CHAPTER

5 Business Ethics and the Legal Environment of Business

Learning Objectives

After studying this chapter you should be able to:

1. Understand the relationship between ethics and the law and appreciate why it is important to behave ethically.
2. Differentiate between the claims of the different stakeholder groups affected by a company's actions.
3. Identify the four main sources of business ethics, and describe four rules that can be used to help companies and their employees behave ethically.
4. Describe some methods companies can use to strengthen their ethical rules and positions.
5. Appreciate the important ways in which a nation's business laws and regulations affect business commerce, occupations, and organizations.

WHY IS THIS IMPORTANT ?

A friend who is an A-student has offered to write your paper, which is worth 25% of your grade, for $50. You need the course to graduate because you only have a low C average. You hate writing, do it very poorly, and know others have had good results submitting this student's papers as their own. Will you pay the money and submit the paper or submit your own paper and pray for a good result?

This chapter will help you learn how to act ethically when facing dilemmas in your business and personal life. This is important because the decisions you make will affect your own future and those of stakeholders of the organizations that employ you.

A Question of Business

How Different Ethical Stances Can Help or Harm a Company

How can companies ensure their managers and employees follow their ethical codes of conduct?

In 1982, managers at Johnson & Johnson (J&J), the well-known medical products company experienced a crisis. Seven people in the Chicago area had died after taking Tylenol capsules that had been laced with cyanide. J&J's top managers needed to decide what to do. The FBI advised them to take no action because the likelihood that supplies of Tylenol outside the Chicago area were contaminated was very low. Moreover, withdrawing the drug from the market would cost the company millions of dollars. J&J's managers were of a different mind, however. They immediately ordered that supplies of all Tylenol capsules in the U.S. market be withdrawn and sent back to the company, a move that eventually cost J&J more than $150 million.

In 1992, managers at Dow Corning (DC), a large pharmaceutical company that had pioneered the development of silicon breast implants, received disturbing news. An increasing number of reports from doctors throughout the United States indicated that many women who had received DC's silicon implants were experiencing health problems ranging from fatigue to cancer and arthritis due to ruptured implants. DC's managers believed that the available evidence did not prove that fluid leaking from the implants was the cause of these health problems. Nevertheless, a few months later, DC's chairman, Keith McKennon, announced that the company was discontinuing its breast

implant business and closing the factories that produced them.

Soon after DC's withdrawal from the implant business, it became known that a DC engineer had questioned the safety of silicon breast implants as early as 1976. In 1977, the engineer had sent top managers a memo summarizing the results of a study by four doctors who reported that 52 out of 400 implant procedures had resulted in ruptures. In response to a court order, the company eventually released this memo, along with hundreds of other pages of internal documents. Women filed hundreds of lawsuits against DC for knowingly selling a product that may have been defective. Lawyers

accused DC of deliberately misleading the public and of giving women whose implants had caused medical problems false information to protect the interests of the company.

Dow Corning's ethical stance eventually cost the company billions in product liability claims. In fact, the size of these claims pushed the company into Chapter 11 bankruptcy, and it remained there for eight unprofitable years until 2004 when a judge accepted its plan to pay future damages to settle all the lawsuits against it and allowed it to resume full control of its business. Its managers' unethical behavior almost destroyed the company.

In 2002 the accounting giant, Arthur Andersen (AA) was found guilty of obstruction of justice for shredding documents related to its audits of the Enron Corp. Apparently, senior partners at AA, to hide evidence of its fraudulent auditing of Enron's accounts, ordered AA's middle managers to shred thousands of pages of accounting documents in an effort to hide AA's role in the Enron scandal.

When knowledge of AA's illegal actions became public in 2001, however, the company's reputation had already collapsed. Most of the companies it audited, such as Merck, Freddie Mac, and Delta Airlines had terminated their contracts with the company. After AA was convicted of obstruction of justice it lost its auditing license to practice accounting in the United States. With the collapse of their company, its partners and employees found themselves without jobs. They also lost much of the personal capital they had invested in the company. In this case, the unethical and illegal behavior of its managers and employees destroyed their company.

The behavior of DC and AA managers seemed out of character to many people. Both companies had widely publicized and well-developed internal ethics rules that were supposed to reign in and prevent unethical behavior. When confronted with a crisis, their ethics systems did not prevent either company's managers behaving unethically and illegally. J&J also had a system of ethical rules in place. At its center is a credo describing its ethical stance toward customers, employees, and other groups (see Table 5.2, p. 156). Why did J&J's credo lead its managers to act ethically while DC's and AA's did not?

One reason appears to be that J&J's managers believed in their company's ethical values, so that when confronted with an ethical dilemma as in 1982, they consistently followed the credo's rules when making business decisions. At DC and AA, in contrast, managers had been just "going through the motions." When push came to shove, they protected their own interests and those of their companies in illegal ways. Both companies paid the price. Within months of its decision to pull Tylenol from store shelves, however, J&J regained its status as leader in the painkiller market and has since increased its market share because of its enhanced reputation for being a highly ethical company.[1] •

Overview

As the behavior of Johnson & Johnson's, Dow Corning's, and Arthur Andersen's managers suggests, managers may interpret their responsibilities to their customers and to their organizations in very different ways. Johnson & Johnson moved immediately to protect the public even though there was little chance that any other supplies of Tylenol were contaminated. Dow Corning's managers postponed action and, to safeguard the profits of their company, did not confront the fact that their product was defective and dangerous. As a result, women continued to receive silicon breast implants, and the potential for harm increased. Arthur Andersen's managers intentionally committed illegal actions to protect their own interests. Their sole goal was to hide evidence of their wrongdoing at the expense of the public.

As the story of these companies suggests, an important ethical dimension is present in most kinds of business decision making. In this chapter, we examine the nature of the obligations and responsibilities a business has to the people and society affected by the way it operates. First, we examine the nature of ethics and the sources of ethical problems. Second, we discuss the major groups of people, called *stakeholders,* who are affected by business. Third, we look at four rules or guidelines that companies can use to decide whether a specific business decision is ethical or unethical. Fourth, we

consider the sources of business ethics and the way companies can promote ethical behavior. Finally, we examine the legal environment of business and describe the many kinds of laws, rules and regulations that must be followed, both at home and abroad, if a company is to do business in an honest and ethical way. By the end of this chapter you will understand the central role that ethics plays in shaping the practice of business and the life of a people, society, and nation.

The Nature of Ethics

Suppose you see a person being mugged in the street. How will you behave? Will you act in some way to help even though you risk being hurt? Will you walk away? Perhaps you might adopt a "middle-of-the-road approach" and not intervene but call the police instead? Does the way you act depend on whether the person being mugged is a fit male, an elderly person, or even a street person? Does it depend on whether there are other people around, so you can tell yourself, "Oh well, someone else will help or call the police. I don't need to"?

Ethical Dilemmas

ethical dilemma The quandary people experience when they must decide whether or not they should act in a way that benefits someone else even if it harms others and isn't in their own self-interest.

ethics The inner-guiding moral principles and values people use to analyze a situation and decide what is "right."

The situation described above is an example of an **ethical dilemma,** the quandary people find themselves in when they have to decide if they should act in a way that might help another person or group, and is the "right" thing to do, even though doing so might not be in their own self-interest. A dilemma may also arise when a person has to decide between two different courses of action, knowing that whichever course he or she chooses will result in harm to one person or group even though it may benefit another. The ethical dilemma here is to decide which course of action is the "lesser of two evils."

People often know they are confronting an ethical dilemma when their moral scruples come into play and cause them to hesitate, debate, and reflect upon the "rightness" or "goodness" of a course of action. Moral scruples are thoughts and feelings that tell a person what is right or wrong; they are a part of a person's ethics. **Ethics** are the inner-guiding moral principles, values, and beliefs people use to analyze a situation and decide what is "right." At the same time, ethics also indicate what inappropriate behavior is and how a person should behave to avoid doing harm to another person.

What would you do if you witnessed a mugging?

The essential problem in dealing with ethical issues, and thus solving moral dilemmas, is that there are no absolute or indisputable rules or principles that can be developed to decide if an action is ethical or unethical. Put simply, different people or groups may dispute which actions are ethical or unethical depending on their own personal self-interest and specific attitudes, beliefs, and values. How, therefore, are we and companies and their managers to decide what is ethical and act accordingly?

Ethics and the Law

The first answer to this question is that society as a whole, using the political and legal process, can lobby for and pass laws that specify what people can and cannot do. In the last chapter, for example, we examined the many different kinds of laws that exist to govern business. Laws also specify what sanctions or punishments will follow if those laws are broken.

Different groups in society lobby for laws to be passed based on what they believe is right or wrong. Once a law is passed, the decision about how to behave in a certain

situation moves from the personally determined ethical realm to the socially determined legal realm. If you do not conform to the law, you can be prosecuted and punished.

Changes in Ethics over Time

Neither laws nor ethics are fixed principles cast in stone, however. Both change over time. As a society's ethical beliefs change, its laws change to reflect them. As we saw in Chapter 2, it was considered both ethical and legal to own slaves in ancient Rome and Greece and in the United States until the nineteenth century. Ethical views regarding whether slavery was morally right subsequently changed, however, and slavery was later outlawed.

In most societies today behaviors like murder, theft, slavery, and rape are considered unacceptable and prohibited. But many other kinds of behaviors are open to dispute when it comes to whether they are ethical or should be made illegal or not. Some people might believe that a particular behavior such as smoking tobacco or possessing guns is unethical and should be made illegal. Others might argue that it is up to individual people if they want to own guns or smoke. In the United States it is, of course, illegal to possess or use marijuana even though it has been shown to have many medical uses. Some cancer sufferers and AIDS patients find that marijuana relieves many of the side effects of medical treatment, like nausea and lack of appetite. Yet, in the United States, the Supreme Court has held that the federal government can prohibit doctors from prescribing marijuana to these patients, so their suffering goes on. By contrast in Canada there has been a widespread movement to decriminalize marijuana, and in other countries, marijuana is perfectly legal.

The point is laws can and do change as people's ethical beliefs change. For example, in Britain in 1830, there were over 350 different crimes for which a person could be executed, including sheep stealing. Today there are none. Capital punishment has been abolished. As you can see, both ethical and legal rules are *relative*: No absolute standards exist to determine how we should behave. Consequently, we frequently get caught in moral dilemmas and are continually faced with ethical choices. It is a part of life.

Companies and their managers are no different. Some make the right choices, while others do not. In the early 2000s, a rash of scandals occurred at major U.S. companies, including Enron, WorldCom, Tyco, Merrill Lynch, and others. Managers in some of these companies clearly broke the law and defrauded investors. In other cases, managers used legal loopholes to divert hundreds of millions of dollars in corporate money for their own use. At WorldCom, for example, former CEO Bernie Ebbers used his position to place six of his friends on WorldCom's 13-member board of directors. Obviously these six people voted in favor of Ebbers's recommendations to the board. As a result, Ebbers received huge stock options and a personal loan of over $150 million from WorldCom. In return, his supporters were well rewarded for being directors. Among other perks, Ebbers allowed them to use WorldCom's corporate jets for a minimal fee–something that saved them hundreds of thousands of dollars each year.

Do you think marijuana should be legalized, and, if so, under what circumstances? Do you think U.S. laws will eventually change to allow marijuana to be used more freely?

Although not all of the activities Ebbers and other corporate wrongdoers engaged in were illegal, this does *not* make these behaviors ethical. In many cases societies later pass laws to close the loopholes used by unethical people, such as Ebbers and Rockefeller, discussed in Chapter 2, who gain at the expense of others. But ordinary people, not just corporate executives make everyday decisions in the course of business about what is ethical and what is not. A case in point is the pirating of digital products using the Internet, as Business in Action discusses.

Business in Action

Is Digital Piracy Unethical? Or Just Illegal?

Today, almost all written text, music, movies, and software are recorded digitally and can be easily copied and sent between PCs via the Internet. Millions of people and companies have taken advantage of this to make illegal copies of music CDs, software programs, and DVDs. In 2003, for example, it was estimated that more than one-third of all CDs and cassettes around the world were recorded illegally. This is costing the music industry billion of dollars in sales revenues. As you can imagine, media industries have been doing everything they can to crack down on this practice, including shutting down Napster.

Shawn Fanning created Napster.com while he was an undergraduate student at Northeastern University. His roommate had got into the habit of downloading music from Internet sites using the MP3 format, which compresses digital files, making them faster to transmit and easier to store. Fanning watched his roommate search the Internet for new material, and he realized that there was an opportunity to create a software platform that would allow people to more easily locate and download digital music files. Fanning created the software needed to do this, and word about Napster and the enormous volume of music available for free on the site, quickly spread. Soon, hundreds of thousands of people were swapping and downloading music. Computer servers at a number of colleges actually shut down, overwhelmed by people downloading songs from Napster.

Obviously, companies in the music industry became desperate to stop this practice. Collectively, they sought a legal injunction to shut Napster down. Since it was clear that Napster was violating copyright laws, the courts stopped Napster from providing the free service. However, many other Internet sites quickly sprang up to fill the void. The music industry then successfully sought to have individual downloaders prosecuted.

Is swapping songs on the Internet really unethical? Why are so many people doing it if it is illegal? The obvious answer is that people are doing it for their own personal gain. Who, goes the argument, suffers anyway? Music companies have been making billions of dollars from music sales for decades. True, the songs might be the property of music stars like the Rolling Stones and Eminem, but these people are fabulously wealthy. Why, then, shouldn't the average person benefit from the new technology? After all, the pleasure gained by hundreds of millions of people is more important than the harm done to only a few thousand rich musicians and a handful of wealthy music companies. Therefore, copying is not *really* unethical. It may be illegal, but it's not actually such a bad thing to do–or is it?

One enterprise that music companies went after with a vengeance for digital piracy was Napster. Why do you think digital piracy is considered unethical?

Arguments like these may make people feel that their copying is doing no real harm to others, but the other side of this ethical dilemma also needs to be taken into consideration. What about the rights of artists and companies to profit from their own property–the songs, books, and movies that result from their creative endeavors? Those who claim the practice should be made illegal say that copiers should think about how they would react if someone tried to take *their* property away. Would they like it if a "poorer" person came along who believed, "They don't need all those appliances, cars, and jewelry? I'll just help myself; they'll never miss it"?

The fact is that those who steal digital media not only are weakening the rights of musicians and

writers to own property, they are also weakening *their* own personal rights to own property. Digital piracy is neither fair nor equitable. And, although each person that engages in it might argue that the pilferage doesn't have much of an effect because he or she is "only one person," if many people do it, it's clearly a problem. And that's exactly what's happening.

To illustrate the problem, suppose that by 2010, 75% of all music and movies are illegally copied rather than bought. What will musicians, music companies, movie stars, and movie studios do? If these people and companies cannot protect their property and profit from it, then they are not going to make or sell digital products. Over time, music and movie companies will cease to operate. Creative people will find new ways to make money. Musicians will make music only for their own pleasure or perform only in live concerts (where recording devices are not permitted). Fewer new songs and movies will be recorded, and the world will become a less interesting place to live in.[2]

Stakeholders and Business Ethics

Just as people have to work out the right and wrong ways to act, so do companies. When the law does not specify how companies should behave, their managers must make these decisions. Who are the people or groups affected by a company's business decisions? If a company behaves in an ethical way, how does this benefit people and society? Conversely, how are people harmed by a company's unethical actions?

stakeholders People or groups of people who supply a company with its productive resources and thereby have an interest in how the company behaves.

The people and groups affected by the way a company does business are called its stakeholders. **Stakeholders** supply a company with its productive resources. As a result, they have a claim on and stake in the company. Because stakeholders can directly benefit or be harmed by its actions, the business ethics of a company and its managers are important to them. Who are a company's major stakeholders? What do they contribute to a company, and what do they claim in return? Next we examine the claims of these stakeholders–stockholders, managers, employees, suppliers and distributors, customers, the community, and the nation-state. These various stakeholders are shown in Figure 5.1.

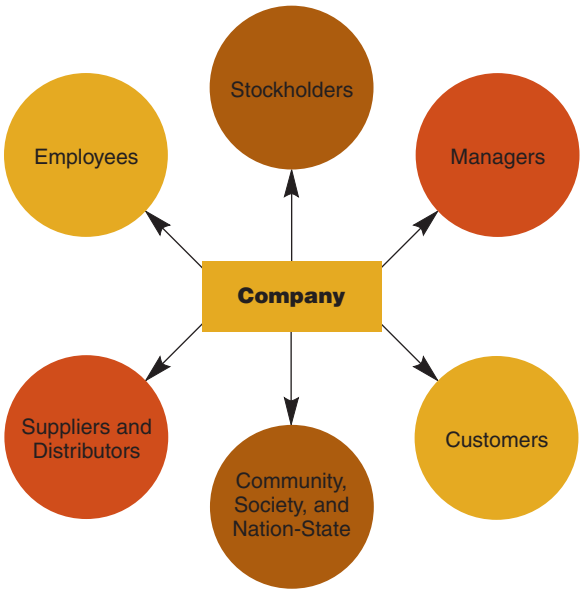


Figure 5.1
Types of Company Stakeholders

Stockholders

Stockholders have a claim on a company because when they buy its stock, or shares, they become its owners. This stock grants them the right to receive some of the company's profits in the form of dividends. And they expect to get these dividends. In 2003, for example, Microsoft had over $46 billion in cash on hand to fund its future operations. Under pressure from its shareholders, Microsoft declared a dividend of 31 cents per share be paid to the owners of its 5 billion shares. (Bill Gates received $100 million in dividends based on his own personal stockholdings.) Stockholders are interested in the way a company operates because they want to maximize their return on their investment. Thus, they watch the company and its managers closely to ensure they are working diligently to increase the company's profitability. Stockholders also want to ensure that managers are behaving ethically and not risking investors' capital by engaging in actions that could hurt the company's reputation and quickly bankrupt it. Once-mighty Enron took less than one year to fall after the covert

actions of its top managers came to light. The Enron tragedy was brought about by a handful of greedy top managers who abused the trust of stakeholders. A number of pension funds that had invested heavily in Enron stock were especially hard hit, adversely affecting thousands of retirees. The collapse of Enron is also said to have precipitated the crash of the entire stock market in 2001, wiping out the savings of millions of Americans.

Managers

Managers are a vital stakeholder group because they are responsible for using a company's financial capital and human resources to increase its profitability and stock price. Managers have a claim on an organization because they bring to it their skills, expertise, and experience. They have the right to expect a good return or reward by investing their human capital to improve a company's performance. Such rewards include good salaries and benefits, the prospect of promotion and a career, and stock options and bonuses tied to the company's performance.

As we discussed in Chapter 3, managers must be motivated and given incentives to work hard in the interests of stockholders. Their behavior must also be scrutinized to ensure they do not behave illegally or unethically and pursue goals that threaten stockholders' (and employees') interests. Unfortunately, we have seen in the 2000s how easy it is for top managers to find ways to ruthlessly pursue their self-interest at the expense of stockholders and employees because laws and regulations were not strong enough to force them to behave ethically.

In a nutshell, the problem has been that in many companies, corrupt managers focus not on building the company's capital and stockholders' wealth but on maximizing their own. In an effort to prevent future scandals the Securities and Exchange Commission (SEC), the government's top business watchdog, began in 2003 to rework the rules governing a company's relationship with its auditor, as well as regulations concerning stock options, and to increase the power of outside directors to

Video Small Business in Action

Small Biz Power

Summary: As shown in this segment from *BusinessWeek TV* on your Student DVD, 99% of all US companies are considered small businesses. These small businesses are responsible for employing over 50% of the nation's employees. The segment features small businesses such as Oki Ton Restaurant in California. The restaurant has experienced tremendous success. The emphasis on "service" to the customer is seen as a key success factor.

The report shows that small business is thriving in a "down" economy while larger companies are not performing well. In recessionary economies, it appears that small businesses are most prevalent in the fastest growing segments of the economy and are virtually nonexistent in the declining segments. Service such as restaurants, convenience stores, and health care are seen as expanding areas where manufacturing characterizes the declining economic segments.

A recent survey found that small business owners are feeling optimistic about their future even in a less than robust economy. There are some states in the U.S. where that enthusiasm is not as robust. In California, for example, small business owners are not as positive as in other areas of the country. The state ranks as the 6th worst in the U.S. for small business. The principal reasons for this ranking are due to high property, income, and sales taxes as well as high energy costs.

Discussion Questions

1. Generally, who represent the significant stakeholder groups for small businesses?
2. What are the rules for ethical decision making for the small business owner/manager?
3. What are two types of law that are particularly relevant to a company's form of business organization?

scrutinize a CEO. The SEC's goal is to turn many acts that were only unethical behavior in 2003 into illegal behavior in the near future. Managers could then be prosecuted if they engage in these acts.

Many experts are also arguing that the rewards given to top managers, particularly the CEO and COO (chief operating officer), grew out of control in the 1990s. Top managers are the new "aristocrats" today. Via their ability to influence corporate boards and raise their own pay, they have amassed personal fortunes worth hundreds of millions of dollars. For example, in 1982 a typical CEO earned about 18 times as much as the average worker. By 2002 that number had risen to 2,600 times as much—a staggering increase. Michael Eisner, the CEO of Disney, has received over $800 million in Disney stock options. Jack Welch, the former CEO of General Electric and one of the most admired managers in the United States, received more than $500 million in GE stock options as a reward for his services. Upon his retirement he was also awarded $2.5 million in annual perks ranging from round-the-clock access to a corporate jet to free dry cleaning service. When this information was revealed to the press, Welch quickly agreed to pay GE $2 million for these services.

Is it ethical for top managers to receive such vast amounts of money from their companies? Do they really earn it? Remember, this money could have gone to shareholders in the form of dividends. It could also have gone to reduce the huge salary gap between those at the top and those at the bottom of the hierarchy. Many people argue that the growing disparity between the rewards given to CEOs and those given to other employees is unethical and should be regulated. CEO pay has become too high because CEOs are the people who set and control one another's salaries and bonuses! They can do this because they sit on the boards of other companies, as outside directors, and thus can control the salaries and stock options paid to other CEOs. As the example of Bernie Ebbers at WorldCom suggests, when a CEO can control and select many of the outside directors, the CEO can abuse his or her power.

Others argue that because top managers play an important role in building a company's capital and wealth, they deserve a significant share of its profits. Jack Welch, for example, deserved his $500 million because he created hundreds of billions of dollars in stockholder wealth. The debate over how much money CEOs and other top managers should be paid is currently raging. The recent changes at Walt Disney illustrate many of these issues, as discussed in Business in Action.

Business in Action

All Change at Walt Disney

In the early 2000s, the performance of the Walt Disney Company fell precipitously. By 2003, many analysts were wondering if Michael Eisner, who had been its CEO for the last 18 years, was still the right person for the job. Eisner had a hands-on approach to running the business: He wanted to be involved in every major business decision, and he kept a tight reign on his managers. He was also criticized because although he was 60 and due to retire in 2006, he had not laid out a succession plan that indicated which managers would assume the top roles at Disney after he stepped down. Such a plan is important because many companies flounder if a new CEO has not been groomed to take over the top job.

In addition, Eisner was criticized for creating a weak, captive board of directors that was unwilling to scrutinize and question his business decisions, some of which were major errors. Over the years, Eisner created a 16-member board of directors in the company, at least 8 of whom had personal ties to him. This did not serve Disney's stockholders well because Eisner's decisions often hurt the company's performance. For example, Eisner pushed through the merger between Disney and Capital/ABC. But since the acquisition, the poorly performing ABC network has dragged down Disney's stock price. Neither was it lost on Disney's shareholders that Eisner had received more than $800 million in stock options during his 19 years as CEO, along with lavish perks, including the use of Disney's corporate jets, penthouse suites, and all-expenses paid trips.

Upset by Disney's poor performance and CEO Michael Eisner's lavish perks, stockholders ousted him as chairman of the board. But he remained Disney's CEO until 2005.

With its performance falling, Eisner came under increasing criticism for his autocratic management style, his lack of a succession plan for the company, and his creation of a weak board of directors, as well as the fact that he is still paid vast sums of money despite his company's declining performance. Indeed, many analysts began to wonder if Eisner was behaving ethically as CEO or whether his behavior was a prime example of the agency problem (see Chapter 4). So, in 2003 Disney reorganized its board of directors. Two new special outside directors were appointed, one of whom chairs two board meetings a year that Eisner–who normally chairs these meetings–was not permitted to attend. The board now had more freedom to assess Eisner's performance.

Many analysts claimed these changes were not enough because the majority of Disney's board members were still beholden to Eisner. In 2004, Roy Disney, Walt Disney's nephew and a major stockholder began a campaign to remove Eisner from his position as CEO and he lobbied board members for a change in leadership. Although unsuccessful in removing Eisner, in the fall of 2004, Eisner announced that he would not seek another term as CEO when his contract expired in 2006. The board then began an immediate search for Disney's next CEO, and in 2005, named Robert Iger, Eisner's second in command, to be its next CEO when Eisner stepped down in September 2005, one year early. However, it appeared likely that Eisner would become Disney's new chairman of the board. This means he would still retain substantial control of the company. Once again analysts wondered, is this the ethical thing to do? Wouldn't Disney's shareholders be better served if the company had an all-new team at the top?[3]

Employees

A company's employees are the hundreds of thousands of people who work in its various functions, like research, sales, and manufacturing. Employees expect that they will receive rewards consistent with their performance. One principal way a company acts ethically toward employees and meets their expectations is by creating an occupational structure that fairly and equitably rewards them for their contributions. Companies, for example, need to develop recruitment, training, performance appraisal, and reward systems that do not discriminate between employees and that employees believe are fair.

Suppliers and Distributors

No company operates alone. Every company relies on a network of other companies that supply it with the inputs it needs to operate. Companies also depend on intermediaries such as wholesalers and retailers to distribute its products to the final customer. Suppliers expect to be paid fairly and promptly for their inputs; distributors expect to receive quality products at agreed-upon prices.

Once again, many ethical issues arise in the way companies contract and interact with their suppliers and distributors. Important issues concerning how and when payments are to be made or product quality specifications are governed by the terms of the legal contracts a company signs with its suppliers and distributors. Many other

Table 5.1
Select Principles from Gap Inc.'s Code of Vendor Conduct

As a condition of doing business with Gap Inc., each and every factory must comply with this Code of Vendor Conduct. Gap Inc. will continue to develop monitoring systems to assess and ensure compliance. If Gap Inc. determines that any factory has violated this Code, Gap Inc. may either terminate its business relationship or require the factory to implement a corrective action plan. If corrective action is advised but not taken, Gap Inc. will suspend placement of future orders and may terminate current production.

I. General Principles
Factories that produce goods for Gap Inc. shall operate in full compliance with the laws of their respective countries and with all other applicable laws, rules, and regulations.

II. Environment
Factories must comply with all applicable environmental laws and regulations. Where such requirements are less stringent than Gap Inc.'s own, factories are encouraged to meet the standards outlined in Gap Inc.'s statement of environmental principles.

III. Discrimination
Factories shall employ workers on the basis of their ability to do the job, without regard to race, color, gender, nationality, religion, age, maternity, or marital status.

IV. Forced Labor
Factories shall not use any prison, indentured, or forced labor.

V. Child Labor
Factories shall employ only workers who meet the applicable minimum legal age requirement or are at least 14 years of age, whichever is greater. Factories must also comply with all other applicable child labor laws. Factories are encouraged to develop lawful workplace apprenticeship programs for the educational benefit of their workers, provided that all participants meet both Gap Inc.'s minimum age standard of 14 and the minimum legal age requirement.

VI. Wages & Hours
Factories shall set working hours, wages and overtime pay in compliance with all applicable laws. Workers shall be paid at least the minimum legal wage or a wage that meets local industry standards, whichever is greater. While it is understood that overtime is often required in garment production, factories shall carry out operations in ways that limit overtime to a level that ensures humane and productive working conditions.

issues are dependent on business ethics. For example, numerous products sold in U.S. stores are produced in countries that do not have U.S.-style regulations and laws to protect the workers who make these products. All companies must take an ethical position on the way they obtain and make the products they sell. Commonly this stance is published on the company's Web site. Table 5.1 presents part of the The Gap's statement on global ethics.

Customers

Customers are often regarded as the most critical stakeholders: If a company cannot persuade them to buy its products, it cannot stay in business. Thus, managers and employees must work to increase efficiency and effectiveness in order to create loyal customers and attract new ones. They do so by selling customers quality products at a fair price and providing good after-sales service. They can also strive to improve their products over time.

Many laws exist that protect customers from companies that attempt to provide dangerous or shoddy products. Laws exist that allow customers to sue a company that produces a bad product, such as a defective tire or vehicle, causing them harm. Other laws force companies to clearly disclose the interest rates they charge on purchases–a cost that customers frequently do not factor into their purchase decisions. Every year thousands of companies are prosecuted for breaking these laws, so "buyer beware" is an important business rule customers must follow.

Community, Society, and Nation

community The physical society in which a company is located.

As we have seen in previous chapters, the effects of business activity permeate all aspects of the community, society, and nation in which it takes place. **Community** refers to the physical location in which a company is located, like a city, town, or neighborhood. A community provides a company with the physical and social infrastructure that allows it to do business; its utilities and labor force; the homes in which its managers and employees live; the schools, colleges, and hospitals that service their needs, and so on.

Through the salaries, wages, and taxes it pays, a company contributes to the economy of the town or region in which it operates and often determines whether the community prospers or suffers. Similarly, a company affects the prosperity of a society and a nation and, to the degree that a company is involved in global trade, all of the countries in which it operates.

Although the way an individual McDonald's restaurant operates might be of small consequence, the combined effects of the way *all* McDonald's (and other fast-food companies) do business are enormous. In the United States alone, over 500,000 people work in the fast-food industry, and many thousands of suppliers like farmers, paper cup manufacturers, builders, and so on, depend on it for their livelihood. Small wonder then, that the ethics of the fast-food business are scrutinized closely. The industry is the major lobbyer against attempts to raise the minimum wage, for example, because a higher minimum wage would substantially increase its operating costs. However, responding to protests about chickens raised in cages in which they cannot move their wings, McDonald's–the largest egg buyer in the United States–issued new ethical guidelines concerning cage sizes and related matters. Its egg suppliers must abide by these guidelines if they are to retain its business.

Business ethics are also important because the failure of companies can have catastrophic effects on the communities in which they operate, and, if the businesses are large enough, entire regions and evens nations. The decision of a large company to pull out of a community can seriously threaten its future. Some companies attempt to improve their profits by engaging in actions that, although not illegal, can hurt communities and nations. One of these actions is pollution. As we discussed in the last chapter, many U.S. companies reduce costs by trucking their waste to Mexico where it is legal to dump it in the Rio Grande. The dumping pollutes the river from the Mexican side, and the effects are increasingly being felt on the U.S. side, too.

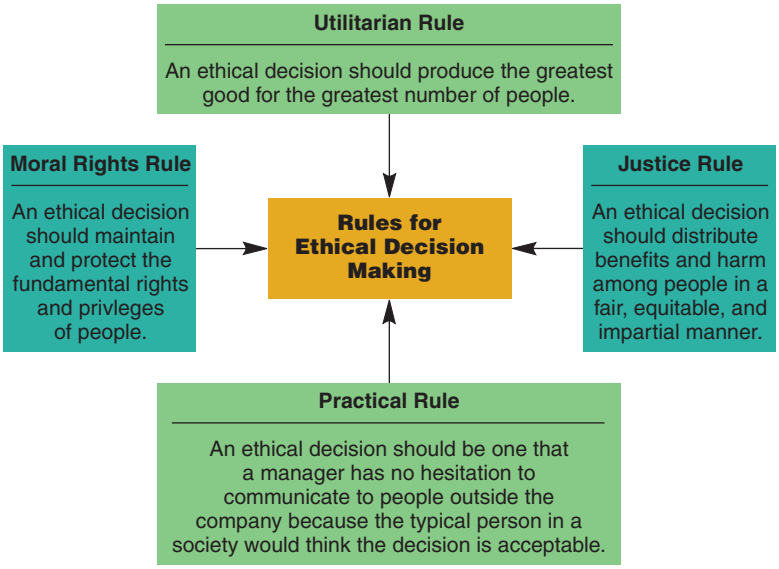
Rules for Ethical Decision Making

When a stakeholder perspective is taken, questions of business ethics abound. What is the appropriate way to manage the claims of all stakeholders? Business decisions that favor one group of stakeholders, for example, are likely to harm the interests of others. High prices to customers might lead to high returns for shareholders and high salaries for managers in the short run. But if in the long run, customers turn to companies that offer lower-cost products, the result could be declining sales, laid-off employees, and the decline of the communities that support the high-priced company's business activity.

When companies act ethically, their stakeholders support them. For example, banks are willing to supply them with new capital, the companies attract highly qualified job applicants, and new customers are drawn to their products. Thus, ethical companies grow and expand over time, and all of their stakeholders benefit as a result. By contrast, unethical behavior will eventually result in the loss of a company's reputation and, ultimately, its resources–its shareholders, who will sell their shares, its managers and employees, who will leave the company to find better jobs, and its customers, who will turn to the products of more reputable companies.

When making business decisions, managers must consider all of the firm's stakeholders. The loss of any one of these groups can be very detrimental. Managers can

Figure 5.2
Four Ethical Rules



use four ethical rules or principles to analyze the effects of their business decisions on stakeholders: *utilitarian, moral rights, justice,* and *practical* rules, all of which are outlined in Figure 5.2. These rules are useful guidelines that can help managers decide what to do and how to balance the interests of different stakeholders. Remember, the right choices will result in resources being used to create the most value. If all companies make the right choices, all stakeholders will benefit in the long run.

The Utilitarian Rule

utilitarian rule A rule stating that an ethical decision is one that produces the greatest good for the greatest number of people.

The **utilitarian rule** is that an ethical decision is a decision that produces the greatest good for the greatest number of people. To decide which is the most ethical course of business action, managers should first consider how different possible courses of business action would benefit or harm different stakeholders. They should then choose the course of action that provides the most benefits, or conversely, the one that does the least harm, to stakeholders.

The ethical dilemma for managers is as follows: How do you measure the benefits and harms that will be done to each stakeholder group? Moreover, how do you evaluate the rights of different stakeholder groups and the relative importance of each? Because stockholders are the owners of the company, shouldn't their claims be held above those of employees? Consider a decision to outsource work globally: This decision can benefit shareholders and customers if it enhances the company's profits, but it will nonetheless result in layoffs affecting its domestic employees and the communities in which they live. Typically under capitalism, the interests of shareholders are put above those of employees, so production will move abroad. This is commonly regarded as being an ethical choice because in the long run, the alternative, domestic production, might cause the business to collapse and go bankrupt. If this happens, all of the company's stakeholders will suffer–not just its employees. According to the utilitarian view, the decision that produces the greatest good for the greatest number of people is best. In this case, that means outsourcing the jobs.

The Moral Rights Rule

moral rights rule A rule stating that an ethical decision is one that best maintains and protects the fundamental, inalienable rights and privileges of the people affected by it.

Using the **moral rights rule,** an ethical decision is a decision that best maintains and protects the fundamental or inalienable rights of the people affected by it. According to the moral rights rule, an ethical decision is one that protects people's rights to freedom, life and safety, property, privacy, free speech, and freedom of conscience. "Do unto others as you would have them do unto you" is the basis for the moral rights rule.

Even if someone benefits personally by ruthlessly pursuing his or her own self-interests, he or she will suffer. The adverse impact on society as a whole will make it a less desirable place for that person (and all of us) to live.

From a moral rights perspective, managers should compare and contrast different courses of business action on the basis of how each will affect the rights of the company's different stakeholders. Managers should then choose the course of action that best protects and upholds the rights of *all* the stakeholders. For example, decisions that might result in significant harm to the safety or health of employees or customers would clearly be unethical choices.

The ethical dilemma for managers is that business decisions that will protect the rights of some stakeholders often will hurt the rights of others. How should they choose which group to protect? For example, does an employee's right to privacy outweigh an organization's right to protect its property? Suppose your manager is having personal problems and is coming in late and leaving early. You are then forced to pick up the manager's workload. Do you tell your manager's supervisor, even though you know this will probably get that manager fired? How should the manager's supervisor deal with the problem? Is it morally right to fire someone who is already having personal problems?

The Justice Rule

justice rule An rule stating that an ethical decision is one that distributes benefit and harms among people in a fair or impartial way

According to the **justice rule**, a decision is ethical if it distributes benefit and harm among people and groups in a fair or impartial way. Managers should compare and contrast alternative courses of action based on the degree to which they will result in a fair or equitable distribution of outcomes for stakeholders. For example, employees who are similar in their levels of skill, performance, or responsibility should receive the same kind of pay. The allocation of outcomes should not be based on differences such as gender, race, or religion.

The ethical dilemma for managers is to determine the fair rules and procedures for distributing outcomes to stakeholders. Managers must not give people they like bigger raises than they give to people they do not like, for example, or bend the rules to help their favorites. On the other hand, if employees want managers to act fairly toward them, then employees need to act fairly toward their companies and work hard and be loyal. Similarly, customers need to act fairly toward a company if they expect it to be fair to them–something people who illegally copy digital media should consider.

The Practical Rule

Each of the above rules offers a different and complementary way of determining whether a decision or behavior is ethical, and all three rules should be used to sort out the ethics of a particular course of action. Ethical issues, as we just discussed, are seldom clear-cut, however, because the rights, interests, goals, and incentives of different stakeholders often conflict. For this reason many experts on ethics add a fourth rule to determine whether a business decision is ethical: The **practical rule** is that an ethical decision is one that a manager has no hesitation about communicating to society because the typical person would think it is acceptable. Think of this as the *60 Minutes* rule. How will the public react if the decision were publicized (broadcast on the TV show *60 Minutes,* for example)? A business decision is probably acceptable on ethical grounds if a manager can answer *yes* to each of these questions:

practical rule A rule stating that an ethical decision is one that a manager can communicate to society because the typical person would think it is acceptable.

1. Does my decision fall within the accepted *values* or *standards* that typically apply in business activity today?
2. Am I willing to see the decision *communicated* to all people and groups *affected* by it–for example, by having it reported in newspapers or on television?

3. Would the people with whom I have a *significant* personal relationship, such as my family members, friends, or even managers in other organizations, *approve* of the decision?

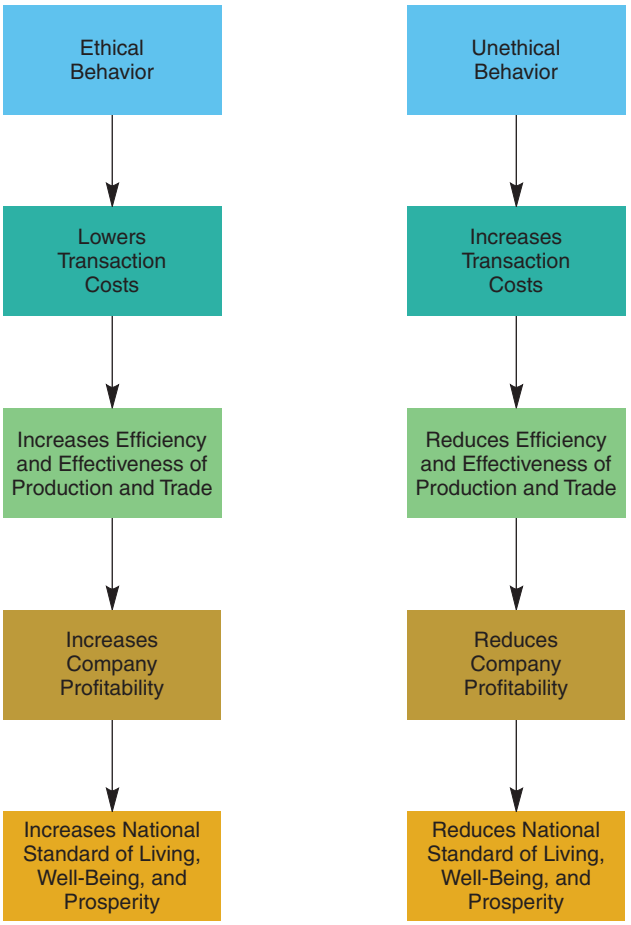
If the answer to any of these questions is *no,* chances are the decision is not an ethical one.

Why Should Managers Behave Ethically?

Why is it so important for managers and people, in general, to act ethically? The answer was given in Chapter 2. The relentless pursuit of self-interest can lead to a collective disaster. When one or more people start to profit from being unethical, this encourages others to act in the same way. Quickly, more and more people jump onto the bandwagon, and soon everybody is trying to manipulate the situation in the way that best serves his or her personal ends with no regard for the effects of the action on others. The situation brought about by Napster is an example of how what is called the "tragedy of the commons" works.

Suppose that in an agricultural community there is common land that everybody has an equal right to use. Pursuing self-interest, each farmer acts to make the maximum use of the free resource by grazing his or her own cattle and sheep on the land. Collectively, all of the farmers overgraze the land, which quickly becomes worn out. Then a strong wind blows away the exposed topsoil, so the common land is destroyed. The pursuit of individual self-interest with no consideration for societal interests leads to disaster for each individual and for the whole society because scarce resources are destroyed. In the Napster case, the tragedy that would result if all people were to steal digital media would be that fewer records, movies, and books would be produced because there would be little incentive to do so.

Figure 5.3
Some Effects of Ethical and Unethical Behavior



We can look at the effects of unethical behavior on business commerce and activity in another way. Go back to the example of people who are engaged in trading corn for sheep. Suppose this business activity takes place in an unethical society, meaning one in which people routinely try to cheat or defraud one another. If both parties expect the other to cheat, how long will it take them to negotiate an exchange? When they do not trust each other, stakeholders will probably spend hours bargaining over fair prices and looking to close any loopholes in a deal they can. This is a largely unproductive activity that reduces efficiency and effectiveness in an economy. All the time and effort that could be spent on improving the land and livestock is being lost because it is spent on negotiating and bargaining. Thus, unethical behavior and distrust hampers business commerce. Less capital and wealth are created in a society, so living standards are lower. Figure 5.3 illustrates this.

It has been said that there are two ways to acquire wealth: by plunder or productivity. In many African countries plunder is the order of the day. Theft, war, and lawlessness are widespread. As a result, few companies want to invest in these countries, productivity is very low, and most people are poverty stricken. Is this the type of society you would like to live in? Likewise, if corporate executives go unpunished for bilking shareholders, fewer people will be inclined to invest their money in the stock market. As a result, companies will have less money to invest in better products, new plants, and jobs for people. This will have an adverse effect on the economy as a whole and the quality of life for everyone.

trust A person's confidence and faith in another person's goodwill.

Now suppose companies and their managers operate in an ethical society. Stakeholders believe they are dealing with others who are basically moral and honest. In this society stakeholders have a greater reason to **trust** others, which means they have more confidence and faith in the other person's goodwill. When trust exists, people are more likely to signal their good intentions by cooperating and providing information that makes it easier to trade and price goods and services. When one person does so, this encourages others to act in the same way. Over time greater trust between stakeholders allows them to work together more efficiently and effectively; transaction costs fall, and business commerce becomes more profitable (see Figure 5.3). When people can see that acting in an honest way yields positive results, ethical behavior becomes a valued social norm, and people in society become better off.

In summary, in a complex, diverse society, stakeholders and people, in general, need to recognize they are all part of a larger social group. The way in which we personally make decisions affects the lives of other people and the society around us. This, in turn, affects us.

Business Ethics

Some companies, like Merck, Johnson & Johnson, Prudential Insurance, Fannie Mae, and Blue Cross-Blue Shield, are well known for their ethical business practices. Other companies, like Arthur Andersen, Enron, and WorldCom, are either out of business or struggling to survive. What explains such differences between the business ethics of these companies and their managers?

There are four main determinants of differences in business ethics between companies and countries: *societal* ethics, *occupational* ethics, *individual* ethics, and *organizational* ethics, as outlined in Figure 5.4.

Societal Ethics

societal ethics Standards that govern how members of a society should deal with one another in matters involving issues such as fairness, justice, poverty, and the rights of the individual.

Societal ethics are standards that govern how members of a society should deal with one another in matters involving fairness, justice, poverty, and the rights of individuals. Societal ethics emanate from a society's laws, customs, and practices, and from the unwritten values and norms that influence how people interact with each other. Most people have *internalized* (made a part of their moral fabric) certain values, beliefs, and norms that specify how they should behave when confronted with an ethical dilemma. In other words, an "internal compass" of sorts guides their behavior.

Figure 5.4
Sources of Business Ethics

Societal ethics vary among societies. Countries like Germany, Japan, Sweden, and Switzerland are well known as being some of the most ethical countries in the world, with strong values about social order and the need to create a society that protects the welfare of all people. In other countries the situation is very different. In many economically poor countries bribery is standard practice to get things done–such as getting a telephone installed or a contract awarded. As we learned in Chapter 4, in the United States and other economically advanced countries, bribery is considered unethical and is illegal.

IBM came under fire after managers in its Argentina division paid a $6 million bribe to land a $250 million contract servicing the computers of a large, state-owned bank. IBM won the contract, but the managers who arranged the bribe were fired. Although bribes such as these are not necessarily illegal under Argentine law, IBM's organizational rules forbid the practice. Moreover, the payment of bribes violates the U.S. *Foreign Corrupt Practices Act*, which prohibits U.S. companies from paying bribes in order to win contracts abroad. It also makes companies liable for the actions of their foreign managers, and allows companies found in violation to be prosecuted in the United States. By firing the managers, IBM signaled that it would not tolerate unethical behavior by any of its employees, and it continues today to take a rigorous stance toward ethical issues.

Countries also differ widely in their beliefs about appropriate treatment for their employees. In general, the poorer a country is, the more likely employees are to be treated with little regard. One issue of particular ethical concern that has set off protests around the world is the use of child labor, discussed in Business in Action.

Business in Action

Is It Right to Use Child Labor?

In recent years, the number of U.S. companies that buy their inputs from low-cost foreign suppliers has been growing, and concern about the ethics associated with employing young children in factories has been increasing. In Pakistan, children as young as age six work long hours in deplorable conditions to make rugs and carpets for export to Western countries. Children in poor countries throughout Africa, Asia, and South America work in similar conditions. Is it ethical to employ children in factories, and should U.S. companies buy and sell products made by these children?

Opinions about the ethics of child labor vary widely. The International Labor Organization and other labor activists believe that the practice is reprehensible and should be outlawed globally. Another view, championed by *The Economist* magazine, is that, although no one wants to see children employed in factories, in many poor countries, children must work to ensure their families' survival. Thus, denying children employment would cause entire families to suffer. Instead, *The Economist* favors regulating the conditions under which children are employed and hopes that over time, as poor countries become richer, the need for child employment will disappear.

Should child labor be outlawed worldwide? Some people feel the practice is reprehensible. Others see it as a matter of survival in many countries.

Many U.S. retailers that typically buy their clothing from low-cost foreign suppliers have had to take an ethical stance on the child labor issue. Managers in Wal-Mart, Target, J.C. Penney, and The Gap all have policies in place prohibiting their foreign suppliers from employing children. These companies vow to sever ties with any foreign supplier found to be in violation of these policies.

But retailers differ widely in the way they choose to enforce such policies. It has been estimated that more than 300,000 children under age 14 are being employed in garment factories in Guatemala, a popular low-cost location for clothing manufacturers that supply the U.S. market. These children frequently work more than 60 hours a week and often are paid less than $3 a day, close to the minimum wage in Guatemala. Many U.S. retailers do not check up on their foreign suppliers. Clearly, if U.S. retailers want to avoid the customer backlash that invariably results from the use of child labor, they must do more to regulate the conditions under which these children work.[4]

Occupational Ethics

occupational ethics Standards that govern how members of a profession, trade, or craft, should conduct themselves when performing work-related activities.

Occupational ethics are standards that govern how members of a profession, trade, or craft should conduct themselves when performing work-related activities. For example, medical ethics govern the way doctors and nurses should treat their patients. Doctors are expected to perform only necessary medical procedures and to act in the patient's interest–not in their own. Most professional groups can punish their members for ethics violations. Doctors and lawyers can be prevented from practicing their professions if they disregard professional ethics and put their own interests first.

Likewise, within a business organization, occupational rules and norms often govern how employees such as lawyers, researchers, and accountants should behave to further the interests of its stakeholders. Employees internalize the rules and norms of their occupational groups (just as they do those of society) and often follow them automatically when deciding how to behave. Sometimes, however, a person's occupational ethics conflict with those of the firm in which they work. A scientist is surely aware of the fact that fabricating data goes against the grain of his or her profession. But what should he or she do if under corporate pressure to do so? In this case, the decision the scientist makes ultimately depends upon his or her own individual ethics. This is what we discuss next.

individual ethics A person's standards and values that determine how he or she should act in situations when his or her own self-interest is at stake.

organizational ethics The practices and beliefs that guide an organization's behavior towards its stakeholders.

Individual and Organizational Ethics

Individual ethics are personal standards and values that determine how people should act towards others when their own self-interests are at stake. The influence of one's family, peers, and upbringing in general are the basis of a person's individual ethics. The individual ethics of a company's founders and top managers are especially important "shapers" of an organization's ethics. **Organizational ethics** are the values and beliefs that guide an organization's behavior toward its stakeholders. Organizations whose founders created highly ethical codes of organizational behavior include Merck, Hewlett-Packard,

Did You Know?

The gross domestic product of the poorest 30 nations is less than the wealth of the world's five richest people combined.[5]

Table 5.2
Johnson & Johnson's Credo

We believe our first responsibility is to the doctors, nurses, and patients, to mothers and fathers and all others who use our products and services.
In meeting their needs everything we do must be of high quality.
We must constantly strive to reduce our costs in order to maintain reasonable prices.
Customers' orders must be serviced promptly and accurately.
Our suppliers and distributors must have an opportunity to make a fair profit.
We are responsible to our employees, the men and women who work with us throughout the world.
Everyone must be considered as an individual.
We must respect their dignity and recognize their merit.
They must have a sense of security in their jobs.
Compensation must be fair and adequate, and working conditions clean, orderly and safe.
We must be mindful of ways to help our employees fulfill their family responsibilities.
Employees must feel free to make suggestions and complaints.
There must be equal opportunity for employment, development, and advancement for those qualified.
We must provide competent management, and their actions must be just and ethical.
We are responsible to the communities in which we live and work and to the world community as well.
We must be good citizens–support good works and charities and bear our fair share of taxes.
We must encourage civic improvements and better health and education.
We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.
Our final responsibility is to our stockholders.
Business must make a sound profit.
We must experiment with new ideas.
Research must be carried on, innovative programs developed and mistakes paid for.
New equipment must be purchased, new facilities provided and new products launched.
Reserves must be created to provide for adverse times.
When we operate according to these principles, the stockholders should realize a fair return.

Johnson & Johnson, and the Prudential Insurance Company. Johnson & Johnson's code of ethics–that is, its credo, shown in Table 5.2–reflects a well-developed concern for the firm's stakeholders. Company credos, such as that of Johnson & Johnson, are meant to deter self-interested, unethical behavior–to demonstrate to managers and employees that a company will punish people who put their own interests above others and inflict harm on the organization's stakeholders.

Employees are much more likely to act unethically when a credo does not exist or is disregarded by a company's top managers. Arthur Andersen, for example, did not follow its credo at all. Its unscrupulous partners ordered the firm's middle managers to shred evidence of their wrongdoing. Although the middle managers knew this was wrong, they followed orders because the power of the firm's partners, not the company's code of ethics, dictated the firm's culture. The firm's middle managers were afraid they would lose their jobs if they didn't shred the documents. But they lost them anyway after the shredding came to light and the company's reputation was ruined.

Because they bear ultimate responsibility for setting policy, top managers establish the ethical values and norms of their organizations. A company's board of directors therefore needs to carefully scrutinize its top managers. It is the responsibility of the board to decide if a prospective CEO has the maturity, experience, and integrity needed to lead a company and be entrusted with its vast capital and wealth on which the well-being of its stakeholders depend. In 2003, the former CEO of Kmart was scrutinized for poor managerial decision making that ultimately led to the company's downfall. (Apparently, the scrutiny did not come soon enough.)

A financial track record of success is not enough to decide this issue because it could have been achieved by unethical or illegal means. Boards need to delve deeper than the bottom line and examine the other credentials of prospective top managers. In the early 2000s it was disclosed that the top managers of several major companies lacked the degrees or experience listed on their resumes–facts that should have been uncovered prior to their being hired. Often, the best predictor of future behavior is past behavior, but the board of directors needs to be on guard against unethical people who use unethical means to rise to the top of the organizational hierarchy.

These three sources of ethics collectively influence the ethics that develop inside of an organization. Each organization has a set of ethics. Some of these ethics are unique to an organization and are an important aspect of its organizational culture, a topic discussed in detail in Chapter 7. However, many ethical rules go beyond the boundaries of any individual company. Companies, collectively, are also expected to follow ethical and legal rules. If one company breaks the rules, others frequently follow.

The Advantages of Behaving Ethically

reputation The trust, goodwill, and confidence others have in a company that leads them to want to do business with it.

Several advantages result when companies and their managers behave in an ethical way. First, companies known for their ethical behavior enjoy a good reputation. **Reputation** is the trust, goodwill, and confidence others have in a company such that they want to do business with it. A company with a good reputation will find it easier to do more business and obtain resources from stakeholders. Behaving ethically is therefore the economically right thing to do because it increases a company's profits.

A second reason for companies to behave ethically is because when they don't, the government (and taxpayers) has to bear the costs of protecting their stakeholders–by providing laid-off employees with health care and unemployment benefits, bailing out pension plans gone bust, or seeking compensation for shareholders. If all companies in a society act socially responsibly the quality of life for people as a whole increases. Experts point to Japan, Sweden, Germany, the Netherlands, and Switzerland as examples. In these countries, organizations act in a highly ethical way towards their stakeholders. As a result, crime, poverty, and unemployment rates are relatively low, literacy rates are relatively high, and sociocultural values promote harmony between different groups of people. Business activity affects all aspects of people's lives, so the way business behaves toward stakeholders affects how stakeholders will behave toward businesses. You "reap what you sow," as the adage goes.

Creating an Ethical Organization

Although ethical values flow down from the top of the organization, they can be strengthened or weakened by the design of an organization's structure. Creating authority relationships and rules that promote ethical behavior and punish unethical acts is one way of strengthening this structure. The federal government, for example, continually tries to improve the set of standards governing the conduct of its 5 million federal employees. These standards govern activities such as gift giving and receiving, assigning government contracts on an impartial basis, and avoiding conflict of interest.

whistleblower A stakeholder who reveals an organization's misdeeds to the public.

Often, an organization uses its mission statement to guide employees in making ethical decisions. Policies regarding the treatment of whistleblowers can also be put into place. A **whistleblower** is a stakeholder (usually an employee) who reveals an organization's misdeeds to the public. Employees typically become whistleblowers when they feel powerless to prevent an organization from committing an unethical act or when they fear retribution if they voice their concerns. Whistle blowing, which is becoming more commonplace, can lead to steep fines and lawsuits levied against the firm and even prison time for its personnel. As a result, companies are now encouraging employees to come forward internally with

Did You Know?

Price of a medium Coca-Cola at a fast-food restaurant: $1.29
Price of the Coca-Cola syrup: $.09[6]

their concerns versus airing "their dirty laundry in public." Procedures are being put into place giving lower-level employees a forum in which to voice their concerns and access to air their grievances to the firm's upper-level managers.

In addition, many companies have installed "chief ethics officers." Chief ethics officers are managers employees can go to to report wrongdoing. After an alleged incident is investigated, the firm's ethics "committee" can make a formal judgment about whether wrongdoing has actually occurred, and, if so, what the consequences should be. Today, 20% of Fortune 500 companies have ethics officers. In addition to investigating unethical and illegal corporate conduct, these ethics officers are responsible for keeping employees informed about the firm's conduct codes and training them to make good ethical decisions.

There are many ways in which individual managers can, and should, personally influence the people in their companies to behave ethically. For example, as we mentioned earlier in the chapter, a manager acts as a figurehead and personifies the organization's ethical position. As such, he or she can promote moral values and norms that employees use to make decisions. He or she can demonstrate those values by behaving in a certain way–such as by being honest and acknowledging errors. Outside the organization, as a liaison or spokesperson, the manager can inform prospective customers and other stakeholders about the organization's ethical values and then unfailingly abide by them.

Homemaking maven Martha Stewart learned this the hard way–after she was found guilty of insider trading and the stock of Martha Stewart Living Omnimedia Inc. plummeted. Stewart was later sentenced to five months in prison and five months of house arrest. Many business analysts speculated that had Stewart "come clean" when charges against her were initially filed, both she and her company would have been better off.

The Legal Environment of Business

It is time to look at the U.S. laws and regulations that have been passed over the decades to curb unethical business activities. The most important laws, and the reasons why they were passed, are discussed below from the perspective of business as commerce, occupation, and organization. (See Figure 5.5.)

Laws Affecting Business Commerce

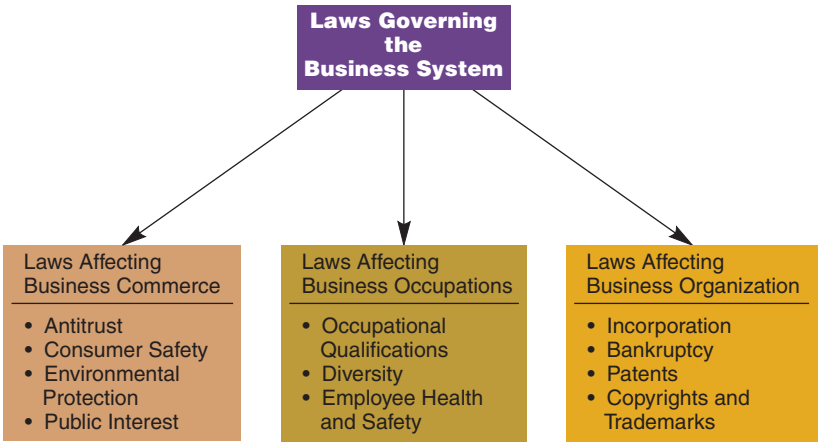
Four main types of laws affecting business commerce are antitrust laws, consumer protection laws, environmental laws, and laws protecting the public's general interest.

ANTITRUST LAWS Perhaps the single most important reason U.S. laws governing trade and commerce were initially passed was to prevent the abuse of monopoly power. We discussed in Chapter 2 how throughout history merchants and traders have sought to monopolize their industries. U.S. capitalists such as John D. Rockefeller were well aware of the advantages a monopoly provided. They therefore developed "trusts," or groups of companies, to disguise the fact that they were really acting as one company (a monopolist) to limit supply and keep prices high. As this scheme became clear to the public, however, a number of powerful **antitrust laws** were passed making it illegal for one or more companies to conspire to limit supply and control a product's price. This was a huge blow to "big" business. Violators face severe penalties. It should be noted that we are referring here to U.S. antitrust laws, which cannot be universally enforced. OPEC, an international organization of oil producing countries, for example, controls the amount of crude oil produced worldwide. But there is nothing the U.S. government can do about OPEC.

antitrust laws Laws passed to curb the power of big business and make it illegal for companies to conspire with one another to limit supply and keep prices high.

The antitrust laws passed in the United States led to the creation of many other government agencies charged with overseeing corporate behavior and business commerce. The Securities and Exchange Commission (SEC) is the most important of these agencies. It has the power to investigate companies that seem to be behaving illegally. Microsoft is one of many companies investigated by the SEC. The SEC also

Figure 5.5
Types of Business Laws and Regulations



has the power to create new regulations that make emerging forms of unethical commercial behavior illegal. It can impose severe sanctions against people and companies who break those laws, including bringing lawsuits against them. In addition, the SEC is responsible for managing the agencies or committees that regulate specific kinds of business practices. For example, in 2002 the Arthur Andersen-Enron accounting scandal put accounting companies' audit procedures under the spotlight. Prior to the scandal, audits had been scrutinized only by the industry's regulatory committee. (After the scandal broke, however, it became clear that the industry had done a very poor job of policing itself.) Under pressure from Congress, the SEC moved to create a new, independent watchdog agency to oversee the auditing industry. One proposal was that the large accounting firms should not be allowed to audit a particular company's books for more than five consecutive years. The idea behind the proposal was that outside accountants, and a particular company's managers, would not break the law if they knew another accounting company would be reviewing the company's books in the future. Worried that if the proposal became law, it would cost them long-term clients, companies in the accounting industry lobbied Congress heavily to prevent that from happening. They succeeded. The new rules developed by the SEC to prevent illegal auditing practices are much weaker today as a result.

CONSUMER SAFETY LAWS "Snake oil" salesmen peddling their noxious tonics around the United Stated in the 1800s were an early warning of the need for consumer safety laws. Some of these tonics were probably safe to use in small quantities; others were pure poison and resulted in the deaths of hundreds of early settlers. Unfortunately, this type of behavior still goes on. In 2002, a Kansas City pharmacist pled guilty to diluting the chemotherapy drugs of 34 patients in an effort to pad his profits. Another example of this disregard for consumer safety became apparent in the early 2000s, as profiled in Business in Action.

Business in Action

How Metabolife Swept the Dangers of Ephedra under the Rug

In 2002, Metabolife International was one of largest companies that produced and sold ephedra, a supplement widely used for weight loss and body building. Fears about ephedra's safety had been around for years. Still, Metabolife resisted attempts by the U.S. Food and Drug Administration (FDA) to obtain a list of its customers' complaints. After the U.S. Justice Department opened a criminal investigation and the company was forced to turn over the list, it was revealed that over 16,000 customers had complained about the product. Nearly 2,000 adverse reactions, including 3 deaths, 20 heart attacks, 24 strokes, and 40 seizures had been reported.

Metabolife was not required by law to disclose the adverse effects its customers were experiencing, but should it have been? If you were a Metabolife stockholder, would you want the firm to disclose that information? What would this do to the price of your stock?

How was Metabolife able to get away with this behavior? Unlike prescription drugs, the FDA does not regulate over-the-counter supplements even though some of these supplements can have life-threatening effects. Because no laws existed to force Metabolife to disclose the adverse side effects–something all pharmaceutical companies are required to do by law–it chose to hide this information. Although Metabolife's actions were legal, they were anything but ethical.

Hundreds of personal injury lawsuits were later filed against Metabolife by consumers. In 2003 the company was ordered by an Alabama court to pay $4.1 million to four people who had suffered a stroke or seizure after using the product. If more of these consumers prevail in court, it seems likely that Metabolife will be put out of business. In the meantime a national campaign to ban ephedra was successful, and new laws governing supplements and the FDA's power to police their distribution have been proposed.[7]

ENVIRONMENTAL PROTECTION LAWS A third class of commercial laws governs how companies treat the natural environment. This is one of the primary functions of government–to preserve the long-term health and prosperity of people when unregulated markets fail to do so. In the 2000s, the costs of disposing both toxic and nontoxic waste products increased substantially. Land has become more scarce and expensive. So to protect it, more laws are being passed to regulate the way products are disposed of. Stricter air pollution regulations have also been passed to, among other things, limit acid rain caused by the emissions of coal-fired power stations.(Whole forests around the world have been killed by acid rain.) Similarly, there is increasing realization that our seas are becoming overpolluted and overfished. Laws and regulations now govern the size of fish catches and oil drilling at sea throughout Canada, Alaska, the Gulf Coast, and elsewhere.

Unfettered by laws and regulations, unethical companies will simply maximize their own short-run returns at the expense of the environment and the people in it. Future generations will not only suffer physically because of pollution but also economically as the world's natural resources are depleted. The long-run consequences future generations face when these companies exploit the environment are not part of their business models.

Legal regulations can change this, however. When companies are forced to pay the real cost of obtaining valuable inputs and properly disposing of their waste products–costs they would otherwise impose on the rest of us in terms of the waste's cleanup, the higher health costs we experience, or the depleted resources we no longer have access to–their incentives change. These costs then become part of companies' total operating costs and must be considered in their business models. In the long run this motivates companies to pollute less and use their resources wisely. Society as a whole benefits.

The Clean Air Act passed by Congress in 1990 was a major step in this direction. Under this law, the U.S. Environmental Agency sets limits on how much of a pollutant can be in the air anywhere in the United States, and companies are responsible for bearing the cost of keeping this emission low (by installing cleaner burning equipment, and so forth). This ensures that all Americans, no matter what state they are living in, have the same basic health and environmental protections.

Of course, pollution isn't just limited to the United States. Recognizing this, countries worldwide are beginning to work together to reduce it. The Kyoto Protocol is an

amendment to the United Nations' treaty on global warming. Countries that ratify the Kyoto Protocol pledge to reduce their emissions of carbon dioxide and other greenhouse gases. A total of 141 countries have ratified the agreement; however, notable exceptions include the United States and Australia.

public interest
Country-specific standards used to evaluate how a proposed course of action affects the welfare of society.

LAWS RELATING TO THE PUBLIC INTEREST There are many other laws that also govern how a company should behave that further the public interest. The **public interest** is a country-specific set of standards or beliefs used by lawmakers and the courts to evaluate the appropriateness of certain actions–such as business actions. The private benefits that a person or company would receive from pursuing a certain course of action are weighed against the effects on the public at large. If lawmakers or judges decide that a particular course of action would significantly reduce the public's welfare even if private parties might benefit substantially, then the action might be made or deemed to be illegal.

Public interest judgments are made about all kinds of business practices. These judgments determine which system of business law exists in a society such as the United States. In general, the more economically developed the country is, the better developed and stringent are its business laws regulating economic activity.

One kind of public interest judgments is made about the ethics involved in trade between a company and its suppliers and distributors. While driving a hard bargain is not necessarily unethical, sometimes a company that either buys in large quantities, like Wal-Mart, or controls the supply of a product, can force its suppliers or distributors to agree to business practices that could be considered uncompetitive under antitrust laws. Toys "R" Us, the most powerful toy buyer in the United States, was accused of this.

Faced with stiff competition from Wal-Mart and Target, Toys "R" Us told toy suppliers like Hasbro that it would not sell their toys in its stores if they sold the same toys to discount retailers who were undercutting its prices. This could be regarded as a use of "monopoly" power. It would threaten the public interest because it would limit competition, and consumers would pay higher toy prices. In a similar move, in 2002, Hasbro, the world's largest toymaker, attempted to artificially raise toy prices in the United Kingdom. Hasbro told U.K. toy retailers they could not discount the price of its toys–they had to be sold at *its* recommended price. Hasbro was later fined millions of pounds for *price-fixing,* a practice that is illegal in many countries.

Public interest judgments are also made to assess how a company should behave towards its stockholders to guarantee their welfare. Laws governing the rights of stockholders are particularly stringent. Strict rules and regulations exist that specify the way companies should report their financial results so that stockholders can understand how well they have performed. Among these requirements are that companies publish the salaries paid their top managers and the number of stock options awarded their employees. Of course, unethical managers can find many loopholes in these laws and many managers, such as those at Arthur Andersen and Enron, are driven by greed to act illegally and "cook the books."

In 2002, Hasbro was found guilty of using its power as the world's largest toymaker to artificially raise toy prices in the United Kingdom.

To help prevent this, new laws and regulations have been enacted to force companies to more fully disclosure their financial results. In 2002, Congress passed the Sarbanes-Oxley Act, which requires CEOs and CFOs (chief financial officers) to personally vouch for the accounting numbers their firms report to Wall Street–and face jail time if those numbers are falsified. Stockholders rights become a prominent issue in the 2000s as company after company admitted it had broken business laws and regulations. In 2002, for example, Salomon Smith Barney agreed to pay a $5 million fine to settle charges that one of its star brokers was promoting a stock to investors–even though the company's internal e-mails suggested the stock was a dog. Brokers at Merrill Lynch were also found to have done a similar thing, privately laughing about the poor prospects of

companies whose stocks they continued to recommend to thousands of investors. In 2004, many major mutual fund companies admitted they had allowed their fund managers and large investors to make stock market trades that made them millions of dollars for big investors but hurt millions of small investors. The companies have paid hundreds of millions in fines to settle these charges.

Laws Affecting Business Occupations

Many types of laws have been passed to prevent unethical practices related to business occupations: laws regulating occupational qualifications, laws governing business diversity, and laws promoting employee health and safety.

LAWS REGULATING OCCUPATIONS In many countries regulations exist that specify the skills, qualifications, and experience people must possess to be hired for government occupations. Air traffic controllers, tax auditors, schoolteachers, firefighters, and police officers, for example, all must have certain credentials. This serves the public interest because it ensures people have the skills they need to properly serve the public. It also prevents people from being hired for *whom* they knew versus *what* they know. Certainly, no person wants to feel he or she wasn't hired or promoted because the person who was went to the same school or belonged to the same club as the boss. Unethical hiring practices also mean that best people are *not* being hired. They are not being put to their most highly valued uses, so there is a loss in social welfare, and the public interest is threatened.

Many private-sector jobs also have occupational requirements designed to protect the well-being of society. Surely none of us would like to be treated by a doctor without a medical license or defended by an attorney who lacked a license to practice law. Most of us would also prefer to buy our medications from a licensed pharmacist rather than snake-oil salesman. Like the other laws in this chapter, occupational regulations are an attempt to prevent people from trying to unfairly profit at the expense of others.

LAWS GOVERNING DIVERSITY Laws governing diversity seek to create a level playing field for people in the job market. Once again, the goal of these laws is to foster the hiring, promotion, and retention of people based on their ability to do a job–not based on their ethnicity, religion, gender, age, and so on. If a company decides it needs to lay off workers, for example, the layoffs cannot unfairly affect a particular group of employees, such as workers over 50, or women or minorities. The procedures used to decide who should be hired, promoted, or laid off have to be defendable in court.

One reason such laws are necessary is to lessen the impact of the psychological bias called the "similar to me" effect, which research shows is a common tendency. As the name implies, people commonly tend to recruit, promote, and retain people from within their own religious, ethnic, or age groups because it's "easier" dealing with people who are more like themselves. Diversity laws help prevent this from happening by making it illegal to choose between people on nonjob-related grounds.

Breaking antidiscrimination laws makes companies vulnerable to employees' lawsuits. In 2003 Fed Ex was sued by a group of its minority employees claiming the company overlooked them for managerial promotions.

Of course, companies can be fined for discriminatory employment behavior and sued by people who feel they've been wronged. In 2003, female employees waged a class action suit against Wal-Mart claiming that the company systematically discriminated against women by unfairly promoting men to management positions. Also in 2003, FedEx was sued by a group of minority employees who, like the Wal-Mart employees, claimed they were unfairly passed over for promotions. In both cases, the companies paid hundreds of millions of dollars to settle these lawsuits.

Ultimately, companies do themselves a disservice by engaging in discrimination. In addition to facing fines and lawsuits, these companies do not take advantage of the best talent available to them when they discriminate. In addition, because the United States (and the world) is becoming a more diverse place, companies that fail to embrace minority employees often find themselves out-of-step with the marketplace. This puts them at a competitive disadvantage.

LAWS PROMOTING OCCUPATIONAL HEALTH AND SAFETY A final set of laws governs how companies must protect the health and safety of their employees while on the job. The U.S. Department of Labor Occupational Safety and Health Organization (OSHA) is the government agency primarily responsible for enforcing these laws. Each year in the United States and other countries, thousands of employees are killed in work-related accidents, and hundreds of thousands more are injured in some way. The risks facing firefighters and police officers are clear, but the workers who build skyscrapers and cooling towers and are employed in industries like building and manufacturing must all be protected from harm.

Most companies make the need to protect their employees from harm a major priority. But because abiding by health and safety regulations can be expensive, other companies do not or they take shortcuts to save money. For example, in 2001 a huge power generator blew up in one of Ford's car plants killing several employees and inuring many others. Although Ford had generally followed U.S. health and safety laws, it became clear to investigators that Ford could have been more proactive. For instance, it could have better trained the workers responsible for repairing and servicing the generator. Instead, the workers had been allowed to take shortcuts that saved them time and Ford money, which indirectly may have contributed to the explosion.

One particularly horrid example of how an unethical company can cause harm by failing to follow basic health and safety procedures occurred in a chicken processing plant in 1991. Twenty-five employees were killed in a huge fire at a North Carolina plant because managers had illegally locked all of the plant exits. Why? To prevent employee theft. Although stealing chickens is not ethical behavior, there were other ways to prevent it, like putting alarms on doors or hiring security personnel. But that would have been more expensive.

The company chose to lock the doors, instead, and when the fire broke out employees could not escape and perished in the blaze. The plant's owner subsequently entered a plea bargain with the state of North Carolina and was sentenced to 15 years in prison. The company also was fined over $1 million, its plants in North Carolina and Georgia were shut down, and it went bankrupt as a result of the tragedy. Survivors of the blaze lobbied for the federal government and state of North Carolina to hire more inspectors to enforce laws that govern safe work practices so that such a tragedy will never happen again.

Laws Affecting Business Organization

In general most companies are free to group and organize their employees as they see fit. It is up to managers to design their company's organizational structure to make profitable use of its resources. To help promote the survival and increase the profitability of business enterprises, however, two types of law have been enacted: laws concerning a company's incorporation and bankruptcy and laws that help a company protect its resources.

LAWS OF INCORPORATION AND BANKRUPTCY Companies are bound by laws that specify how they can incorporate. In addition, in order to "go public," or raise capital in the stock market, companies must provide detailed information about their business models and financial condition. This allows government agencies, such as the SEC, mutual fund companies, and individual investors to scrutinize a company's activities to ensure it is acting ethically and legally. All around the

world business laws make it necessary for companies to issue periodic financial reports. These reports must discuss how well a company's business model is working, analyze the opportunities and threats a company is facing, and detail its current financial condition so investors can scrutinize the performance of its managers.

The directors and managers of a company are legally liable for the actions they take to manage a company's resources. They can be sued if they fail to carry out their duty to protect the assets of stockholders and the health and safety of employees. At the other end of the scale, companies that are performing poorly must abide by the laws that govern how they should restructure or dissolve their companies. Just as people in the United States can declare personal bankruptcy, so a company can declare **Chapter 7 bankruptcy**, in which case it is dissolved and its remaining assets go to its creditors and owners.

Chapter 7 bankruptcy The dissolution of a business whereby its assets are sold to repay its creditors and owners.

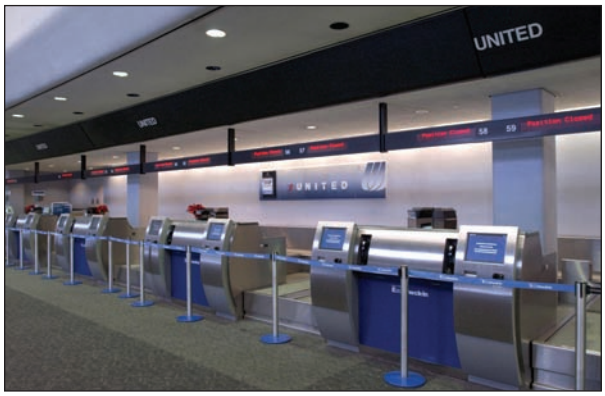
Chapter 11 bankruptcy The dissolution of a company whereby it is legally protected from its creditors and allowed to develop a viable new business model.

In the United States large companies typically declare **Chapter 11 bankruptcy**, in which case its creditors and owners cannot seize its assets while the company prepares a new business model. A judge decides if the new model will allow the company to survive and perform better. If so, it is approved, and the company is allowed to leave Chapter 11 and function normally. In 2004, for example, United Airlines, the fourth largest U.S. airline declared Chapter 11 bankruptcy for the second time after it continued to lose millions of dollars a month. The judge hearing the case is scrutinizing its managers' new business model that details how it will be able to reduce its operating costs. If the reorganization plan is not approved, the judge could order that United be dissolved and its assets sold to pay its creditors.

LAWS PROTECTING A BUSINESS'S RESOURCES When a company's managers use its resources in an enterprising way, the result is a stream of innovations that create new and improved products and increase its profitability. Companies invest enormous amounts of money in research and development to develop innovative new products. It also costs a great deal to build new manufacturing facilities to make the products and to pay for the nationwide marketing campaigns necessary to attract customers.

It would hardly be fair or equitable if, after a company spends hundreds of millions of dollars on these activities, a competitor could just come along and piggyback on the company's innovations and begin to produce a copycat product. If it were easy to do such a thing, few companies would make the investment necessary to develop new products. Technological progress would wane, and the standard of living in a society would advance little over time.

As Chapter 2 discusses, property rights give people the right to own and control productive resources and to profit from them. To motivate entrepreneurs and companies to take risks and invest in new ventures with unknown payoffs, laws have been enacted to protect the profits that result from successful efforts to innovate or create new products. People and companies are given the legal property rights to own and protect their creations by applying for and being granted, patents, copyrights, and trademarks.



United Airlines has filed bankruptcy twice in recent years. The company was given an opportunity to fix its business model and reorganize after the first filing. Unfortunately, it did not work, and United was forced to file again. If the judge adjudicating the second filing doesn't believe a second reorganization will improve United's prospects, the company could be dissolved.

Patents give their owners the property right to use, control, license, and otherwise profit from their creations for a period of 20 years from the date the patent is issued by the U.S. Patent Office. In other words, patents confer a monopoly right to their owners—the individual inventors or companies that conducted and paid for the research that led to the new products. One of the most profitable kinds of patent is that received by pharmaceutical companies that develop new drugs. Merck, the company that developed Prozac and Viagra, made billions from the sale of these drugs. Once a patent has expired, however (as the patent for Prozac

patents Legal documents that give their owners the right to use, control, license, and profit for a 20-year period from new products or processes they have created.

copyrights Legal documents that give their owners the right to own and profit from intellectual property such as written or visual media.

trademarks Property rights to the name of a product or the company that produces it.

has), any company can manufacture a copy, or generic, version of the original drug. Generic drugs are sold at a much lower price because it's far easier to analyze and copy their chemical formulas than it is to develop the drugs in the first place.

Copyrights also confer a monopoly right on their owner. They are typically granted to people who create "intellectual property," such as written or visual works–books, videogames, poems, and songs produced by authors, software experts, poets and musicians. If they wish, the owners of the copyright can sell it to other people or companies–such as when a movie company buys the rights to turn a new book into a movie from its author. Copyrights last for much longer periods than patents, often the lifetime of the work's creator and beyond.

Currently, laws governing the length of copyrights are changing. There is a growing feeling that copyrights should be granted for much shorter periods, perhaps for just 20 years or for the life of their creator. Once a copyright expires, intellectual property enters the public domain and becomes a public good, meaning that anyone is free to make use of it at no cost.

To increase the benefits from their creations, innovators of new products and services are also given the legal right to the trademarks that they use to identify their products to customers. **Trademarks** are property rights to the name of a product (such as Nescafé or Ivory soap), any symbols or logos associated with it, and the company that produces it (such as Nestlé or Procter & Gamble). Trademarks give their owner the sole legal right to use these names or symbols and control the use to which they are put, for example, advertising a product.

Since people and companies have to invest their creativity, time, and money to obtain copyrights and trademarks and develop a "brand name" it is only fair to allow them to benefit from the "identity" of their creations. Thus, J.K. Rowling, the creator of Harry Potter, holds the copyrights to her books, and she and her publishing company own the trademarks associated with the Harry Potter brand name. Nobody can issue Harry Potter toys or clothing without paying a licensing fee to them. Protecting property and resources of all kind is one of the principal purposes of the law.

In summary, a complex system of laws and regulations exists to govern business commerce, occupations, and organizations. They have been passed to protect the rights of companies, their stockholders, employees, and the public at large–all of whom are affected by their business activities. In essence, these laws have been passed to protect the public interest and ensure the continuing prosperity and well-being of a nation. A society's goal is to create a legal system that motivates entrepreneurs and companies to create goods and services that are profitable. At the same time, the purpose of law is to ensure that no person or group is able to ruthlessly profit at the expense of others.

Did You Know?

Descriptive terms–such as speedy, tasty, express, and sweet–cannot be trademarked unless they are so closely affiliated with one product that they would cause confusion among consumers if used to describe something else.[8]

Summary of the Chapter

Ethical issues permeate business decision making and affect the efficiency and effectiveness of a nation's business commerce. The result of ethical behavior is a general increase in a company's profitability and in a nation's standard of living, well-being, and prosperity. This chapter has made the following main points:

1. An ethical dilemma is the quandary people find themselves in when they have to decide if they should act in a way that might help one person or group (and is the "right" thing to do) even though it might hurt others or not be in their own self-interests.
2. Ethics are the inner-guiding moral principles, values, and beliefs that people use to analyze a situation and then decide the "right" way to behave.

3. Ethical beliefs alter and change as time passes, and, as they do so, laws change to reflect them.
4. Stakeholders are people and groups who have a claim on and a stake in a company. The main stakeholder groups are stockholders, managers, employees, suppliers and distributors, customers, and a community, society, and nation.
5. It is in the best interests of a company to behave ethically.
6. To determine if a business decision is right or wrong, companies can use four ethical rules to analyze it: the utilitarian, moral rights, justice, and practical rules.
7. When companies behave ethically, the tragedy of the commons can be averted. This lowers transaction costs and leads to a general increase in a company's profitability and benefits society as a whole.
8. Differences in a company's or a country's business ethics are based on societal, occupational, individual, and organizational factors.
9. The legal environment of business consists of the laws and regulations that have been passed to prevent unethical business activities from occurring when free markets cannot.
10. Four main types of laws affecting business commerce are antitrust laws, consumer protection laws, environmental laws, and laws relating to the public interest.
11. Several types of laws have been passed to prevent unethical practices related to business occupations: laws regulating occupational qualifications, laws governing business diversity, and laws promoting employee health and safety.
12. Two types of law that are especially relevant to a company's form of business organization are laws concerning incorporation and bankruptcy and laws that help it to protect its valuable resources. The granting of patents, copyrights, and trademarks are main ways of allowing people and companies to protect and profit from their creations.

Developing Business Skills

QUESTIONS FOR DISCUSSION AND ACTION

1. What is the relationship between ethics and the law?
2. Why do the claims and interests of stakeholders sometimes conflict?
3. Why should managers use ethical criteria to guide their decision making?
4. *Action*. Find a manager and ask about the most important ethical rules he or she follows to make the right decisions.
5. What are some of the most unethical business practices you have encountered as an employee?
6. What are main determinants of business ethics?
7. What purpose do laws and regulations governing business serve, and why is the public interest important?

ETHICS IN ACTION

Dealing with Ethical Dilemmas

Use the chapter material to decide how you should respond to each of the following three ethical dilemmas.

- You are planning to leave your job to go work for a competitor. Your boss invites you to an important meeting about the new products the company will be rolling out in the New Year. Do you go to the meeting?
- You sell expensive sports cars. A young manager who has just received a promotion comes in and really wants to buy one that you know is out of his or her price range. Do you encourage the manager to buy it so you can receive a big commission from the sale?
- You sign a contract with a young rock band, and they agree to let you produce their next seven records for which they will receive 5% of royalties. Their first record is a smash hit and sells millions. Do you automatically increase the band's royalty rate on their future records?

SMALL GROUP EXERCISE

Is Chewing Gum the "Right" Thing to Do?

Read the following. Then break up into groups or three or four people and answer the following discussion questions.

In the United States the right to chew gum is taken for granted. But if you chew gum on a street in Singapore and throw it on the ground you can be arrested. Chewing gum is strictly controlled in Singapore because those in power believe it creates a disgusting mess on pavements and people cannot be trusted to throw away their gum safely. Although in the United States you can generally chew gum anywhere you want, it is often against the rules to chew gum in a high school classroom, church, and so on.

1. What makes chewing gum acceptable in the United States and unacceptable in Singapore?

2. Why can you chew gum on the street but not in school or church in the United States?

3. How can you use ethical principles to decide whether gum chewing is ethical or unethical, or if its use should be strictly controlled by law?

DEVELOPING GOOD BUSINESS SENSE

Creating an Ethical Code

You are an entrepreneur who has decided to go into business and open a steak and chicken restaurant. Your business plan requires you to hire at least twenty people as chefs, waiters, and so on. As the owner, you are drawing up a list of ethical principles that each of these people will receive and must agree to when they accept your job offer. These principles outline your view of what behavior is acceptable both from you and from them.

1. Create a list of the five main ethical rules or principles you will use to govern the way your business operates. Be sure to spell out how these principles relate to your stakeholders. For example, specifically state the rules you intend to follow when dealing with your employees and customers.

EXPLORING THE WORLD WIDE WEB

3M's Code of Ethics

Go to 3M's Web site (www.3M.com), and click on About 3M tab. Then click on "Business Conduct Policies" tab and look at the chairman's statement. Finally, click on and read some of 3M's specific ethical policies. **For more Web activities, log on to www.mhhe.com/jonesintro.**

1. Why is reputation so important to 3M?

2. What kinds of laws and regulations most relate to 3M's businesses both at home and abroad?

3. How would you describe 3M's ethical stance?

BusinessWeek CASE FOR DISCUSSION

Putting Teeth in Corporate Ethics Codes

Clark Consulting, a compensation and benefit consulting firm, has had a corporate code of ethics in place for years. But following the 2002 passage of the Sarbanes-Oxley law reforming corporate governance, Chief Executive Tom Wamberg revised it, redistributed it, and started referring to it in weekly newsletters distributed to all employees. It wasn't long before the code was put to the test.

Earlier this year, Wamberg learned that one of his senior consultants was bragging to other employees about how he had "fired" a particularly demanding client. Wamberg was outraged. Rule No. 1 of the code is that clients come first. "For us, that was a cardinal sin," says Wamberg, who dismissed that consultant, citing the code.

Now he sees the benefits of having a public statement in place and sticking to it. "If you don't have something to stand up to and look to, you could easily

give a slap on the wrist and say, 'Don't do it again,'" says Wamberg.

"SANCTIONS" SECTION. Well, not so easily anymore. In part due to new regulatory requirements (including a new Nasdaq rule requiring listed companies to distribute a code to all employees)–and also because of so many high-profile cases recently where corporate malfeasance has brought down major businesses–chief executives are doing their best to turn the code of ethics into a document with real teeth.

"There's a whole spectrum of activities that can make this thing come alive," says Dan DiFilippo, who leads PricewaterhouseCoopers' governance and compliance practice. Companies are rewriting the codes, making them much more detailed and specific. German software giant SAP has a 14-page code with sections that describe conduct with customers, vendors, and competitors, as well as stock-trading rules.

Businesses are adding enforcement measures, including guidelines for employees to follow if they see violations. A "sanctions" section in SAP's code explains that any act "in opposition to this Code of Conduct is subject to internal review, and can result in consequences that affect employment, and could possibly lead to external investigation, civil law proceedings, or criminal charges."

SIGNATURES REQUIRED. No longer just published in an employee handbook, the codes are being posted on corporate Web sites and around offices. Companies now want the statement to be visible to people outside, like regulators, vendors, and customers–as well as employees.

"It always was part of our DNA," says Harold Tinkler, chief ethics and compliance officer at accounting firm Deloitte & Touche, which is finalizing a new, more detailed code. "But in today's world, the public at large wants to see it demonstrated." According to a recent survey by New York-based research firm Governance Metrix, which rates companies on their compliance efforts, 51% of U.S. concerns disclose a code of ethics, although 32% allow a waiver in some cases.

Perhaps most notably, businesses are increasingly requiring all employees to read and sign the ethics statement. This measure is an apparent extension of the Sarbanes-Oxley rule that CEOs and CFOs certify the accuracy of company financials. "They're pushing that requirement down the ranks," says Kirk Jordan, a compliance attorney who's vice-president for research at Integrity Interactive, which provides Web-based ethics and compliance training programs. Usually the sign-off is a condition of employment–and sometimes a condition of getting a bonus or a raise.

TECH BACKUP. Another new trend: Companies are adding more training around their codes of ethics. Jordan says the new focus is on providing guidance for senior managers, rather than assuming they understand the issues. At software concern Hyperion Solutions, CEO Jeff Rodek trains managers to distinguish between employees who underperform–who should be given several chances to improve–and workers who violate the ethics code, where "it can be one strike, you're out," he says. "It's important that people know the difference."

One goal of the training is to bring ethics into play during key decision-making points. Some outfits are making research into ethical issues a part of the due diligence on another company during an acquisition, says PwC's DiFilippo. Deloitte & Touche will ask managers to explore ethical issues with the engagement team before starting each new audit, says Tinkler.

Technology is increasingly involved in all these pursuits. Integrity Interactive's code-of-ethics training course includes a testing component. All employees must continue training until they score 100% on a test.

HOW MUCH GOOD? Last November ACL Services, which makes software used in internal audits, launched a new "Continuous Controls Monitoring" solution, which flags possible code-of-conduct violations, like purchasing from a vendor that charges more than the standard price (that might mean the employee is getting some sort of kickback). "Actively testing for controls begins to create a culture of accountability and ethics," says Harald Will, ACL's president and CEO.

It's still unclear how much good a code of conduct can do in preventing ethical lapses. Even though accounting firm Arthur Andersen had a strong ethics program in place, it didn't survive the fallout of having signed off on failed energy giant Enron's books. The program clearly didn't do much good when the firm's Houston office should have raised questions about a major client's activities.

"It's during difficult decisions that someone's ethics are put to the test," says William Henrich, vice-chairman of turnaround consulting firm Getzler Henrich & Associates and a former partner at Arthur Andersen. "At that point, whether or not they signed a piece of paper doesn't make a difference."

FROM THE TOP. Many consultants on business-risk issues say a company needs to take more important measures than a statement to prevent ethical lapses from harming it. "A code of ethics is an easy thing to redo," says Michael Chagares, who leads consulting firm Marsh's business-risk practice. "The question is how you get a real change in behavior."

More important than emphasizing the code is making sure the board has independent members and that a system of checks and balances on management is in place throughout the company. It's also essential that the business has mechanisms in place that lets problems come to the surface, Chagares says.

Even if a code of ethics is just a starting point, it certainly doesn't hurt, consultants and chief executives agree. And it has the most power if it appears to come straight from the top. Wamberg says he worries that people at his company pay only lip service to standing by the corporate code of ethics. "That's why I just pound it in," he says. When it comes to ethics statements, employees can expect more pounding in the months to come.

Source: Amy Stone, "Putting Teeth in Corporate Ethics Codes," *BusinessWeek Online,* February 19, 2004.

QUESTIONS

1. In what ways are companies trying to strengthen their ethics codes?

2. One issue raised in the article and in the opening case of this chapter concerns instituting "real change" in the ethical behavior of companies and their employees. What more can a company do to make sure its code of ethics is followed?

BusinessWeek **CASE FOR DISCUSSION**

It Takes a Village—And a Consultant

Last summer, accounting-and-consulting giant PricewaterhouseCoopers (PwC) tapped partner Tahir Ayub for a consulting gig unlike anything he had done before. His job: helping village leaders in the Namibian outback grapple with their community's growing AIDS crisis. Faced with language barriers, cultural differences, and scant access to electricity, Ayub, 39, and two colleagues had to scrap their PowerPoint presentations in favor of a more low-tech approach: face-to-face discussion. The village chiefs learned that they needed to garner community support for programs to combat the disease, and Ayub learned an important lesson as well: Technology isn't always the answer. "You better put your beliefs and biases to one side and figure out new ways to look at things," he said.

Ayub may never encounter as extreme a cultural disconnect at PwC as he did in Namibia. But for the next generation of partners, overcoming barriers and forging a connection with clients the world over will be a crucial part of their jobs. It's those skills that PwC hopes to foster in partners who take part in the Ulysses Program, which sends top midcareer talent to the developing world for eight-week service projects. For a fairly modest investment of $15,000 per person, plus salaries, Ulysses both tests the talent and expands the worldview of the accounting firm's future leaders. Since the company started the program four years ago, it has attracted the attention of Johnson & Johnson, Cisco Systems, and other big companies considering their own programs.

While results are hard to quantify, PwC is convinced that the program works. All two dozen graduates are still working at the company. Half of them have been promoted, and most have new responsibilities. Just as important, all 24 people say they have a stronger commitment to PwC–in part because of the commitment the firm made to them and in part because of their new vision of the firm's values. Says Global Managing Partner Willem Bröcker: "We get better partners from this exercise."

The Ulysses Program is PwC's answer to one of the biggest challenges confronting professional services companies: identifying and training up-and-coming leaders who can find unconventional answers to intractable problems. By tradition and necessity, new PwC leaders are nurtured from within. But with 8,000 partners, identifying those with the necessary business savvy and relationship-building skills isn't easy. Just as the program gives partners a new view of PwC, it also gives PwC a new view of them, particularly their ability to hold up under pressure.

For midcareer partners who were weaned on e-mail and the Blackberry, this was no walk in the park. They had become accustomed to a world of wireless phones, sleek offices, and Chinese take-out–so the rigors of the developing world came as quite a shock. Brian P. McCann, 37, a mergers and acquisitions expert from PwC's Boston office, had never been to a third-world country before his stint in Belize, where he encountered dirt-floored houses, sick children, and grinding poverty.

Ayub, having been born in Africa, considered himself worldly. Even so, long days spent among Africa's exploding HIV-positive population took their psychological toll. With his work confined to daylight hours–there was often no electricity–Dinu Bumbacea, a 37-year-old partner in PwC's Romanian office who spent time in Zambia working with an agricultural center, had plenty of time to dwell on the misery all around him. "Africa is poor, and we all know that," says Bumbacea. "But until you go there, you don't understand how poor it is. We take so much for granted."

For more than 15 years, companies have used social-responsibility initiatives to develop leaders. But PwC takes the concept to a new level. Participants

spend eight weeks in developing countries lending their business skills to local aid groups–from an ecotourism collective in Belize to small organic farmers in Zambia to AIDS groups in Namibia. Ulysses also presents participants with the challenge of collaborating across cultures with local clients as well as with PwC colleagues from other global regions. Ayub, for example, was paired with partners from Mexico and the Netherlands.

BEYOND ACCOUNTING

PWC says the program, now in its third cycle, gives participants a broad, international perspective that's crucial for a company that does business around the world. Traditional executive education programs turn out men and women who have specific job skills but little familiarity with issues outside their narrow specialty, according to Douglas Ready, director of the International Consortium for Executive Development Research. PwC says Ulysses helps prepare participants for challenges that go beyond the strict confines of accounting or consulting and instills values such as community involvement that are fundamental to its corporate culture.

Ulysses is also a chance for partners to learn what they can accomplish without their usual resources to lean on. The program forces them to take on projects well outside their expertise. In the summer of 2003, for example, McCann developed a business plan for an ecotourism group in Belize. The experience was an eye-opener. McCann's most lasting memory is a dinner he shared in the home of a Mayan farmer after they spent a day discussing their plan. "He didn't even have electricity," McCann recalls, "but he made do."

PwC partners say they've already adapted their experiences to the task of managing people and clients. Malaysian partner Jennifer Chang says her team noticed a shift in her managerial style after the Belize trip. She listened more and became more flexible. "Once you see how slowly decisions are made in other places, you gain patience for the people you work with," she says. Ayub, who was promoted in June, now manages 20 partners. He says he favors face-to-face conversations over e-mail because the low-tech approach builds trust. "It made the difference in Namibia," he says.

If insights like those ripple out across the firm, Ulysses will be more than a voyage of personal discovery for a handful of partners. It could help build leaders capable of confronting the challenges of an increasingly global business. And that, says PwC, is the whole point.

QUESTIONS

1. What does PwC's program of sending consultants to help people in developing countries say about its corporate ethics?

2. In what ways will the program benefit PwC and its consultants as well as the people the program is intended to help?

Source: Jessi Hempel and Seth Porges, "It Takes a Village—And a Consultant," *BusinessWeek Online,* September 2004.

BUILDING YOUR MANAGEMENT SKILLS

Know Thyself

Have you ever cheated on a test or seen another student do it? Watched another employee take something from your workplace without paying for it or play a computer game instead of working? How did you feel about the way you handled the situation? Lockheed Martin, the aerospace company, has devised a board game to help its employees develop their ethical and social responsibility decision-making skills. You can assess your own "Ethical Decision-Making Skills" by using a version of the game that is on your Student DVD.

CHAPTER VIDEO

New Belgium Brewery (NBB)

Business ethics and social responsibility are not equivalent concepts. Ethics guides behavior regarding appropriate business practices of individuals whereas social responsibility is organizational behavior that is directed toward the greater community.

At New Belgium Brewery, environmental ethics are part of the core value system of the company's corporate culture. Jeff Lebesch, owner of NBB, started the firm with very low capital investment, low volume production, and small margins. He and his company were forced to think outside the box. And think they did! Looking to cut costs, the company was able to

reduce the amount of resources used as raw materials, invested in technology to achieve broader energy efficiency, re-uses resources, and recycles materials that cannot be immediately reused in the process. All of these goals are part of the core value system of social responsibility.

Social responsibility, environmentally safe production processes, and a corporate culture that is supportive, combine to create an organization where individuals forgo personal gain in order to achieve social responsibility for the firm. These values run so deep in fact that the employees voted to use part of their bonus pool to invest in longer-term solutions to achieve environmentally safer production methods.

The cost savings achieved by using a socially responsible approach have more than compensated for the investments made by Jeff and his employees.

1. What would be considered the basic "ethical dilemma" for New Belgium Brewery?

2. Is there a difference between ethics and values?

3. Theoretically, how did the decisions to be environmentally conscious and create a socially responsible corporate culture, evolve at NBB?