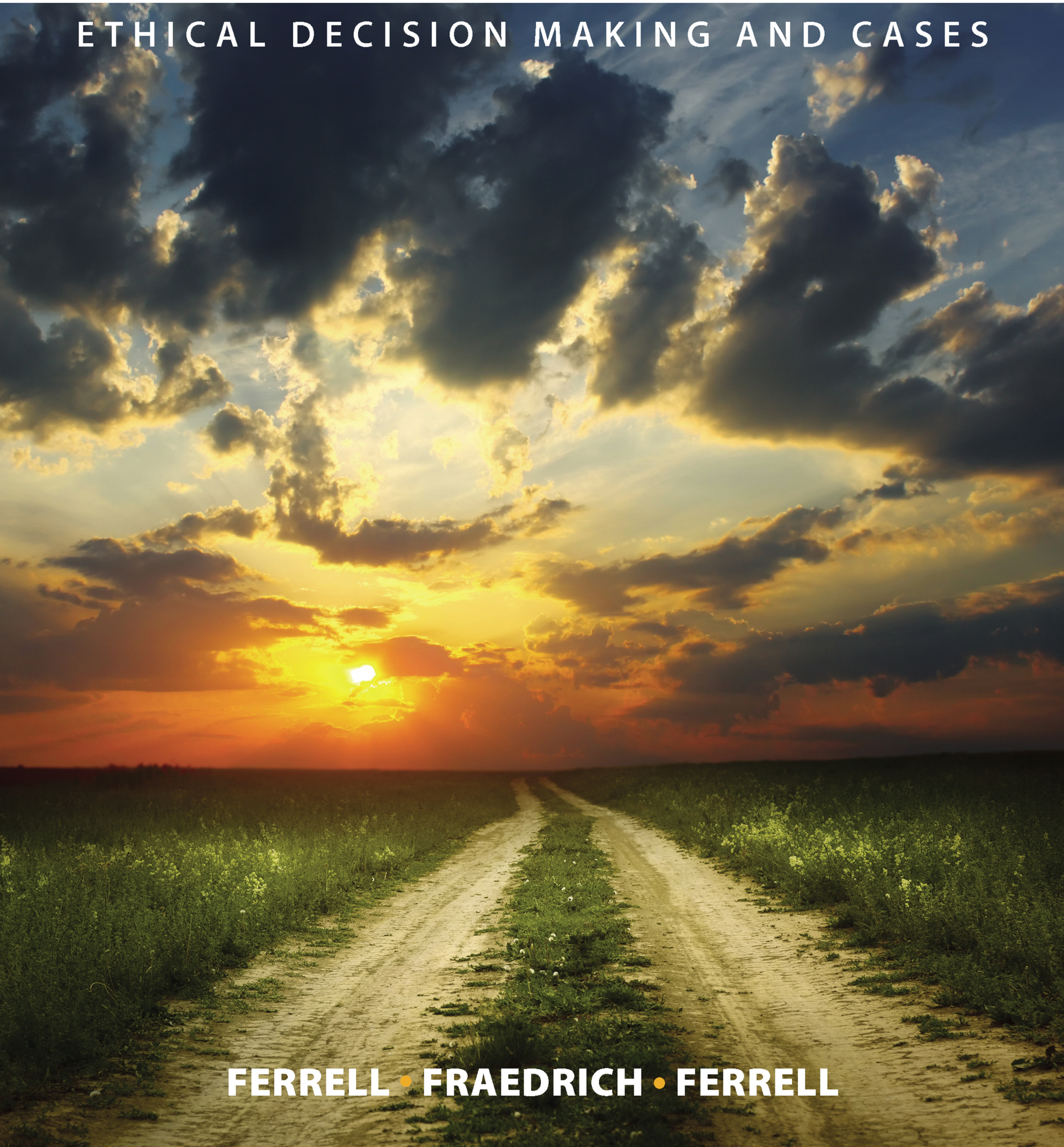
NINTH EDITION

# BUSINESS ETHICS

## ETHICAL DECISION MAKING AND CASES



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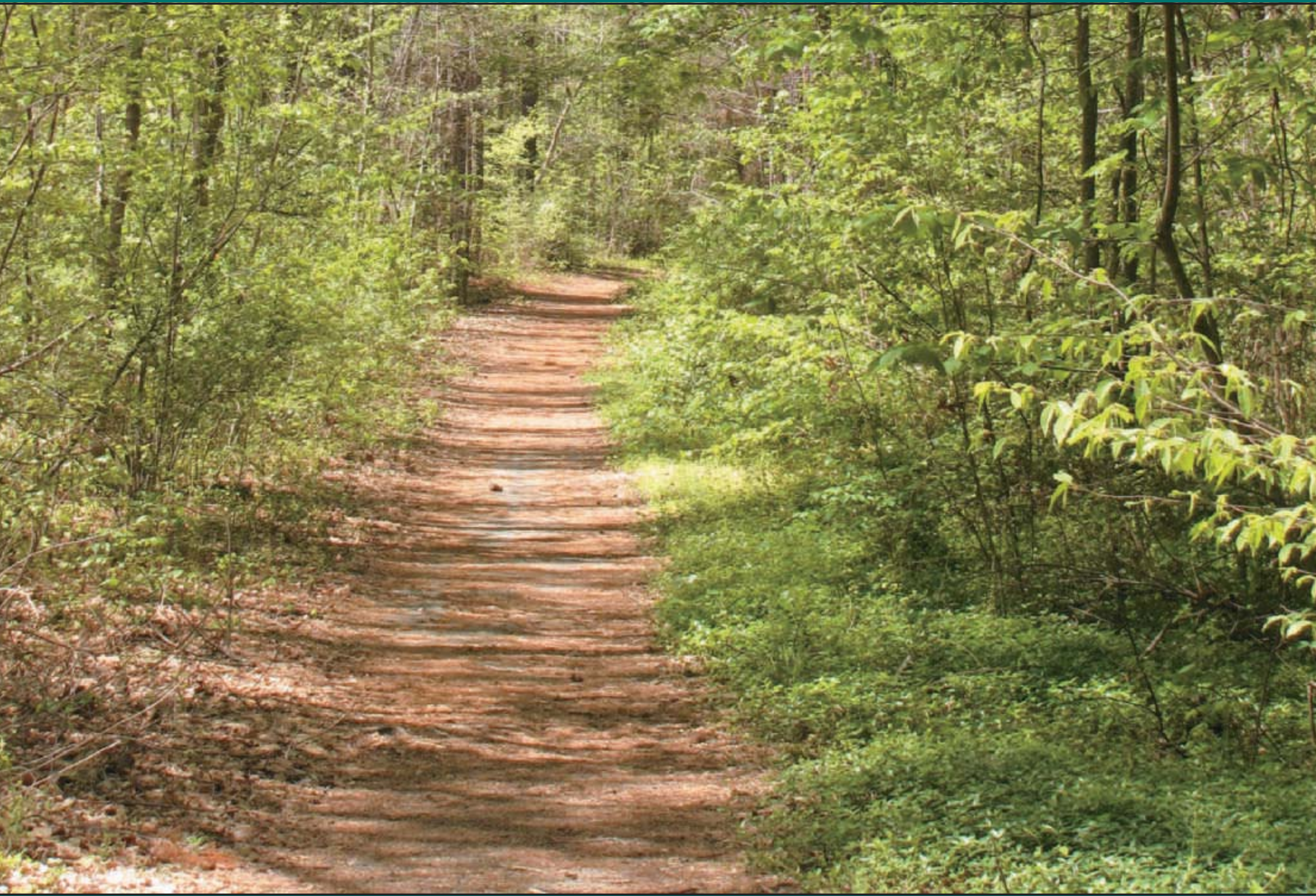
# CHAPTER 1



# THE IMPORTANCE OF BUSINESS ETHICS

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## 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



## 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 had graduated from Midwest State University and started work at Marell and Pew Brokerage. While at Marell and Pew, he had learned that in finance, one must follow both the letter and the spirit of the law. BS started courting John after he had worked 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 the 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 he 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 had been 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. 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 and cross-reference them with other IPO boards in the last 5 to 7 years. Next, cross-check everyone to see where the connections are, especially if they have good ties to the SEC (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. 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 from Marell and Pew until late on Friday so that BS could send out packets to each of his accounts to explain that he was 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 there were no negative consequences for either John or the firm. Six months went by and John’s portfolio 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 the 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 were rising fast. John’s expense account included country club memberships, sports tickets, and trips for clients. Instead of charging the firm, John always paid for these out of his own pocket. He was indirectly letting his clients know that it was his money he was spending on them; the 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. 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 a lot of his personal and professional time if he had done it right. For example, because John was a senior partner, he had to sign off on every trade they made; he needed to budget an hour a day just to sign the four other brokers' trades. But John also 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 much attention to the four new brokers and their training.

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 as a courtesy 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 would probably be found partially responsible because he was supposed to be training them. At the very least, 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 are John's ethical issues?
2. Are there any legal considerations for John?
3. Discuss the implications of each decision John has made thus far and may make in the future to handle his situation.

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

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 subsequent 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.

Highly visible business ethics issues influence the public's attitudes toward business and can destroy trust. Ethical decisions are a part of everyday life for those who work in organizations. Ethics is a part of decision making at all levels of work and management. Business ethics is not just an isolated personal issue; policies and informal communications for responsible conduct are embedded in an organization's operations. This means that ethical or unethical conduct is the province of everyone who works in an organizational environment.

Making good ethical decisions is just as important to business success as mastering marketing, finance, and accounting decisions. While education and training emphasize functional areas of business, business ethics is often viewed as easy to master, something that happens with little effort. In fact, ethical behavior requires understanding and identifying real-life issues, areas of risk, and approaches to making choices in an organizational environment. Some approaches to business ethics look only at its philosophical dimensions and the social consequences of decisions. This approach fails to address the complex organizational environment of businesses and pragmatic business concerns. By contrast, our approach is managerial and reflects how business ethics is practiced in the business world.

It is important to learn how to make decisions in the internal environment of an organization to achieve goals and career advancement. But business does not exist in a vacuum. The decisions of people in business have implications for shareholders, workers, customers, and society. Ethical decisions must take these stakeholders into account, for unethical conduct can negatively affect society as a whole. Our approach focuses on the practical consequences of decisions and on positive outcomes that have the potential to contribute to both business success and society at large. 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.



A Josephson Institute of Ethics Report Card survey of teens showed that 89 percent feel that being an ethical person is more important than being rich. However, of those surveyed, 59 percent admitted to cheating on a test within the last year. One-third admitted to using the Internet to plagiarize an assignment. One-fourth of the students surveyed admitted to lying on some of the survey questions.[1]

If today's students are tomorrow's leaders, unethical behavior seems poised to become more common. Perhaps even more distressing, an Arizona State University survey of state educators revealed that 50 percent admitted to cheating on state tests, either accidentally or intentionally. One percent admitted to changing answers on their students' tests or encouraging certain students to avoid the tests altogether.[2]

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 the 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."[3] 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."[4] 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."[5] 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. Competitors in particular are quick to point out a company's misconduct. For instance, in the battle between Microsoft's Bing search engine and Google, Google accused Microsoft Corp. of copying its Internet search engine results. Recognizing the damage this could do to its reputation, Microsoft quickly defended its reputation and claimed that Google's accusations were little more than a publicity stunt.[6] Second, businesses must balance their desire 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.

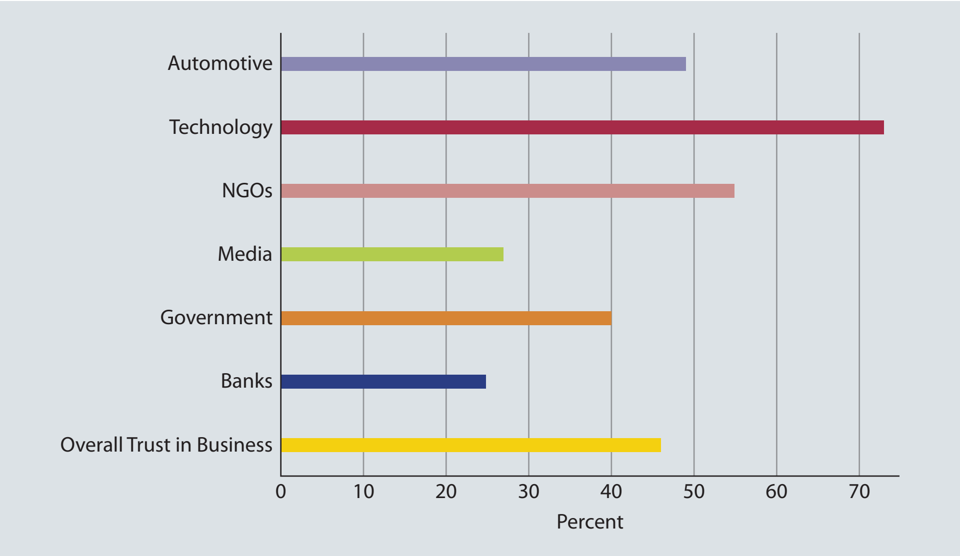
Most definitions of business ethics reference rules, standards, and moral principles regarding what is right or wrong in specific situations. For our purposes, **business ethics** comprises the principles, values, and standards that guide behavior in the world of business. **Principles** are specific 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 civil rights. **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 49 percent of employees reported observing at least one type of misconduct. Approximately 63 percent reported the misconduct to management, an increase from previous years.[7] Largely in response to the financial crisis, business decisions and activities have come under greater scrutiny by many different constituents, including consumers, employees, investors, government regulators, and special interest groups. For instance, regulators are looking carefully at Countrywide Financial to see whether its top executives purposefully misled investors about the risks of certain securities it was selling. One lawsuit alleges that Countrywide and top executives like former CEO Angelo Mozilo misled investors by portraying its investments as low risk.[8] Such misconduct has lowered consumer trust in business. Figure 1.1 shows the percentage of respondents who say that they trust a variety of businesses in various industries. Notice that the levels of consumer trust in most industries is declining. Banks have some of the lowest ratings, indicating that

**FIGURE 1.1 Americans' Trust in Business Sectors (percentage of respondents who say they trust companies in the following categories)**




Source: "2011 Edelman Trust Barometer Findings," Edelman Trust Barometer, http://www.edelman.com/trust/2011/uploads/Edelman%20Trust%20 Barometer%20Global%20Deck.pdf (accessed February 15, 2011).

the financial sector has not been able to restore its reputation since the 2008–2009 recession. Most significant is the fact that less than half of all respondents surveyed have an overall trust in business. There is no doubt that negative publicity associated with major misconduct has lowered the public's trust in business.[9]

## Specific Issues

Misuse of company resources, 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, BP has received negative publicity for a number of ethical issues, particularly after the 2010 *Deepwater Horizon* explosion and Gulf Coast disaster. Shortly after BP's announcement that it is committed to becoming the safest offshore energy operator, the public learned that a safety regulator had ordered BP to fix safety lapses on three of its rigs in the North Sea. Such an incident makes one question the extent of BP's commitment.[10] Other ethical issues relate to recognizing the interest of communities and society. For instance, Walmart dropped plans to build a Supercenter near a Civil War site after two years of fighting with historians and residents. This is not the first instance in which Walmart battled with communities about building around areas with historical significance. However, in this case, Walmart listened to stakeholder concerns and decided to move to a new location.[11] Although large companies like Walmart have significant power, pressures from society and government still limit what they can do.

Ethics plays 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. Former House Majority Leader Tom DeLay received a three-year prison sentence for money laundering and conspiracy charges. DeLay was accused of channeling $190,000 of corporate money into the Republican National Committee to help elect Republicans to the Texas Legislature.[12] The DeLay scandal demonstrates that ethical behavior must be proactively practiced at all levels of society.

Every organization has the potential for unethical behavior, as the FBI realized after discovering that several of its agents had cheated on a test. A Justice Department investigation revealed that several FBI agents, including some supervisors and a legal advisor, cheated on a test about FBI procedures for the surveillance of Americans. According to the investigation, certain agents took the test together, got the answer sheets in advance, and even took advantage of a design flaw in their computers to reveal the answers. The FBI announced that it would take disciplinary action against those agents found guilty of misconduct.[13]

Even sports can be subject to ethical lapses. Former Atlanta Falcons quarterback Michael Vick spent 18 months in prison after authorities found out he had been operating a dogfighting ring. Vick was released by the Atlanta Falcons and signed on with the Philadelphia Eagles. Although Vick has seemingly turned over a new leaf, many sports fans were outraged that he was reaccepted into the NFL.[14] In Japan, another ethical dilemma in sports occurred when as many as 13 sumo wrestlers were suspected of fixing matches. Guilty verdicts could seriously jeopardize the sport, thus reiterating the importance of ethics in maintaining the integrity of an industry.[15]

Whether they are made in the realm of business, politics, science, or sports, most decisions are judged 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 not an issue in most business organizations.

Professionals in any field, including business, must deal with individuals' personal moral dilemmas because such dilemmas 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.

> **"Having sound personal ethics may not be sufficient to enable you to handle the ethical issues that arise in a business organization."**

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 moral high 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 that 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, when are highly disparaging advertising claims unethical? H&R Block claimed that it had found errors in two out of three tax returns prepared by Jackson Hewitt, thus implying that Jackson Hewitt customers had been shortchanged due to incompetence. Disputes over the accuracy of claims like this are complex and, in this case, Jackson Hewitt sued H&R Block over the advertising campaign.[16]

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 also 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 1.1).

### Before 1960: Ethics in Business

Prior to 1960, the United States endured 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

**TABLE 1.1 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 consumers | 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.

President Harry S Truman's Fair Deal, a program that 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 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 and other religions also developed ethics courses in their seminaries and schools of theology and addressed the issue of 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 witnessed the development of an anti-business trend, as many critics attacked the vested interests that controlled the economic and political aspects 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 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.[17]

After Kennedy came President Lyndon B. Johnson and the "Great Society," a series of programs that extended national capitalism and told the business community that the U.S. government's responsibility was to provide all citizens 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 moral 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 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 together business professors, theologians, philosophers, and businesspeople. 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, including bribery, deceptive advertising, price collusion, product safety, and ecology. *Business ethics* became a common expression. 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, and a growing and varied group of institutions with diverse interests promoted it. 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 18 defense contractors drafted principles for guiding business ethics and conduct.[18] 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, the DII supports codes of conduct and their widespread distribution. These codes of conduct must be understandable and cover their more substantive areas in detail. 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, the DII insists that member companies preserve the integrity of the defense industry. And sixth, member companies must adopt a philosophy of public accountability.[19]

The 1980s ushered in the Reagan–Bush era, 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 cigarette vending machine sales, and ending the use of cigarette logos in connection with sports events.[20] 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.[21]

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,[22] 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.[23] Provisions in the guidelines mitigate penalties for businesses that are striving to root out misconduct and establish high ethical and legal standards.[24] 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; that is, 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. We will provide more detail on the FSGO's role in business ethics programs in Chapter 4 and Chapter 8.

## 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. After George W. Bush became President in 2001, highly visible corporate misconduct at Enron, WorldCom, Halliburton, and the accounting firm Arthur Andersen caused the government and the public to look for new ways to encourage ethical behavior.[25] Accounting scandals, especially falsifying financial reports, became 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 global accounting fraud. Although the Bush administration tried to minimize government regulation, there appeared to be no alternative to developing more regulatory oversight of business.

Such abuses increased public and political demands to improve ethical standards in business. To address the loss of confidence in financial reporting and corporate ethics, in 2002 Congress 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 positions. The legislation further requires company executives to disclose stock sales immediately and prohibits companies from giving loans to top managers.[26]

The 2004 and 2008 amendments to the FSGO require 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 provide resources to oversee the discovery of risks and to design, implement, and modify approaches to deal with those risks.

> "Business leaders should consider that the greatest danger to their organizations lies in *not* discovering any serious misconduct or illegal activities that may be lurking."

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 risks associated with their operations and develop ethics programs that will prevent ethical misconduct before it creates a crisis. Most firms are developing formal and informal mechanisms that effect interactive communication and transparency about issues associated with the risk of misconduct. Business leaders should consider that the greatest danger to their organizations lies in *not* discovering any serious misconduct or illegal activities that may be lurking. Unfortunately, most managers do not view the risk of an ethical disaster as being as important as the risk associated with fires, natural disasters, or technology failure. In fact, 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 were realized 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.

In 2009 Barack Obama became president in the middle of a great recession caused by a meltdown in the global financial industry. Many firms, such as AIG, Lehman Brothers, Merrill Lynch, and Countrywide Financial, had engaged in ethical misconduct in developing and selling high-risk financial products. President Obama was able to lead the passage of legislation to provide a stimulus for recovery. His legislation to improve health care and to provide more protection for consumers focused on social concerns. Congress passed legislation regarding credit card accountability, improper payments related to federal agencies, fraud and waste, and food safety. The Dodd–Frank Wall Street Reform and Consumer Protection Act addressed some of the issues related to the financial crisis and recession. The Dodd–Frank Act was the most sweeping financial legislation since the Sarbanes–Oxley Act and possibly since laws put into effect during the Great Depression. It was designed to make almost every aspect of the financial services industry more ethical and responsible. This very complex law required regulators to create hundreds of rules to promote financial stability, improve accountability and transparency, and protect consumers from abusive financial practices.

The basic assumptions of capitalism are under debate as countries around the world work to stabilize markets and question those who manage the money of individual corporations and nonprofits. The financial crisis caused many people to question government institutions that provide oversight and regulation. As societies work to create change for the better, they must address issues related to law, ethics, and the required level of compliance necessary for government and business to serve the public interest. 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.

## DEVELOPING AN ORGANIZATIONAL AND GLOBAL ETHICAL CULTURE

Legally based compliance initiatives in organizations are usually designed to help establish cultural initiatives that make ethics a part of organizational values. Ethical culture is positively related to workplace confrontation over ethics issues, reports to management of observed misconduct, and the presence of ethics hotlines.[27] 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 of the decision-making process that employees use to determine whether their responses to ethical issues are right or wrong. Ethical culture is 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 Southern Common Market (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. Many companies demonstrate their commitment toward acceptable conduct by adopting globally recognized principles emphasizing human rights and social responsibility. For instance, the Global Sullivan Principles (GSP) are based on the activism of Reverend Leon Sullivan. Sullivan's activism was a response to South African apartheid, during which he encouraged companies to withdraw their investments from South Africa. Sullivan's activism inspired him and other interested citizens to develop requirements for companies concerning employee rights and workplace conditions. These standards include nonsegregation, equal and fair compensation, programs to move minorities into management ranks, and other human rights measures. Over one hundred companies have adopted the Sullivan Principles, and this landmark code has inspired a multitude of organizations to formulate their own codes of conduct.[28] The Global Sullivan Principles are discussed in greater detail in Chapter 10.

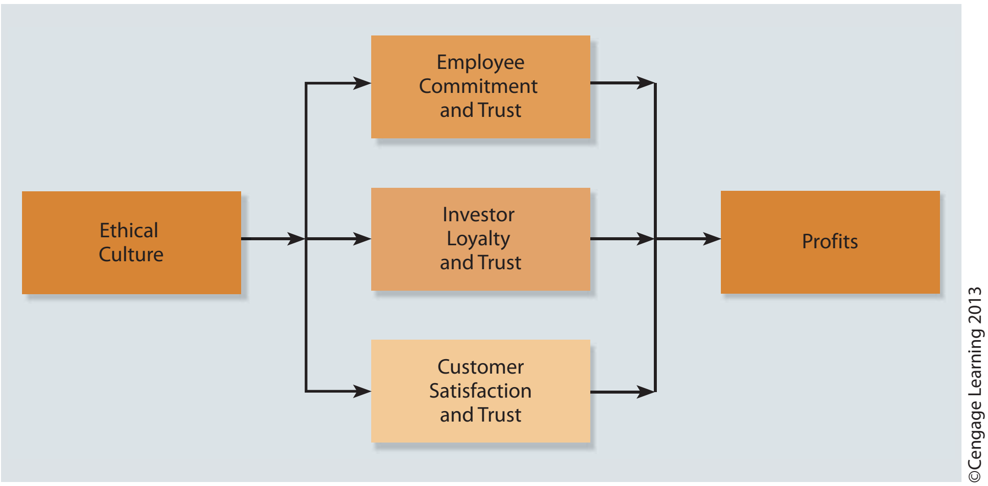
The Coalition for Environmentally Responsible Economies (CERES) is an international union of businesses, consumer groups, environmentalists, and other stakeholders. In 1989 this organization created ten principles of environmental conduct for businesses: (1) Protection of the Biosphere, (2) Sustainable Use of Natural Resources, (3) Reduction and Disposal of Waste, (4) Energy Conservation, (5) Risk Reduction, (6) Safe Products and Services, (7) Environmental Restoration, (8) Informing the Public, (9) Management Commitment, and (10) Audits and Reports. Companies choosing to adopt the CERES principles commit to providing regular reports of their environmental management and progress. Over 50 companies have adopted the CERES principles.[29]

In 2000 the United Nations launched the Global Compact, a set of 10 principles concerning human rights, labor, the environment, and anti-corruption. The purpose of the Global Compact is to create openness and alignment among business, government, society, labor, and the United Nations. Companies that adopt this code agree to integrate the ten principles into their business practices, publish their progress toward these objectives on an annual basis, and partner with others to advance broader objectives of the UN.[30] These 10 principles are covered in Chapter 10.

## 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 1.2 provides an overview of the relationship between business ethics and organizational performance. Although we believe that 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 responsible members of society. Granite Construction has earned a place in *Ethisphere*'s "World's Most Ethical Companies" for two consecutive years as a result of its integration of ethics into the company culture. Granite formulated its ethics program to comply with the Federal Sentencing Guidelines for Organizations and helped to inspire the Construction Industry Ethics and

**FIGURE 1.2 The Role of Organizational Ethics in Performance**



> "The reputation of a company has a major effect on its relationships with employees, investors, customers, and many other parties."

Compliance Initiative. To ensure that all company employees are familiar with Granite's high ethical standards, the firm holds six mandatory training sessions annually, conducts ethics and compliance audits, and uses field compliance officers to make certain that ethical conduct is taking place throughout the entire organization.[31] 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 Contributes to Employee Commitment

Employee commitment comes from employees who believe their future is tied to that of the organization and from employee willingness to make personal sacrifices for the organization.[32] 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. 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 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 to stock ownership plans to community service. Home Depot associates, for example, participate in disaster-relief efforts after hurricanes and tornadoes, rebuilding roofs, repairing water damage, planting trees, and clearing roads in their communities. Because employees spend a considerable number of their waking hours at work, a commitment by an organization to goodwill and respect for its employees usually increases the employees' loyalty to the organization and their support of its objectives. The software company SAS has topped *Fortune*'s "100 Best Places to Work for" list for two consecutive years thanks to the way it values its employees. During the 2008–2009 recession, founder Charles Goodnight refused to lay off workers and instead asked his employees to offer ideas on how to reduce costs. By actively engaging employees in cost-cutting measures, SAS was able to cut expenses by 6 to 7 percent. SAS is also unusual in that its annual turnover rate is four percent, versus the 20 percent industry average.[33]

Employees' perceptions that their firm has an ethical culture leads to performance-enhancing outcomes within the organization.[34] A corporate culture that integrates strong ethical values and positive business practices has been found to increase group creativity and job satisfaction and decrease turnover.[35] For the sake of both productivity and teamwork, it is essential that employees both within and among departments throughout an 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 among departments as well. Programs that create a work environment that is trustworthy make individuals more willing to rely and act on the decisions 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.[36]

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.[37] Also, employees who view their company as having a strong community involvement feel more loyal to their employers and feel more positive about themselves.

## Ethics Contributes to Investor Loyalty

Ethical conduct results in shareholder loyalty and can contribute to success that supports even broader social causes and concerns. Former Walmart CEO Lee Scott has stated, "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."[38]

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 help investors purchase stock in ethical companies. Investors are also recognizing that an ethical culture provides a foundation for efficiency, productivity, and profits. 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. 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.[39] At the same time, even Buffett must remain constantly alert for ethical misconduct. This became clear when David Sokol, the leading contender to succeed Buffett, resigned after committing what many believed to be a conflict of interest. This ethical conflict highlights a potential need for more oversight at Berkshire Hathaway to ensure compliance with company standards.[40]

When TIAA-CREF investor participants were asked if they would 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.[41] 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.

## Ethics Contributes to Customer Satisfaction

It is generally accepted that customer satisfaction is one of the most important factors in a successful business strategy. Although a company must continue to develop and adapt products to keep pace with customers' changing desires and preferences, it must also seek to develop long-term relationships with its customers and stakeholders. Patagonia, Inc., has engaged in a broad array of ecological, socially responsible, and ethical behaviors over many years to better connect with its target markets. The company has donated approximately $40 million to environmentally oriented causes. Employees can volunteer for environmental

## DEBATE ISSUE TAKE A STAND

### Does Being Ethical Result in Better Performance?

While research suggests that more ethical businesses have better performance, there is also an alternate view. Many businesspeople think that ethics and social responsibility require resources that do not contribute to profits and that time spent in ethics training could be better used for other business activities. One viewpoint is that when companies push the edge, pay minor fines for misconduct, or are not caught in wrongdoing, they may end up being more profitable than companies with a strong ethical culture. Many financial companies became extremely profitable when taking high-risk opportunities with limited transparency about the nature of the complex products they were selling. To gain competitive advantage, a firm needs to be able to reach markets and make sales. If a firm is too ethical, it might lose competitive advantages. On the other hand, *Ethisphere*'s World's Most Ethical Companies index indicates that since 2005, more ethical companies have had the best financial performance.

1. Ethical businesses are the most profitable.
2. The most ethical businesses are not always the most profitable.



groups and earn up to one month's pay. The entire clothing line was sourced using organic cotton beginning in 1996. 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, demonstrating a commitment to green building and the environment.[42]

For most businesses, both repeat purchases and an enduring relationship of mutual respect and cooperation with 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 that 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.

Trust is essential to 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.[43] As social responsibility becomes more important for companies, corporate social responsibility may be viewed as a sign of good management and may, according to one study, indicate good financial performance. However, another study indicates that the reverse may be true, and companies who have good financial performance are able to spend more money on social responsibility.[44] Google would be an example of such a company. Google shows extreme care for its employees at its Googleplex headquarters in Mountain View, California. Investment in employee 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, pool tables, volleyball courts, outdoor seating for brainstorming, snack rooms packed with various snacks and drinks, and more.[45]

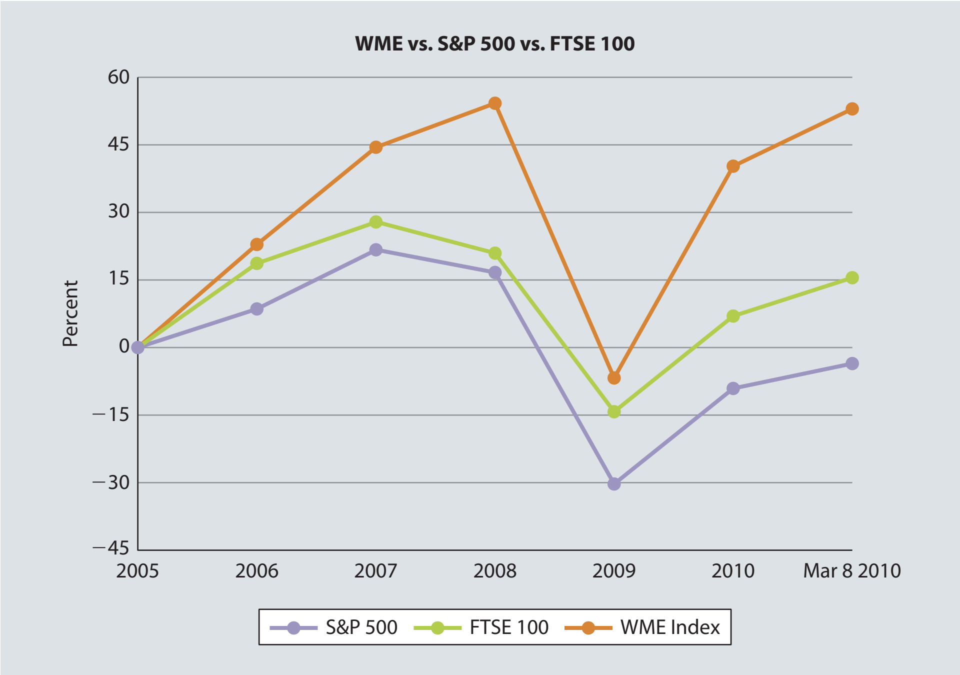
When an organization has a strong ethical environment, it usually focuses on the core value of placing customers' interests first. Putting customers first does not mean that the interests of employees, investors, and local communities should be ignored, however. An ethical culture that focuses on customers 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 positively affect business performance and product innovation.

## Ethics Contributes 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 positively affect business performance and product innovation.[46] When Intel discovered a design flaw in one of its chips, it recognized the need to put stakeholders ahead of profits. Even though it cost the company $1 billion in repairs and delays, the company halted shipments so it could fix the problem. By acting responsibly to ensure that it offered a quality product, Intel may be more profitable in the long run than if it had simply ignored the problem and gotten caught after the product introduction.[47] 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.[48] Figure 1.3 compares publicly

**FIGURE 1.3** ***Ethisphere*'s 2010 World's Most Ethical Companies versus S&P 500 and FTSE 100**




Source: "*Ethisphere*'s 2010 World's Most Ethical Companies," *Ethisphere,* Quarter 01, p. 28.

traded companies in *Ethisphere*'s 2010 World's Most Ethical Companies index with companies from the S&P 500 and the FTSE 100 indexes. The World's Most Ethical Companies index was developed through methodology designed by a committee of leading attorneys, professors, and organization leaders. As Figure 1.3 indicates, between 2005 and 2010, the companies in this index outperformed the other indexes of publicly traded companies. 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 function of compliance, ethics is becoming an integral part of management's efforts 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 1.2 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. This chapter has defined the term *business ethics* and explored 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 lead to 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 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. Finally, Chapter 10 considers ethical issues in a global context. In addition, we provide an appendix that describes the ethical and social responsibility considerations of sustainability.

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 seemed 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 these will give you a better sense of the challenges of making ethical decisions in the real business world.

**TABLE 1.2 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 |
| | • How leadership styles influence ethical decisions |
| | • Habits of strong ethical leaders |
| 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 |

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(*continued*)

**TABLE 1.2 Our Framework for Studying Business Ethics *(continued)***

| Chapter | Highlights |
|---|---|
| 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 | • Global Culture and Cultural Relations |
| | • Economic Foundations of Business Ethics |
| | • Multinational Corporations |
| | • Global Cooperation |
| | • Global Ethics Issues |

## SUMMARY

This chapter has provided an overview of the field of business ethics and introduced 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 has 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 concept 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 and 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 of the 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**
**Consumers' Bill of Rights**
**Federal Sentencing Guidelines for Organizations**
**principles**
**social responsibility**
**Sarbanes–Oxley Act**
**values**
**Defense Industry Initiative on Business Ethics and Conduct**
**ethical culture**

# RESOLVING ETHICAL BUSINESS CHALLENGES*

Frank Garcia was just starting out as a salesperson with Acme Corporation, a medical supplies company. 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 led to 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 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 ran 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 queried 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 create consumer, employee, and shareholder loyalty and positive behavior that contribute to the bottom line.

# NOTES

## Chapter 1


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