldn't forget."

Quang Yeh, a single, 27-year-old Asian American, graduated from State University in the top 3 percent of her class and has been with the company for three years. She is known for putting in 60-hour weeks and for her meticulous management style, which has generated some criticism from her sales staff. The last area that she managed showed record increases, despite the loss of some older accounts that for some reason did not like dealing with Quang.

Moreover, Quang sued her previous employer for discrimination and won. A comment that Lael heard from that company was that Quang was intense and that nothing would stop her from reaching her goals. As Lael was going over some of her notes, another upper-management individual came to her office and said, "You know, Lael, Quang is engaged to my son. I've looked over her personnel files, and she looks very good. She looks like a rising star, which would indicate that she should be promoted as quickly as possible. I realize that you're not in my division, but the way people get transferred, you never know. I would really like to see Quang get this promotion."

As she was considering the choices, Lael's immediate supervisor came to her to talk about Liz. "You know, Lael, Liz is one of a very few people in the company who is both an African American woman and qualified for this position. I've been going over the company's hiring and promotion figures, and it would be very advantageous for me personally and for the company to promote her. I've also spoken to public relations, and they believe that this would be a tremendous boost for the company."

As Lael pondered her decision, she mentally went through each candidate's records and found that each had advantages and disadvantages. While she was considering her problem, the phone rang. It was Liz, sounding frantic. "Lael, I'm sorry to disturb you at this late hour, but I need you to come to the hospital. Janeen has been in an accident, and I don't know who to turn to." When Lael got to the hospital, she found that Janeen's injuries were fairly serious and that Liz would have to miss some work to help with the recuperation process. Lael also realized that this accident would create a financial problem for Liz, which a promotion could help solve.

The next day seemed very long and was punctuated by the announcement that Roy's son was getting married to the vice president's daughter. The wedding would be in June, and it sounded as though it would be a company affair. By 4:30 that afternoon, Lael had gone through four aspirins and two antacids. Her decision was due in two days. What should she do?

QUESTIONS • EXERCISES

1. Discuss the advantages and disadvantages of each candidate.
2. What are the ethical and legal considerations for Lael?
3. Identify the pressures that have made her promotion decision an ethical and legal issue.
4. Discuss the implications of each decision that Lael could make.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

Most discussions of business ethics address the role of the individual in ethical decision making. The ethical decision making model that was described in Chapter 5 placed the individual moral perspectives as a central component in making an ethical decision. In this chapter, we provide a detailed description and analysis of how individuals' backgrounds and philosophies influence their decisions. It is important to determine when one action is right and when another is viewed as wrong, and individual moral philosophies are often used to justify decisions or explain actions. To understand how people make ethical decisions, it is useful to have a grasp of the major types of moral philosophies. In this chapter, a discussion of the stages of cognitive development as they relate to these moral philosophies and their shortcomings is addressed. Finally, we examine white-collar crime as it relates to moral philosophies and personal values.

MORAL PHILOSOPHY DEFINED

When people talk about philosophy, they usually mean the general system of values by which they live. **Moral philosophy,** on the other hand, refers in particular to the specific principles or rules that people use to decide what is right or wrong. It is important to understand the distinction between moral philosophies and business ethics. A moral philosophy is a person's principles and values that define what is moral or immoral. Moral philosophies are person-specific, whereas business ethics is based on decisions in groups or those made when carrying out tasks to meet business objectives. In the context of business, ethics refers to what the group, firm, or strategic business unit (SBU) defines as right or wrong actions pertaining to its business operations and the objective of profits, earnings per share, or some other financial measure of success as defined by the group. For example, a production manager may be guided by a general philosophy of management that emphasizes encouraging workers to know as much as possible about the product that they are manufacturing. However, the manager's moral philosophy comes into play when he must make decisions such as whether to notify employees in advance of upcoming layoffs. Although workers would prefer advance warning, giving it might adversely affect the quality and quantity of production. Such decisions require a person to evaluate the "rightness," or morality, of choices in terms of his or her own principles and values.

Moral philosophies present guidelines for "determining how conflicts in human interests are to be settled and for optimizing mutual benefit of people living together in groups," guiding businesspeople as they formulate business strategies and resolve specific ethical issues.[1] However, there is no single moral philosophy that everyone accepts. Some managers, for example, view profit as the ultimate goal of an enterprise and therefore may not be concerned about the impact of their firms' decisions on society. As we have seen, the economist Milton Friedman supports this viewpoint, contending that the market will reward or punish companies for unethical conduct without the need for government regulation.[2] The emergence of this Friedman-type capitalism as the dominant and most widely accepted economic system has created market-driven societies around the world. Over the past six decades, the United States has been waging an ideological war over capitalism; first with the Soviet Union, then with Latin America in the 1980s, and finally with China. Even China's communist government has adapted capitalism and free enterprise to help it become a leading economic power. The United States has been actively exporting the idea that the invisible hand of free market capitalism can solve the troubles of mankind and lead toward greater happiness and prosperity. Such happiness is derived from the increased availability of products and services. Marketing helps consumers to understand, compare, and obtain these products and services, thereby increasing the efficiency and effectiveness of the exchange. However, free markets may not be a panacea- For example, empirical research and a study of history show that excessive consumption can have negative effects and may be psychologically, spiritually, and physically unhealthy.[3] In other words, more is not necessarily best.

Adam Smith is considered the father of free market capitalism. He was a professor of logic and moral philosophy and wrote the seminal "The Theory of Moral Sentiments" and the book *Inquiry into the Nature and Causes of the Wealth of Nations* (1776). Smith believed that business was and should be guided by the morals of good men. But in the eighteenth century, Smith could not image the complexity of modern markets or the size of multinationals, nor could he fathom the concept that four or five companies could gain control of the vast

majority of the resources of the world. His ideas did not take into account the full force of democracy, nor the immense wealth and power some firms wield within countries.

Economic systems not only allocate resources and products within a society but also affect individuals and society as a whole. Thus, the success of an economic system depends both on its philosophical framework and on the individuals within the system who maintain moral philosophies that bring people together in a cooperative, efficient, and productive marketplace. Going back to Aristotle, there is a long Western tradition of questioning whether a market economy and individual moral behavior are compatible. In reality, individuals in today's society exist within the framework of social, political, and economic institutions.

People who face ethical issues often base their decisions on their own values and principles of right or wrong, most of which are learned through the socialization process with the help of family members, social groups, religions, and formal education. Individual factors that influence decision making include personal moral philosophies. Ethical dilemmas arise in problem-solving situations in which the rules governing decision making are often vague or in conflict. In real-life situations, there is no substitute for an individual's own critical thinking and ability to accept responsibility for his or her decision.

Moral philosophies are ideal moral perspectives that provide individuals with abstract principles for guiding their social existence. For example, individuals' decisions to recycle waste or to purchase or sell recycled or recyclable products are influenced by moral philosophies and attitudes toward recycling.[4] Thus, it is often difficult to implement an individual moral philosophy within the complex environment of a business organization. On the other hand, the functioning of our economic system depends on individuals coming together and sharing philosophies that create the moral values, trust, and expectations that allow the system to work. Most employees within a business organization do not think about what particular moral philosophy they are using when they are confronted with an ethical issue. Individuals learn decision making approaches or philosophies through their cultural and social development.

Many theories associated with moral philosophies refer to a value orientation and such things as economics, idealism, and relativism. The concept of the **economic value orientation** is associated with values that can be quantified by monetary means; thus, according to this theory, if an act produces more value than its effort, then it should be accepted as ethical. **Idealism,** on the other hand, is a moral philosophy that places special value on ideas and ideals as products of the mind, in comparison with the world's view. The term refers to efforts to account for all objects in nature and experience and assign to such representations a higher order of existence. Studies have found that there is a positive correlation between idealistic thinking and ethical decision making. **Realism** is the view that an external world exists independent of our perception of it. Realists work under the assumption that humankind is not inherently benevolent and kind but instead is inherently self-centered and competitive. According to realists, each person is always ultimately guided by his or her own self-interest. Research shows a negative correlation between realistic thinking and ethical decision making. Thus, the belief that all actions are ultimately self-motivated leads to a tendency toward negative ethical decision making.

MORAL PHILOSOPHIES

There are many moral philosophies, but because a detailed study of all moral philosophies is beyond the scope of this book, we limit our discussion to those that are most applicable to the study of business ethics. Our approach focuses on the most basic concepts needed to

help you understand the ethical decision making process in business. We do not prescribe the use of any particular moral philosophy, for there is no one "correct" way to resolve ethical issues in business.

To help you understand how the moral philosophies discussed in this chapter may be applied in decision making, we use a hypothetical situation as an illustration. Suppose that Sam Colt, a sales representative, is preparing a sales presentation for his firm Midwest Hardware, which manufactures nuts and bolts. Sam hopes to obtain a large sale from a construction firm that is building a bridge across the Mississippi River near St. Louis. The bolts manufactured by Midwest Hardware have a 3 percent defect rate, which, although acceptable in the industry, makes them unsuitable for use in certain types of projects, such as those that may be subject to sudden, severe stress. The new bridge will be located near the New Madrid Fault line, the source of the United States' greatest earthquake in 1811. The epicenter of that earthquake, which caused extensive damage and altered the flow of the Mississippi, is less than 200 miles from the new bridge site. Earthquake experts believe there is a 50 percent chance that an earthquake with a magnitude greater than 7 on the Richter scale will occur somewhere along the New Madrid Fault by the year 2020. Bridge construction in the area is not regulated by earthquake codes, however. If Sam wins the sale, he will earn a commission of $25,000 on top of his regular salary. But if he tells the contractor about the defect rate, Midwest may lose the sale to a competitor that markets bolts with a lower defect rate. Thus, Sam's ethical issue is whether to point out to the bridge contractor that, in the event of an earthquake, some Midwest bolts could fail, possibly resulting in the collapse of the bridge.

We will come back to this illustration as we discuss particular moral philosophies, asking how Sam Colt might use each philosophy to resolve his ethical issue. We don't judge the quality of Sam's decision, nor do we advocate any one moral philosophy; in fact, this illustration and Sam's decision rationales are necessarily simplistic as well as hypothetical. In reality, the decision maker would probably have many more factors to consider in making his or her choice and thus might reach a different decision. With that note of caution, we introduce the concept of goodness and several types of moral philosophy: teleology, deontology, the relativist perspective, virtue ethics, and justice theories (see Table 6–1).

TABLE 6–1 A Comparison of the Philosophies used in Business Decisions

Teleology	**Stipulates that acts are morally right or acceptable if they produce some desired result, such as realization of self-interest or utility.**
Egoism	**Defines right or acceptable actions as those that maximize a particular person's self-interest as defined by the individual.**
Utilitarianism	**Defines right or acceptable actions as those that maximize total utility, or the greatest good for the greatest number of people.**
Deontology	**Focuses on the preservation of individual rights and on the intentions associated with a particular behavior rather than on its consequences.**
Relativist	**Evaluates ethicalness subjectively on the basis of individual and group experiences.**
Virtue ethics	**Assumes that what is moral in a given situation is not only what conventional morality requires but also what the mature person with a "good" moral character would deem appropriate.**
Justice	**Evaluates ethicalness on the basis of fairness: distributive, procedural, and interactional.**

Goodness—Instrumental and Intrinsic

To appreciate moral philosophy, one must understand the differing perspectives of goodness. Are there clearly defined goods and bads and, if so, what is the relationship between the ends and the means of bringing them about? Is there some intrinsic way of determining if the ends can be identified independently as good or bad? Aristotle, for example, argued that happiness is an intrinsically good end—in other words, its goodness is natural and universal, without relativity. On the other hand, the philosopher Immanuel Kant emphasized means and motivations to argue that goodwill, seriously applied toward accomplishment, is the only thing good in itself.

Two basic concepts of goodness are monism and pluralism. **Monists** believe that only one thing is intrinsically good, and the pluralists believe that two or more things are intrinsically good. Monists are often exemplified by **hedonism**—that one's pleasure is the ultimate intrinsic good or that the moral end, or goodness, is the greatest balance of pleasure over pain. Hedonism defines right or acceptable behavior as that which maximizes personal pleasure. Moral philosophers describe those who believe that more pleasure is better as **quantitative hedonists** and those who believe that it is possible to get too much of a good thing (such as pleasure) as **qualitative hedonists**.

Pluralists, often referred to as nonhedonists, take the opposite position that no *one* thing is intrinsically good. For example, a pluralist might view other ultimate goods as beauty, aesthetic experience, knowledge, and personal affection. Plato argued that the good life is a mixture of (1) moderation and fitness, (2) proportion and beauty, (3) intelligence and wisdom, (4) sciences and arts, and (5) pure pleasures of the soul.

Although all pluralists are nonhedonists, it is important to note that all monists are not necessarily hedonists. An individual can believe in a single intrinsic good other than pleasure; Machiavelli and Nietzsche, for example, each held power to be the sole good, and Kant's belief in the single virtue of goodwill classifies him as a monistic nonhedonist.

A more modern view is expressed in the instrumentalist position. Sometimes called pragmatists, **instrumentalists** reject the idea that (1) ends can be separated from the means that produce them and (2) ends, purposes, or outcomes are intrinsically good in and of themselves. The philosopher John Dewey argued that the ends–means perspective is a relative distinction, that the difference between ends and means is no difference at all but merely a matter of the individual's perspective; thus, almost any action can be an end or a means. Dewey gives the example that people eat in order to be able to work, and they work in order to eat. From a practical standpoint, an end is only a remote means, and a means is but a series of acts viewed from an earlier stage. From this it follows that there is no such thing as a single, universal end.

So how does this discussion equate to business? Isn't business about shareholder wealth and the wealth of executives? To measure success in business is to measure monetary wealth . . . right? To answer this question, let's go back to 1923 when a meeting was held at the Edgewater Beach Hotel in Chicago. Attending this meeting were nine of the richest men in the world: (1) Charles Schwab, president of the world's largest independent steel company; (2) Samuel Insull, president of the world's largest utility company; (3) Howard Hopson, president of the world's largest gas firm; (4) Arthur Cutten, the greatest wheat speculator; (5) Richard Whitney, president of the New York Stock Exchange; (6) Albert Fall, member of the president's cabinet; (7) Leon Fraizer, president of the Bank of International Settlements; (8) Jessie Livermore, the greatest speculator in the stock market; and (9) Ivar Kreuger, head of the company with the most widely distributed securities in the world. Twenty-five years later, (1) Charles Schwab had died having lived on borrowed money for the last five years of his life, (2) Samuel Insull had died a penniless fugitive,

(3) Howard Hopson had gone insane, (4) Arthur Cutten had died bankrupt, (5) Richard Whitney had spent time in prison, (6) Albert Fall had been pardoned from prison so that he could die at home, and (7) Leon Fraizer, (8) Jessie Livermore, and (9) Ivar Kreuger had committed suicide. Measured by wealth and power, these men had achieved success, at least temporarily. So this begs the question of whether money guarantees happiness; in other words, do the ends always justify the means?

A discussion of moral value often revolves around the nature of goodness—instrumental or intrinsic. Theories of moral obligation, by contrast, change the question to "What makes a given action right or obligatory?" **Goodness theories** typically focus on the *end result* of actions and the goodness or happiness created by them, whereas **obligation theories** emphasize the *means* and *motives* by which actions are justified. These obligation theories are teleology and deontology, respectively.

Teleology

Teleology (from the Greek word for "end" or "purpose") refers to moral philosophies in which an act is considered morally right or acceptable if it produces some desired result such as pleasure, knowledge, career growth, the realization of self-interest, utility, wealth, or even fame. In other words, teleological philosophies assess the moral worth of a behavior by looking at its consequences, and thus moral philosophers today often refer to these theories as **consequentialism**. Two important teleological philosophies that often guide decision making in individual business decisions are egoism and utilitarianism.

> *Teleological philosophies assess the moral worth of a behavior by looking at its consequences*

Egoism defines right or acceptable behavior in terms of its consequences for the individual. Egoists believe that they should make decisions that maximize their own self-interest, which is defined differently by each individual. Depending on the egoist, self-interest may be construed as physical well-being, power, pleasure, fame, a satisfying career, a good family life, wealth, or something else. In an ethical decision making situation, an egoist will probably choose the alternative that contributes most to his or her self-interest. The egoist's creed generally can be stated as "Do the act that promotes the greatest good for oneself." Many believe that egoistic people and companies are inherently unethical, are short-term oriented, and will take advantage of any opportunity. For example, some telemarketers demonstrate this negative tendency when they prey on elderly consumers who may be vulnerable because of loneliness or fear of losing their financial independence. Thousands of senior citizens fall victim to fraudulent telemarketers every year, in many cases losing all of their savings and sometimes their homes.

However, there is also **enlightened egoism**. Enlightened egoists take a long-range perspective and allow for the well-being of others although their own self-interest remains paramount. An example of enlightened egoism is helping a turtle across a highway because, if killed, the person would feel distressed. To feel good, or eliminate the chance of a feeling of distress, the person helps the turtle to cross the road.[5] Enlightened egoists may, for example, abide by professional codes of ethics, control pollution, avoid cheating on taxes, help create jobs, and support community projects. Yet they do so not because these actions benefit others but because they help achieve some ultimate goal for the egoist, such as advancement within the firm. An enlightened egoist might call management's attention to a coworker who is making false accounting reports but only to safeguard the company's reputation and thus the

egoist's own job security. In addition, some enlightened egoists may become whistle-blowers and report misconduct to a government regulatory agency to keep their job and receive a reward for exposing misconduct. When businesses donate money, resources, or time to specific causes and institutions, their motives may not be purely altruistic either. For example, International Business Machines (IBM) has a policy of donating or reducing the cost of computers to educational institutions. In exchange, the company receives tax breaks for donations of equipment, which reduces the cost of its philanthropy. In addition, IBM hopes to build future sales by placing its products on campuses. When students enter the workforce, they may request the IBM products with which they have become familiar. Although the company's actions benefit society in general, in the long run they also benefit IBM.

Let's return to the hypothetical case of Sam Colt, who must decide whether to warn the bridge contractor that 3 percent of Midwest Hardware's bolts are likely to be defective. If he is an egoist, he will probably choose the alternative that maximizes his own self-interest. If he defines self-interest in terms of personal wealth, his personal moral philosophy may lead him to value a $25,000 commission more than a chance to reduce the risk of a bridge collapse. As a result, an egoist might well resolve this ethical dilemma by keeping quiet about the bolts' defect rate, hoping to win the sale and the $25,000 commission, rationalizing that there is a slim chance of an earthquake, that bolts would not be a factor in a major earthquake, and that, even if they were, no one would be able to prove that defective bolts caused the bridge to collapse.

"The utilitarian seeks the greatest good for the greatest number of people."

Like egoism, **utilitarianism** is concerned with consequences, but the utilitarian seeks the greatest good for the greatest number of people. Utilitarians believe that they should make decisions that result in the greatest total *utility,* that achieve the greatest benefit for all those affected by a decision. An argument for utilitarianism may be President Obama's 2009 economic stimulus package. Its costs to the American taxpayer may have been weighted against the greater costs of allowing the market to fall into a depression without government intervention.

Utilitarian decision making relies on a systematic comparison of the costs and benefits to all affected parties. Using such a cost–benefit analysis, a utilitarian decision maker calculates the utility of the consequences of all possible alternatives and then selects the one that results in the greatest benefit. For example, the U.S. Supreme Court has ruled that supervisors are responsible for the sexual misconduct of employees, even if the employers knew nothing about the behavior, establishing a strict standard for harassment on the job. One of the justices indicated in the ruling that the employer's burden to prevent harassment is "one of the costs of doing business."[6] Apparently, the Court has decided that the greatest utility to society will result from forcing businesses to prevent harassment.

In evaluating an action's consequences, some utilitarians consider the effects on animals as well as on human beings. This perspective is especially significant in the controversy surrounding the use of animals for research purposes by cosmetics and pharmaceutical companies. Animal rights groups have protested that such testing is unethical because it harms and even kills the animals, depriving them of their rights. Researchers for pharmaceutical and cosmetics manufacturers, however, defend animal testing on utilitarian grounds. The consequences of the research (such as new or improved drugs to treat disease, or safer cosmetics) create more benefit for society, they argue, than would be achieved by halting the research and preserving the animals' rights. Nonetheless, many cosmetics firms have responded to the controversy by agreeing to stop animal research.

Now suppose that Sam Colt, the bolt salesperson, is a utilitarian. Before making his decision, he would conduct a cost–benefit analysis to assess which alternative would create

the greatest utility. On one hand, building the bridge would improve roadways and allow more people to cross the Mississippi River to reach jobs in St. Louis. The project would create hundreds of jobs, enhance the local economy, and unite communities on both sides of the river. Additionally, it would increase the revenues of Midwest Hardware, allowing the firm to invest more in research to lower the defect rate of bolts it produced in the future. On the other hand, a bridge collapse could kill or injure as many as 100 people. But the bolts have only a 3 percent defect rate, there is only a 50 percent probability of an earthquake *somewhere* along the fault line, and there might be only a few cars on the bridge at the time of a disaster.

After analyzing the costs and benefits of the situation, Sam might rationalize that building the bridge with his company's bolts would create more utility (jobs, unity, economic growth, and company growth) than would result from telling the bridge contractor that the bolts might fail in an earthquake. If so, a utilitarian would probably not alert the bridge contractor to the defect rate of the bolts.

Utilitarians use various criteria to judge the morality of an action. Some utilitarian philosophers have argued that general rules should be followed to decide which action is best.[7] These **rule utilitarians** determine behavior on the basis of principles, or rules, designed to promote the greatest utility rather than on an examination of each particular situation. One such rule might be "Bribery is wrong." If people felt free to offer bribes whenever they might be useful, the world would become chaotic; therefore, a rule prohibiting bribery would increase utility. A rule utilitarian would not bribe an official, even to preserve workers' jobs, but would adhere strictly to the rule. Rule utilitarians do not automatically accept conventional moral rules, however; thus, if they determined that an alternative rule would promote greater utility, they would advocate changing it.

Other utilitarian philosophers have argued that the rightness of each individual action must be evaluated to determine whether it produces the greatest utility for the greatest number of people.[8] These **act utilitarians** examine a specific action itself, rather than the general rules governing it, to assess whether it will result in the greatest utility. Rules such as "Bribery is wrong" serve only as general guidelines for act utilitarians. They would likely agree that bribery is generally wrong, not because there is anything inherently wrong with bribery, but because the total amount of utility decreases when one person's interests are placed ahead of those of society.[9] In a particular case, however, an act utilitarian might argue that bribery is acceptable.

For example, a sales manager might believe that his or her firm will not win a construction contract unless a local government official gets a bribe; moreover, if the firm does not obtain the contract, it will have to lay off 100 workers. The manager might therefore argue that bribery is justified because saving 100 jobs creates more utility than obeying a law. Another example may be found in the actions of farmers in China who use toxic melamine to increase milk quality. Melamine's chemical properties boost the apparent presence of protein in food. Manufacturers of melamine, an industrial chemical used in plastics, say they had noticed a rising demand for their factories' scrap. Actual protein powders are also prohibited from being added to raw milk. They are made from ground animal parts, soy, and other sources. China's biggest local seller of liquid milk, Nestlé SA, said it was aware that Chinese farmers and traders added unauthorized substances to raw milk, but that it didn't know melamine was among them. Among other common milk additives: a viscous yellow liquid containing fat and a combination of preservatives and antibiotics, known as "fresh-keeping liquid" is "very common" and hard to detect. It can be argued that everyone within the milk supply chain saw their actions as helping more people financially rather than harm them from the unknown dangers of the additives.[10]

Deontology

Deontology (from the Greek word for "ethics") refers to moral philosophies that focus on the rights of individuals and on the intentions associated with a particular behavior rather than on its consequences. Fundamental to deontological theory is the idea that equal respect must be given to all persons. Unlike utilitarians, deontologists argue that there are some things that we should *not* do, even to maximize utility. For example, deontologists would consider it wrong to kill an innocent person or commit a serious injustice against a person, no matter how much greater social utility might result from doing so, because such an action would infringe on that person's rights as an individual. The utilitarian, however, might consider as acceptable an action that resulted in a person's death if that action created some greater benefit. Deontological philosophies regard certain behaviors as inherently right, and the determination of this rightness focuses on the individual actor, not society. Thus, these perspectives are sometimes referred to as **nonconsequentialism** an ethics based on *respect for persons.*

> *Teleological philosophies consider the ends associated with an action whereas deontological philosophies consider the means.*

Contemporary deontology has been greatly influenced by the German philosopher Immanuel Kant, who developed the so-called categorical imperative: "Act as if the maxim of thy action were to become by thy will a universal law of nature."[11] Simply put, if you feel comfortable allowing everyone in the world to see you commit an act and if your rationale for acting in a particular manner is suitable to become a universal principle guiding behavior, then committing that act is ethical. For example, if a person borrows money, promising to return it but with no intention of keeping that promise, he or she cannot "universalize" that act. If everyone were to borrow money without the intention of returning it, no one would take such promises seriously, and all lending would cease.[12] Therefore, the rationale for the action would not be a suitable universal principle, and the act could not be considered ethical.

The term *nature* is crucial for deontologists. In general, deontologists regard the nature of moral principles as permanent and stable, and they believe that compliance with these principles defines ethicalness. Deontologists believe that individuals have certain absolute rights:

- Freedom of conscience
- Freedom of consent
- Freedom of privacy
- Freedom of speech
- Due process[13]

To decide whether a behavior is ethical, deontologists look for conformity to moral principles. For example, if a manufacturing worker becomes ill or dies as a result of conditions in the workplace, a deontologist might argue that the company must modify its production processes to correct the condition, no matter what the cost—even if it means bankrupting the company and thus causing all workers to lose their jobs. In contrast, a utilitarian would analyze all the costs and benefits of modifying production processes and make a decision on that basis. This example is greatly oversimplified, of course, but it helps clarify the difference between teleology and deontology. In short, teleological philosophies consider the *ends* associated with an action whereas deontological philosophies consider the *means.*

Returning again to our bolt salesperson, let's consider a deontological Sam Colt. He would probably feel obliged to tell the bridge contractor about the defect rate because

of the potential loss of life that might result from an earthquake-caused bridge collapse. Even though constructing the bridge would benefit residents and earn Sam a substantial commission, the failure of the bolts during an earthquake would infringe on the rights of any person crossing the bridge at the time of the collapse. Thus, the deontological Sam would likely inform the bridge contractor of the defect rate and point out the earthquake risk, even though, by doing so, he would probably lose the sale.

As with utilitarians, deontologists may be divided into those who focus on moral rules and those who focus on the nature of the acts themselves. **Rule deontologists** believe that conformity to general moral principles determines ethicalness. Deontological philosophies use reason and logic to formulate rules for behavior. Examples include Kant's categorical imperative and the Golden Rule of the Judeo-Christian tradition: Do unto others as you would have them do unto you. Such rules, or principles, guiding ethical behavior override the imperatives that emerge from a specific context. One could argue that Jeffery Wigand—who exposed the underside of the tobacco industry when he blew the whistle on his employer, Brown & Williamson Tobacco—was such a rule deontologist. Although it cost him both financially and socially, Wigand testified to Congress about the realities of marketing cigarettes and their effects on society.[14]

Rule deontology is determined by the relationship between the basic rights of the individual and a set of rules governing conduct. For example, a video store owner accused of distributing obscene materials could argue from a rule deontological perspective that the basic right to freedom of speech overrides the other indecency or pornography aspects of his business. Indeed, the free-speech argument has held up in many courts. Kant and rule deontologists would support a process of discovery to identify the moral issues relevant to a firm's mission and objectives. Then, they would follow a process of justifying that mission or those objectives based on rules.[15] An example of rule deontology is Kellogg's president, David Mackay. After hearing about possible salmonella contamination in peanut butter, he encouraged supermarkets not to sell Kellogg's products using peanut butter until the source of the contamination was discovered and peanut butter was deemed safe again.

Act deontologists, in contrast, hold that actions are the proper basis on which to judge morality or ethicalness. Act deontology requires that a person use equity, fairness, and impartiality when making and enforcing decisions.[16] For act deontologists, as for act utilitarians, rules serve only as guidelines, with past experiences weighing more heavily than rules upon the decision making process. In effect, act deontologists suggest that people simply *know* that certain acts are right or wrong, regardless of the consequences or any appeal to deontological rules. In addition, act deontologists regard the particular act or moment in time as taking precedence over any rule. For example, many people view data collection by Internet sites as a violation of personal privacy in itself. Regardless of any website's stated rules or policies, many Internet users want to be left alone unless they provide permission to be tracked while online.[17] A high school teacher at Hoover High in Alabama purportedly lost her job because she refused to change a football player's grade. It would have been much easier for her to do as others had done, yet the philosophy she used was within the act deontologist's range.[18] Current research suggests that rule and act deontological principles play a larger role in a person's decision than teleological philosophies.[19]

As we have seen, ethical issues can be evaluated from many different perspectives. Each type of philosophy discussed here would have a distinct basis for deciding whether a particular action is right or wrong. Adherents of different personal moral philosophies may disagree in their evaluations of a given action, yet all are behaving ethically *according to their own standards.* All would agree that there is no one "right" way to make ethical

decisions and no best moral philosophy except their own. The relativist perspective may be helpful in understanding how people make such decisions in practice.

Relativist Perspective

From the **relativist perspective**, definitions of ethical behavior are derived subjectively from the experiences of individuals and groups. Relativists use themselves or the people around them as their basis for defining ethical standards, and the various forms of relativism include descriptive, metaethical, or normative.[20] **Descriptive relativism** relates to observing cultures. We may observe that different cultures exhibit different norms, customs, and values and, in so doing, arrive at a factual description of a culture. These observations say nothing about the higher questions of ethical justification, however. At this point metaethical relativism comes into play.

Metaethical relativists understand that people naturally see situations from their own perspectives and argue that, as a result, there is no objective way of resolving ethical disputes between value systems and individuals. Simply put, one culture's moral philosophy cannot logically be preferred to another because there exists no meaningful basis for comparison. Because ethical rules are relative to a specific culture, the values and behaviors of people in one culture need not influence the behaviors of people in another culture.[21] At the individual level of reasoning, we have **normative relativism**. Normative relativists assume that one person's opinion is as good as another's.[22]

Normative relativists assume that one person's opinion is as good as another's.

Basic relativism acknowledges that we live in a society in which people have many different views and bases from which to justify decisions as right or wrong. The relativist looks to the interacting groups and tries to determine probable solutions based on group consensus. When formulating business strategies and plans, for example, a relativist would try to anticipate the conflicts that might arise between the different philosophies held by members of the organization, its suppliers, its customers, and the community at large.

The relativist observes the actions of members of an involved group and attempts to determine that group's consensus on a given behavior. A positive consensus, for example, would signify that the group considers the action to be right or ethical. However, such judgments may not remain valid forever. As circumstances evolve or the makeup of the group changes, a formerly accepted behavior may come to be viewed as wrong or unethical, or vice versa. Within the accounting profession, for example, it was traditionally considered unethical to advertise. However, advertising has been gaining acceptance among accountants. This shift in ethical views may have come about as a result of the steady increase in the number of accountants, which has led to greater competition. Moreover, the federal government investigated the restrictions that accounting groups placed on their members and concluded that they inhibited free competition. Consequently, an informal consensus has emerged in the accounting industry that advertising is now acceptable. A problem with relativism is that it places too much emphasis on peoples' differences while ignoring their basic similarities. Similarities within different people and cultures—such as beliefs against incest, murder, and theft or promoting reciprocity and respect for the elderly—are hard to argue away and hard to explain from the relativist perspective.

In the case of the Midwest Hardware salesperson, if he were a relativist, he would attempt to determine the group consensus before deciding whether to tell his prospective customer about the bolts' defect rate. The relativist Sam Colt would look at both his own company's policy and at the general industry practice. He might also informally survey his

colleagues and superiors as well as consulting industry trade journals and codes of ethics. Such investigations would help him determine the group consensus, which should reflect a variety of moral philosophies. If he learns that general company policy, as well as industry practice, is to discuss defect rates with those customers for whom faulty bolts may cause serious problems, he may infer that there is a consensus on the matter. As a relativist, he would probably then inform the bridge contractor that some of the bolts may fail, perhaps leading to a bridge collapse in the event of an earthquake. Conversely, if he determines that the normal practice in his company and the industry is to not inform customers about defect rates, he would probably not raise the subject with the bridge contractor.

Empirical research into the general concept of relativism suggests that it is negatively related to a person's ethical sensitivity to issues. Thus, if someone scores high on relativism, he or she will probably be less likely to detect or be sensitive to issues that are defined by others as having an ethical component.[23]

Virtue Ethics

A moral virtue represents an acquired disposition that is valued as a part of an individual's character. As an individual develops socially, he or she may become disposed to behave in the same way (in terms of reasons, feelings, and desires) as what he or she considers to be moral.[24] A person who has the character trait of honesty will be disposed to tell the truth because it is considered to be right and comfortable. This individual will always try to tell the truth because of its importance in human communication. A virtue is considered praiseworthy because it is an achievement that an individual develops through practice and commitment.[25]

This philosophy is called **virtue ethics**, and it posits that what is moral in a given situation is not only what conventional morality or moral rules (current societal definitions) require but also what the mature person with a "good" moral character would deem appropriate.

Proponents of virtue ethics frequently discuss lists of basic goods and virtues, which are generally presented as positive and useful mental habits or cultivated character traits. Aristotle named, among others, standards of loyalty, courage, wit, community, and judgment as the "excellences" that society requires. While listing the important virtues is a popular theoretical task, the philosopher Dewey cautions that virtues should not be looked at separately. The pluralism of virtues gives the businessperson a positive character and constitutes the very best idea of integrity of character. The virtue ethics approach to business can be summarized as follows:

1. Individual virtue and integrity count, but good corporate ethics programs encourage individual virtue and integrity.
2. By the employee's role in the community (organization), these virtues associated with appropriate conduct form a good person.
3. The ultimate purpose is to serve society's demands and the public good and to be rewarded in one's career.
4. The well-being of the community goes together with individual excellence because of the social consciousness and public spirit of every individual.[26]

The difference between deontology, teleology, and virtue ethics is that the first two are applied *deductively* to problems whereas virtue ethics is applied *inductively*. Virtue ethics assumes that what current societal moral rules require may indeed be the moral minimum

for the beginning of virtue. The viability of our political, social, and economic systems depends on the presence of certain virtues among the citizenry that are vital for the proper functioning of a market economy.[27]

Indeed, virtue theory could be thought of as a dynamic theory of how to conduct business activities. The virtue ethicist believes that to have a successful market economy, society must be capable of carving out sanctuaries such as family, school, church, and community, where virtues can be nurtured. These virtues, including truth, trust, tolerance, and restraint, can play a role in the functioning of an individualistic, contractual economy and create obligations that make social cooperation possible. The operation of a market economy based on virtues provides a traditional existence where individuals in the economic system have powerful inducements to conform to prevailing standards of behavior. Some philosophers think that virtues may be weakened by the operation of the market, but virtue ethicists believe that institutions and society must maintain a balance and constantly add to their stock of virtues.[28] Some of the virtues that could drive a market economy are listed in Table 6–2; the list, although not comprehensive, provides examples of the types of virtues that support the business environment.

TABLE 6–2 Virtues That Support Business Transactions

Trust: The predisposition to place confidence in the behavior of others while taking the risk that the expected behavior will not be performed	Trust eliminates the need for and associated cost of monitoring compliance with agreements, contracts, and reciprocal agreements. There is the expectation that a promise or agreement can be relied on.
Self-control: The disposition to pass up an immediate advantage or gratification. It indicates the ability to avoid exploiting a known opportunity for self-interest	The trade-off is between short-term self-interest and long-term benefits.
Empathy: The ability to share the feelings or emotions of others	Empathy promotes civility because success in the market depends on the courteous treatment of people who have the option of going to competitors. The ability to anticipate needs and satisfy customers and employees contributes to a firm's economic success.
Fairness: The disposition to deal equitably with the perceived injustices of others	Fairness often relates to doing the right thing with respect to small matters in order to cultivate a long-term business relationship.
Truthfulness: The disposition to provide the facts or correct information as known to the individual	Telling the truth involves avoiding deception and contributes to trust in business relationships.
Learning: The disposition to constantly acquire knowledge internal and external to the firm, whether of an industry, culture, or other societies	Learning involves gaining knowledge to make better, more informed decisions.
Gratitude: A sign of maturity that is the beginning of civility and decency	Gratitude is the recognition that people do not succeed alone.
Civility: The disposition or essence of courtesy, politeness, respect, and consideration for others	Civility relates to the process of doing business in a culturally correct way, thus decreasing communication errors and increasing trust.
Moral leadership: Strength of character, peace of mind, heart, and happiness in life	Moral leadership is a trait of those leaders who follow a consistent pattern of behavior based on virtues

Source: Adapted from Ian Maitland, "Virtuous Markets: The Market as School of the Virtues," *Business Ethics Quarterly* (January 1997): 97; and Gordon B. Hinckley, *Standing for Something: 10 Neglected Virtues That Will Heal Our Hearts and Homes* (New York: Three Rivers Press, 2001).

The elements of virtue that are important to business transactions have been defined as trust, self-control, empathy, fairness, and truthfulness. Attributes in contrast to virtue would include lying, cheating, fraud, and corruption. In their broadest sense, these concepts appear to be accepted within all cultures. The problem of virtue ethics comes in its implementation within and between cultures, as those who practice virtue ethics go beyond social norms. For example, if a company tacitly approves of corruption, the employee who adheres to the virtues of trust and truthfulness would consider it wrong to sell unneeded repair parts despite the organization's approval of such acts. Some employees might view this truthful employee as highly ethical but, in order to rationalize their own behavior, judge his or her ethics as going beyond what is required by their job or society. They might argue that virtue is an unattainable goal and thus one should not be obliged to live up to its standards. However, to those who espouse virtue ethics, this relativistic argument is meaningless because they believe in the universal reality of the elements of virtue.

If our salesperson Sam Colt were a virtue ethicist, he would consider the elements of virtue and then tell the prospective customer about the defect rate and about his concerns regarding the building of the bridge. He would not resort to puffery to explain the product or its risks and, indeed, might suggest alternative products or companies that would lower the probability of the bridge collapsing.

Justice

Justice as it is applied in business ethics involves evaluations of fairness or the disposition to deal with perceived injustices of others. Justice is fair treatment and due reward in accordance with ethical or legal standards. In business, this means that the decision rules used by an individual to determine the justice of a situation could be based on the perceived rights of individuals and on the intentions of the people involved in a given business interaction. For that reason, justice is more likely to be based on deontological moral philosophies than on teleological or utilitarian philosophies. In other words, justice deals more with the issue of what individuals feel they are due based on their rights and performance in the workplace. For example, the U.S. Equal Employment Opportunity Commission exists to help employees who suspect they have been unjustly discriminated against in the workplace.

Three types of justice provide a framework for evaluating the fairness of different situations (see Table 6–3). **Distributive justice** is based on the evaluation of the outcomes or results of the business relationship. If some employees feel that they are paid less than their coworkers for the same work, then they have concerns about distributive justice. Distributive justice is difficult to develop when one member of the business exchange intends to take advantage of the relationship. A boss who forces his employees to do more work so that he can take more time off would be seen as unjust because he is taking advantage of his position to redistribute the workers under him. Situations such as this cause an imbalance in distributive justice.

Procedural justice is based on the processes and activities that produce the outcome or results. Evaluations of performance that are not consistently developed and applied can lead to problems with procedural justice. For instance, employees' concerns about inequitable compensation would relate to their perception that the processes of fairness or justice in their company were inconsistent. A climate that emphasizes procedural justice is expected to positively influence employees' attitudes and behaviors toward work-group cohesion. The visibility of supervisors and the work group's perceptions of its own cohesiveness

TABLE 6–3 Types of Justice

Justice Type	Evaluations of Fairness
Distributive justice: Based on the evaluation of outcomes or results of the business relationship	Benefits derived Equity in rewards
Procedural justice: Based on the processes and activities that produce the outcome or results	Decision making process Level of access, openness, and participation
Interactional justice: Based on an evaluation of the communication process used in the business relationship	Accuracy of information Truthfulness, respect, and courtesy in the process

are products of a climate of procedural justice.[29] When there is strong employee support for decisions, decision makers, organizations, and outcomes, procedural justice is less important to the individual. In contrast, when employees' support for decisions, decision makers, organizations, or outcomes is not very strong, then procedural justice becomes more important.[30] For example, Wainwright Bank and Trust Corporation in Boston has made a commitment to promoting justice to all stakeholders by providing a "sense of inclusion and diversity that extends from the boardroom to the mail room."[31] The bank, in other words, uses methods of procedural justice to establish positive stakeholder relationships by promoting understanding and inclusion in the decision making process.

Interactional justice is based on evaluating the communication processes used in the business relationship. Because interactional justice is linked to fairness in communication, it often involves the individual's relationship with the business organization through the accuracy of the information the organization provides. Employees can also be guilty in interactional justice disputes. For example, many employees admit that they stay home when they are not really sick if they feel they can get away with it. Such workplace absenteeism costs businesses millions of dollars each year. Being untruthful about the reasons for missing work is an example of an interactional justice issue.

All three types of justice—distributive, procedural, and interactional—could be used to evaluate a single business situation and the fairness of the organization involved. In the example of Sam Colt, Sam's decision to implement a justice perspective would be identical to using a deontological moral philosophy. That is, he would feel obligated to tell all affected parties about the bolt defect rate and the possible consequences of it. In general, justice evaluations result in restitution seeking, relationship building, and evaluations of fairness in business relationships.

APPLYING MORAL PHILOSOPHY TO ETHICAL DECISION MAKING

Strong evidence shows that individuals use different moral philosophies depending on whether they are making a personal decision outside the work environment or making a work-related decision on the job.[32] Two possible reasons may explain this. First, in the business arena, some goals and pressures for success differ from the goals and pressures in a person's life outside of work. As a result, an employee might view a specific action as "good" in the business sector but "unacceptable" in the nonwork environment. It is often

suggested that business managers are morally different from other people. In a way, this is correct in that business has one variable that is absent from other situations: the profit motive. The weights on the various factors that make up a person's moral philosophy are shifted in a business (profit) situation. The statement "it's not personal, it's just business" demonstrates the conflict businesspeople can have when their personal values do not align with utilitarian or profit-oriented decisions. The reality is that if firms do not make a profit, they will fail. This should not be construed to be a justification for seeking excessive profits or executive pay, issues which are now being questioned by stakeholders. The second reason people change moral philosophies could be the corporate culture where they work. When a child enters school, for example, he or she learns certain rules such as raising your hand to speak or asking permission to use the restroom. So it is with a new employee. Rules, personalities, and historical precedence exert pressure on the employee to conform to the new firm's culture. As this occurs, the individual's moral philosophy may change to be compatible with the work environment. The employee may alter some or all of the values within his or her moral philosophy as he or she shifts into the firm's different moral philosophy. Many people are acquainted with someone who is known for their goodness at home or in their communities who makes unethical decisions in the workplace. Even Bernard Madoff, the perpetrator of the largest Ponzi scheme in history, had a reputation as an upstanding citizen before his fraud was uncovered.

Obviously, the concept of a moral philosophy is inexact. For that reason, moral philosophies must be assessed on a continuum rather than as static entities. Simply put, when examining moral philosophies, we must remember that each philosophy states an ideal perspective and that most individuals seem to shift to other moral philosophies in their individual interpretation of and experiencing of ethical dilemmas. In other words, implementing moral philosophies from an individual perspective is not an exact science. It requires individuals to apply their own accepted value systems to real-world situations. Individuals make judgments about what they believe to be right or wrong, but in their business lives they make decisions that may be based not only on perceived right or wrong but also on producing the greatest benefits with the least harm. Such decisions should respect fundamental moral rights as well as perspectives on fairness, justice, and the common good, but these issues become complicated in the real world.

The virtue approach to business ethics, as discussed earlier, assumes that there are certain ideals and values that everyone should strive for in order to achieve the maximum welfare and happiness of society.[33] Aspects of these ideals and values are expressed through individuals' specific moral philosophies. Every day in the workplace, employees must decide what is right or wrong and act accordingly. At the same time, as a member of a larger organization, an employee cannot simply enforce his or her own personal perspective, especially if he or she adheres narrowly to a single moral philosophy. Because individuals cannot control most of the decisions in their work environment, though they are always responsible for their own actions, they rarely have the power (especially in entry-level and middle-management positions) to impose their own personal moral perspective on others. In fact, the idea that a new employee has the freedom to make independent decisions on a variety of job responsibilities is not realistic.

Sometimes a company makes decisions that could be questionable according to individual customers' values and moral philosophies. For example, a brewery or a distributor of sexually explicit movies could be considered unethical to some stakeholders based on a personal perspective. A company's core values will determine how decisions that bring moral philosophies into conflict are made. Most businesses have developed

a mission statement, a corporate culture, and a set of core values that express how they want to relate to their stakeholders, including customers, employees, the legal system, and society. It is usually impossible to please all stakeholders.

Problems arise when employees encounter ethical situations that they cannot resolve. Sometimes gaining a better understanding of the basic premise of their decision rationale can help them choose the "right" solution. For instance, to decide whether they should offer bribes to customers to secure a large contract, salespeople need to understand their own personal moral philosophies as well as their firm's core values. If complying with company policy or legal requirements is an important motivation to the individual, he or she is less likely to offer a bribe. On the other hand, if the salesperson's ultimate goal is a "successful" career and if offering a bribe seems likely to result in a promotion, then bribery might not be inconsistent with that person's moral philosophy of acceptable business behavior. Even though bribery is illegal under U.S. law, the employee may rationalize that bribery is necessary "because everyone else does it."

COGNITIVE MORAL DEVELOPMENT

"Problems arise when employees encounter ethical situations that they cannot resolve."

Many people believe that individuals advance through stages of moral development as their knowledge and socialization continue over time. In this section, we examine a model that describes this cognitive moral development process—that is, the stages through which people may progress in their development of moral thought. Many models, developed to explain, predict, and control individuals' ethical behavior within business organizations, have proposed that cognitive moral processing is an element in ethical decision making. Cognitive moral processing is based on a body of literature in psychology that focuses on studying children and their cognitive development.[34] Psychologist Lawrence Kohlberg adapted Piaget's theory and developed the six-stage model of cognitive development, which, although not specifically designed for business contexts, provides an interesting perspective on the question of moral philosophy in business. According to **Kohlberg's model of cognitive moral development**, people make different decisions in similar ethical situations because they are in different stages of six cognitive moral development stages:

1. *The stage of punishment and obedience.* An individual in Kohlberg's first stage defines *right* as literal obedience to rules and authority. A person in this stage will respond to rules and labels of "good" and "bad" in terms of the physical power of those who determine such rules. Right and wrong are not associated with any higher order or philosophy but rather with a person who has power. Stage 1 is usually associated with small children, but signs of stage 1 development are also evident in adult behavior. For example, some companies forbid their buyers to accept gifts from salespeople. A buyer in stage 1 might justify a refusal to accept gifts from salespeople by referring to the company's rule that defines accepting gifts as an unethical practice, or the buyer may accept the gift if he or she believes that there is no chance of being caught and punished.
2. *The stage of individual instrumental purpose and exchange.* An individual in stage 2 defines *right* as that which serves his or her own needs. In this stage, the individual no longer makes moral decisions solely on the basis of specific rules or authority figures; he or she now evaluates behavior on the basis of its fairness to him or her. For example, a sales representative in stage 2 doing business for the first time in a foreign country

may be expected by custom to give customers "gifts." Although gift giving may be against company policy in the United States, the salesperson may decide that certain company rules designed for operating in the United States do not apply overseas. In the culture of some foreign countries, gifts may be considered part of a person's pay. So, in this instance, not giving a gift might put the salesperson at a disadvantage. Some refer to stage 2 as the stage of reciprocity because, from a practical standpoint, ethical decisions are based on an agreement that "you scratch my back and I'll scratch yours" instead of on principles of loyalty, gratitude, or justice.

3. *The stage of mutual interpersonal expectations, relationships, and conformity.* An individual in stage 3 emphasizes others rather than him or herself. Although ethical motivation is still derived from obedience to rules, the individual considers the well-being of others. A production manager in this stage might obey upper management's order to speed up an assembly line if he or she believed that this would generate more profit for the company and thus save employee jobs. This manager not only considers his or her own well-being in deciding to follow the order but also tries to put him or herself in upper management's and fellow employees' shoes. Thus, stage 3 differs from stage 2 in that fairness to others is one of the individual's ethical motives.
4. *The stage of social system and conscience maintenance.* An individual in stage 4 determines what is right by considering his or her duty to society, not just to other specific people. Duty, respect for authority, and maintaining the social order become the focal points. For example, some managers consider it a duty to society to protect privacy and therefore refrain from monitoring employee conversations.
5. *The stage of prior rights, social contract, or utility.* In stage 5, an individual is concerned with upholding the basic rights, values, and legal contracts of society. Individuals in this stage feel a sense of obligation or commitment, a "social contract," to other groups and recognize that in some cases legal and moral points of view may conflict. To reduce such conflict, stage 5 individuals base their decisions on a rational calculation of overall utilities. The president of a firm may decide to establish an ethics program because it will provide a buffer against legal problems and the firm will be perceived as a responsible contributor to society.
6. *The stage of universal ethical principles.* A person in this stage believes that right is determined by universal ethical principles that everyone should follow. Stage 6 individuals believe that there are inalienable rights, which are universal in nature and consequence. These rights, laws, or social agreements are valid, not because of a particular society's laws or customs, but because they rest on the premise of universality. Justice and equality are examples of principles that are deemed universal in nature. A person in this stage may be more concerned with social ethical issues and thus not rely on the business organization for ethical direction. For example, a businessperson at this stage might argue for discontinuing a product that has caused death and injury because the inalienable right to life makes killing wrong, regardless of the reason. Therefore, company profits would not be a justification for the continued sale of the product.[35]

Kohlberg's six stages can be reduced to three different levels of ethical concern. At the first level, a person is concerned with his or her own immediate interests and with external rewards and punishments. At the second level, an individual equates *right* with conformity to the expectations of good behavior of the larger society or some significant reference

group. Finally, at the third, or "principled," level, an individual sees beyond the norms, laws, and authority of groups or individuals. Employees at this level make ethical decisions regardless of negative external pressures. However, research has shown that most workers' abilities to identify and resolve moral dilemmas do not reside at this third level and that their motives are often a mixture of selflessness, self-interest, and selfishness.

Kohlberg suggests that people continue to change their decision making priorities after their formative years, and as a result of time, education, and experience, they may change their values and ethical behavior. In the context of business, an individual's moral development can be influenced by corporate culture, especially ethics training. Ethics training and education have been shown to improve managers' cognitive development scores.[36] Because of corporate reform, most employees in *Fortune* 1000 companies today receive some type of ethics training. Training is also a requirement of the Federal Sentencing Guidelines for Organizations.

Some feel that experience in resolving moral conflicts accelerates an individual's progress in moral development. A manager who relies on a specific set of values or rules may eventually come across a situation in which the rules do not apply. For example, suppose Sarah is a manager whose policy is to fire any employee whose productivity declines for four consecutive months. Sarah has an employee, George, whose productivity has suffered because of depression, but George's coworkers tell Sarah that George will recover and soon be a top performer again. Because of the circumstances and the perceived value of the employee, Sarah may bend the rule and keep George. Managers in the highest stages of the moral development process seem to be more democratic than autocratic, more likely to consider the ethical views of the other people involved in an ethical decision making situation.

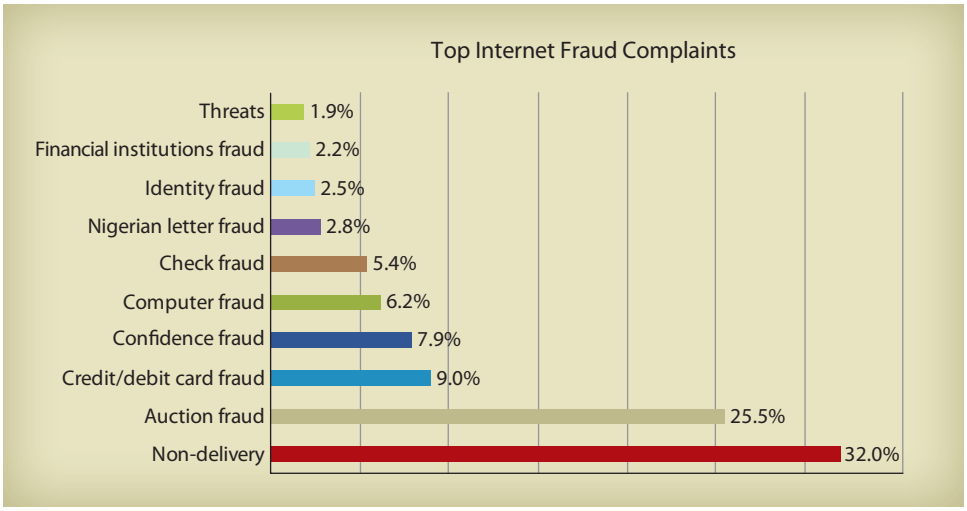
Once thought to be critical, the theory of cognitive moral development and the empirical research for the last 10 years has been mixed, suggesting both a positive and negative relationship between it and ethical decision making. The consensus appears to be that cognitive moral development is difficult at best to measure and connect with ethical decision making.[37]

WHITE-COLLAR CRIME

The terms *crime* and *criminal* normally conjure up thoughts of rape, arson, armed robbery, or murder. The news constantly reports on the damages that occur as a result of these types of crimes. But, although the devastation caused by these "crimes of the street" is more appealing to the evening news, it is no less destructive than the crimes perpetrated every year by seemingly nonviolent white-collar criminals. Referred to as **white-collar crimes** (WCCs), these "crimes of the suite" do more damage in monetary and emotional loss in one year than the crimes of the street over several years combined.[38]

WCC creates victims by establishing trust and respectability. WCCs are often considered to be different than crimes of the street. It is interesting to note in Figure 6–1 that deceptive pricing, unnecessary repairs, and credit card fraud are the three victim categories that were found in the national public household survey of consumers reporting over their lifetime. The victims of WCC are often trusting consumers who believe that businesses are legitimate. Unfortunately, senior citizens and other disadvantaged consumers fall prey to WCC perpetrators. Online white-collar crime is a growing problem around the world. Online WCC surged 33 percent during the most recent recession, accounting for

FIGURE 6–1 Top Internet Fraud Complaints



Source: "2008 Internet Crime Report," Bureau of Justice, http://www.ic3.gov/media/annualreport/2008_ic3report.pdf (accessed August 18, 2009).

nearly $265 billion in losses to U.S. households.[39] As a response to the surge in white-collar crimes, the Unites States government has stepped up its efforts to combat it, with the number of cases being investigated more than tripling since 2005. The government is concerned about the destabilizing effect that WCC has on U.S. households and the economy in general.[40]

At first glance, the job of deciding what constitutes a white-collar crime seems fairly simple. According to the glossary of legal terms for the Office of Justice Programs at the U.S. Department of Justice, a WCC is a "non-violent criminal act involving deceit, concealment, subterfuge and other fraudulent activity." The corporate executive who manipulates the stock market, the tax cheat, or the doctor who sets up an operation to swindle Medicaid are all fairly obvious candidates. However, WCC is not always so easy to define. Because government, Congress, and the American people want to better understand WCC, a number of subcategories have been created. Although the government official who accepts an illegal payment may have been wearing a white collar, he probably will be prosecuted under another title: official corruption. And while the corporate executive who orders his workers to dump illegal toxic waste materials in a nearby river also may be wearing a white collar, he probably will be classified as a violator of environmental regulations.

From various proposed definitions of WCC, the following appears to be inclusive of the main criminology literature yet parsimonious and exacting enough to be understood:

> *An individual or group committing an illegal act in relation to his/her employment, who is highly educated (college), in a position of power, trust, respectability and responsibility, within a profit/nonprofit business or government organization and who abuses the trust and authority normally associated with the position for personal and/or organizational gains.*

As one can see in Figure 6–1, many white-collar crimes are now being perpetrated via the Internet. A few of the most common white-collar offenses include antitrust violations, computer and Internet fraud, credit card fraud, bankruptcy fraud, health care fraud,

tax evasion, violating environmental laws, insider trading, bribery, kickbacks, money laundering, and trade secret theft. According to the FBI, white-collar crime costs the United States an estimated $300 billion annually. The government can charge both individuals and corporations for WCC offenses. The penalties include fines, home detention, paying for the cost of prosecution, forfeitures, and even prison time. However, sanctions are often reduced if the defendant takes responsibility for the crime and assists the authorities in their investigation.

White-collar crime has become a virtual epidemic in the financial world. For example, Federal regulators charged Texas financier R. Allen Stanford and three of his firms with a fraud that centered on high-interest certificates of deposit. The Securities and Exchange Commission alleged that Stanford arranged a fraudulent investment scheme centered on an $8 billion CD program that promised unrealistically high interest rates. The SEC alleged that Stanford and his businesses lied about the security of the deposits and that Stanford was running a second scheme tied to sales of mutual funds, which allegedly used fake historical data to lure investors. The mutual fund scheme grew from under $10 million in 2004 to over $1 billion when it was discovered. According to the SEC, the fraud helped generate $25 million in revenue from fees for Stanford Group in 2007 and 2008.[41] Another example of someone committing WCC is former Illinois Governor Rod Blagojevich, who was arrested for allegedly trying to sell former Senator Obama's vacant Senate seat. He was also found guilty of taking campaign contributions to exchange for official actions.[42] He faces a maximum of 140 years in prison.

The presence of technology also seems to be giving a whole new generation of criminals the opportunity to score big. WCCs that previously originated at the top of organizations are now able to be committed at lower levels. Because of these advanced technology systems and corporate culture's increased reliance on them, anyone with the ability to hack into a system now can access the highly sensitive information necessary to commit WCC.

A classic example of WCC is the fraud perpetrated by Bernard Madoff, which was discovered in December 2008. Madoff's scam was based upon a Ponzi scheme, in which the operating principle is that you must constantly attract new investors to pay off old investors the "gains" they were promised. Most Ponzi schemes self-destruct fairly quickly as the ability to keep attracting new investors dwindles.

However, Madoff kept his scheme going for many years. The business that started with a small circle of friends and relatives was built on the promise of modest and steady returns in spite of market swings. With Madoff's social and business connections, and remarkably steady returns of 10 percent to 12 percent, investors were willing to spend billions of dollars. Part of the appeal was the aura that this investment opportunity was highly exclusive, although it later came out that thousands had given their money to Madoff.

When investors questioned Madoff about their investments, he refused to provide them online access to their accounts. Nonetheless, Madoff's well-dressed, multilingual sales representatives continued to convince European buyers to invest.

Many people indicate that one red flag would have been the fact that Madoff would have overtaken the market had he traded the options in the volumes necessary to meet his financial goals. Madoff ultimately admitted to running a 4,800-client Ponzi scheme for more than a decade. While investors thought they had nearly $65 billion invested with Madoff, his financial advisement firm never had anywhere near that much money. Incredibly, he had not invested a single penny. Instead, Madoff deposited the money in a bank account, which he then used to pay investors when they asked for their money back.

The only way he sustained the operation for as long as he did was through attracting new clients. Madoff will spend the rest of his life in prison for his crime.[43]

The focus of criminology is often the behavior of the individual and discovery of the reasons why people commit such crimes. Advocates of the organizational deviance perspective argue that a corporation is a living, breathing organism that can collectively become deviant; that companies have a life of their own, separate and distinct from biological persons; that the ultimate "actors" in an organization are individuals; and that the corporate culture of the company transcends the individuals who occupy these positions. With time, patterns of activities become institutionalized within the organization that live on after those who established them have left the firm. Table 6–4 lists some of the top justifications given by perpetrators of white collar crimes.

Another common cause of WCC is peer influence, the result of an individual's circle of acquaintances within an organization, with their accompanying views and behaviors. Employees, at least in part, self-select the people with whom they associate within an organization. For companies with a high number of ethical employees, there is a higher probability that a fence sitter (the 40 percent of businesspeople who could be persuaded to be ethical or unethical) will go along with their coworkers.

Finally, there is an argument to be made that some businesspeople may have personalities that are inherently criminal.[44] Personality tests have been used to predict behavior in individuals working within an organization, but such tests presuppose that values and philosophies are constant; thus, they seem to be ineffective as an approach to understanding the subtleties of white-collar criminals.[45] We also know that businesspeople and companies must make a profit on revenue to exist, slanting their orientation toward teleology and making them increasingly likely to commit white-collar crimes. The answer to the increase in WCC is not easy to pinpoint because many variables cause good people to make bad decisions. Many people disagree that the government is devoting enough resources to combat WCC. The current focus of the Federal Sentencing Guidelines for Organizations is that all organizations should develop effective ethics and compliance programs to prevent WCC.

TABLE 6–4 Common Justifications for White Collar Crime

1.	**Denial of responsibility (Everyone can, with varying degrees of plausibility, point the finger at someone else.)**
2.	**Denial of injury (White-collar criminals often never meet or interact with those who are harmed by their actions.)**
3.	**Denial of the victim (The offender is playing tit-for-tat, and claims to be responding to a prior offense inflicted by the supposed victim.)**
4.	**Condemnation of the condemners (Executives dispute the legitimacy of the laws under which they are charged, or impugn the motives of the prosecutors who enforce them.)**
5.	**Appeal to a higher authority ("I did it for my family" remains a popular excuse.)**
6.	**Everyone else is doing it (Because of the highly competitive marketplace, certain pressures exist to perform that may drive people to break the law.)**
7.	**Entitlement (Criminals simply deny the authority of the laws they have broken.)**

Source: Adapted from Daniel J. Curran and Claire M. Renzetti, *Theories of Crime* (Needham Heights, MA: Allyn & Bacon, 1994).

THE ROLE OF INDIVIDUAL FACTORS IN BUSINESS ETHICS

Of course, not everyone agrees on what the role of traditional moral philosophies in ethical decision making in an organization is. Some types such as Machiavellianism, which comes from the writing of Machiavelli, an Italian political theorist, have been found to influence ethical decisions. *The Prince* (a letter that Machiavelli wrote from exile to an Italian prince) argues against the relevance of morality in political affairs and holds that craft and deceit are justified in pursuing and maintaining political power. Machiavelli is famous for the idea that, for a leader, it is better to be feared than to be loved. This type of thinking abounds within *The Prince* because Machiavelli basically presents a guidebook for obtaining and maintaining power without the need for morality. Most business managers do not embrace this extreme philosophy, and most managers cannot communicate the exact moral philosophy that they use to make ethical decisions.

> ***Although a personal moral compass is important, it is not sufficient to prevent ethical misconduct in an organizational context.***

According to ethics consultant David Gebler, "Most unethical behavior is not done for personal gain, it's done to meet performance goals."[46] Unfortunately, many people believe that individual moral philosophies are the main driver of ethical behavior in business. This belief can be a stumbling block in assessing ethical risk and preventing misconduct in an organizational context. The moral values learned within the family and through religion and education are key factors that influence decision making, but as indicated in the models in Chapter 5, it is only one factor. The fact that many companies and business schools focus on personal character or moral development in their training programs as the main consideration reinforces the idea that employees can control the work environment. Although a personal moral compass is important, it is not sufficient to prevent ethical misconduct in an organizational context. The rewards for meeting performance goals and the corporate culture, especially for coworkers and managers, have been found to be the most important drivers of ethical decision making.[47]

Strong abilities in ethical reasoning will probably lead to more ethical business decisions in the future than trying to provide detached character education for each employee.[48] Equipping employees with intellectual skills that will allow them to understand and resolve complex ethical dilemmas that they encounter in complex corporate cultures will help them make the right decisions. This approach will hopefully keep them from being carried along by peer pressure and lulled by unethical managers to engage in misconduct.[49] The West Point model for character development focuses on the fact that competence and character must be developed simultaneously. This model assumes that ethical reasoning has to be approached in the context of a specific profession. The military has been effective in teaching skills and developing principles and values that can be used in most situations that a soldier will encounter. In a similar manner, accountants, managers, or marketers need to develop ethical reasoning in the context of their jobs.

SUMMARY

Moral philosophy refers to the set of principles, or rules, that people use to decide what is right or wrong. These principles, rules, or philosophies present guidelines for resolving conflicts and for optimizing the mutual benefit of people living in groups. Businesspeople

are somewhat guided by moral philosophies as they formulate business strategies and resolve specific ethical issues.

Teleological, or consequentialist, philosophies stipulate that acts are morally right or acceptable if they produce some desired result, such as realization of self-interest or utility. Egoism defines right or acceptable behavior in terms of the consequences for the individual. In an ethical decision making situation, the egoist will choose the alternative that contributes most to his or her own self-interest. Egoism further can be classified into hedonism and enlightened egoism. Utilitarianism is concerned with maximizing total utility, or providing the greatest benefit for the greatest number of people. In making ethical decisions, utilitarians often conduct a cost–benefit analysis, which considers the costs and benefits to all affected parties. Rule utilitarians determine behavior on the basis of rules designed to promote the greatest utility rather than by examining particular situations. Act utilitarians examine the action itself, rather than the rules governing the action, to determine whether it will result in the greatest utility.

Deontological, or nonconsequentialist, philosophies focus on the rights of individuals and on the intentions behind an individual's particular behavior rather than on its consequences. In general, deontologists regard the nature of moral principles as permanent and stable, and they believe that compliance with these principles defines ethicalness. Deontologists believe that individuals have certain absolute rights that must be respected. Rule deontologists believe that conformity to general moral principles determines ethicalness. Act deontologists hold that actions are the proper basis on which to judge morality or ethicalness and that rules serve only as guidelines.

According to the relativist perspective, definitions of ethical behavior are derived subjectively from the experiences of individuals and groups. The relativist observes behavior within a relevant group and attempts to determine what consensus group members have reached on the issue in question.

Virtue ethics posits that what is moral in a given situation is not only what is required by conventional morality or current social definitions, however justified, but also what a person with a "good" moral character would deem appropriate. Those who profess virtue ethics do not believe that the end justifies the means in any situation.

Ideas of justice as applied in business relate to evaluations of fairness. Justice relates to the fair treatment and due reward in accordance with ethical or legal standards. Distributive justice is based on the evaluation of the outcome or results of a business relationship. Procedural justice is based on the processes and activities that produce the outcomes or results. Interactional justice is based on an evaluation of the communication process in business.

The concept of a moral philosophy is not exact; moral philosophies can only be assessed on a continuum. Individuals use different moral philosophies depending on whether they are making a personal or a workplace decision.

According to Kohlberg's model of cognitive moral development, individuals make different decisions in similar ethical situations because they are in different stages of moral development. In Kohlberg's model, people progress through six stages of moral development: (1) punishment and obedience; (2) individual instrumental purpose and exchange; (3) mutual interpersonal expectations, relationships, and conformity; (4) social system and conscience maintenance; (5) prior rights, social contract, or utility; and (6) universal ethical principles. Kohlberg's six stages can

be further reduced to three levels of ethical concern: immediate self-interest, social expectations, and general ethical principles. Cognitive moral development may not explain as much as was once believed.

White-collar crime can be defined as an individual who is educated and in a position of power, trust, respectability, and responsibility committing an illegal act in relation to his or her employment, and who abuses the trust and authority normally associated with the position for personal and/or organizational gains. Some reasons why white-collar crime is not being heavily researched are that it doesn't come to mind when people think of crime, the offender (or organization) is in a position of trust and respectability, criminology or criminal justice systems look at white-collar crime differently, and many researchers have not moved past the definitional issues. The increase in technology use seems to be increasing the opportunity to commit white-collar crime with less risk.

Individual factors such as religion, moral intensity, and a person's professional affiliations can affect a person's values and decision making process. Other factors such as ethical awareness, biases, conflict, personality type, and intelligence have been studied, but no definitive conclusions can be made at this time about their relationship to ethical behavior. One thing we do know is that moral philosophies, values, and business are more complex than merely giving people honesty tests or value profiles that are not business oriented. Paper-and-pencil techniques do not yield accurate profiles for companies.

IMPORTANT TERMS FOR REVIEW

moral philosophy
economic value orientation
idealism
realism
monist
hedonism
quantitative hedonist
qualitative hedonist
pluralist
instrumentalist
goodness theory
obligation theory
teleology
consequentialism
egoism
enlightened egoism
utilitarianism
rule utilitarian
act utilitarian
deontology
nonconsequentialist
rule deontologist
act deontologist
relativist perspective
descriptive relativism
metaethical relativist
normative relativism
virtue ethics
justice
distributive justice
procedural justice
interactional justice
Kohlberg's model of cognitive moral development
white-collar crime

RESOLVING ETHICAL BUSINESS CHALLENGES*

Twenty-eight-year-old Elaine Hunt, who is married and has one child, has been with United Banc Corporation (UBC) for several years. During that time, she has seen the company grow from a relatively small-size to a medium-size business with domestic and international customers. Elaine's husband, Dennis, has been involved in the import–export business.

The situation that precipitated their current problem began six months ago. Elaine had just been promoted to senior financial manager, which put her in charge of 10 branch-office loan managers, each of whom had five loan officers who reported to him or her. For the most part, the branch loan officers would go through the numbers of their loan people, as well as sign off on loans under $250,000. However, recently this limit had been increased to $500,000. For loans over this amount and up to $40 million, Elaine had to sign off. For larger loans, a vice president would have to be involved.

Recently, Graphco Inc. requested a $10 million loan, which Elaine had been hesitant to approve. Graphco was a subsidiary of a tobacco firm embroiled in litigation concerning the promotion of its products to children. When reviewing the numbers, Elaine could not find any glaring problems, yet she had decided against the loan even when Graphco had offered to pay an additional interest point. Some at UBC applauded her moral stance while others did not, arguing that it was not a good financial business decision. The next prospective loan was for a Canadian company that was exporting cigars from Cuba. Elaine cited the U.S. policy against Cuba as the reason for not approving that loan. "The Helms-Burton Amendment gives us clear guidance as to what we shouldn't be doing with Cuba," she said to others in the company, even though the loan was to a Canadian firm. The third loan application she was unwilling to approve had come from Electrode International, which sought $50 million. The numbers had been marginal, but the sticking point for Elaine was Electrode's unusually high profits during the last two years. During dinner with Dennis, she had learned about a meeting in Zurich during which Electrode and others had allegedly fixed the prices on their products. Because only a handful of companies manufactured these particular products, the price increases were very successful. When Elaine suggested denying the loan on the basis of this information, she was overruled. At the same time, a company in Brazil was asking for an agricultural loan to harvest parts of the rain forest. The Brazilian company was willing to pay almost 2 points over the going rate for a $40 million loan. Because of her stand on environmental issues, Elaine rejected this application as well. The company obtained the loan from one of UBC's competitors.

Recently, Elaine's husband's decision making had fallen short of his superior's expectations. First, there was the problem of an American firm wanting to export nicotine and caffeine patches to Southeast Asia. With new research showing both these drugs to be more problematic than previously thought, the manufacturing firm had decided to attempt a rapid-penetration marketing strategy—that is, to price the products very low or at cost in order to gain market share and then over time slightly increase the margin. With 2 billion potential customers, a one-cent markup could result in millions of dollars in profits. Dennis had rejected the deal, and the firm had

gone to another company. One person in Dennis's division had said, "Do you realize that you had the perfect product—one that was low cost and both physically and psychologically addictive? You could have serviced that one account for years and would have had enough for early retirement. Are you nuts for turning it down?!"

Soon afterward, an area financial bank manager wanted Elaine to sign off on a revolving loan for ABCO. ABCO's debt/equity ratio had increased significantly and did not conform to company regulations. However, Elaine was the one who had written the standards for UBC. Some in the company felt that Elaine was not quite up with the times. For example, several very good bank staff members had left in the past year because they found her regulations too provincial for the emerging global marketplace. As Elaine reviewed ABCO's credit report, she found many danger signals; however, the loan was relatively large, $30 million, and the company had been in a credit sales slump. As she questioned ABCO, Elaine learned that the loan was to develop a new business venture within the People's Republic of China, which rumor had it was also working with the Democratic People's Republic of Korea. The biotech venture was for fetal tissue research and harvesting. Recently, attention had focused on the economic benefits of such tissue in helping a host of ailments. Anticipated global market sales for such products were being estimated at $10 billion for the next decade. ABCO was also willing to go almost 2 points above the standard interest equation for such a revolving loan. Elaine realized that if she signed off on this sale, it would signal an end to her standards. However, if she did not and ABCO went to another company for the loan and paid off the debt, she would have made a gross error, and everyone in the company would know it.

As Elaine was wrestling with this problem, Dennis's commissions began to slip, putting a crimp in their cash-flow projections. If things did not turn around quickly for him, they would lose their new home, fall behind in other payments, and reduce the number of educational options for their child. Elaine had also had a frank discussion with senior management about her loan standards as well as her stand on tobacco, which had lost UBC precious income. The response was, "Elaine, we applaud your moral outrage about such products, but your morals are negatively impacting the bottom line. We can't have that all the time."

QUESTIONS • EXERCISES

1. Discuss the advantages and disadvantages of each decision that Elaine has made.
2. What are the ethical and legal considerations facing Elaine, Dennis, and UBC?
3. Discuss the moral philosophies that may be relevant to this situation.
4. Discuss the implications of each decision that Elaine could make.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Teleology defines right or acceptable behavior in terms of consequences for the individual.	**Yes**	**No**
2. A relativist looks at an ethical situation and considers the individuals and groups involved.	**Yes**	**No**
3. A utilitarian is most concerned with the bottom-line benefits.	**Yes**	**No**
4. Act deontology requires that a person use equity, fairness, and impartiality in making decisions and evaluating actions.	**Yes**	**No**
5. Virtues that support business transactions include trust, fairness, truthfulness, competitiveness, and focus.	**Yes**	**No**

ANSWERS **1. No.** That's egoism. **2. Yes.** Relativists look at themselves and those around them to determine ethical standards. **3. Yes.** Utilitarians look for the greatest good for the greatest number of people and use a cost–benefit approach. **4. Yes.** The rules serve only as guidelines, and past experience weighs more heavily than the rules. **5. No.** The characteristics include trust, self-control, empathy, fairness, and truthfulness—not competitiveness and focus.

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