CHAPTER 1

The Importance of Business Ethics

SUMMARY

This chapter provides an overview of business ethics. It develops a definition of business ethics and discusses why it has become an important topic in business education. Next, it examines the evolution of business ethics in North America and explores the benefits of ethical decision making in business. Finally, the chapter provides a framework for examining business ethics in this text.

# INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”

This Ethical Dilemma focuses on salespeople reporting their expense accounts. Sophie had just completed a sales training course stressing the importance of accurately filling out expense vouchers. Yet while filling out her first weekly expense vouchers, Sophie’s mentor Emma encouraged her to pad the expense account. Emma explained the accounting department supervisor was unsympathetic to salespeople and refused to change the expense voucher forms to include a place for tips, making tips an out-of-pocket expense. Emma explained how even though padding violated company policy, it was an accepted practice in the sales department and she was encouraged to do the same by her mentors. Emma showed Sophie how most salespeople use blank cab fare receipts when padding in waiter, bellhop, and skycap tips. Emma then spoke about how the Vice President of Sales never questioned salespeople who went along with the system, but one salesperson was no longer working for the company after accurately reporting expenses. This was Sophie’s first real job out of school and Emma was her mentor. What should Sophie report on her expense account?

Sophie must decide if she should follow policy or follow Emma’s instructions and pad her expense accounts. Should Sophie speak up and voice her concern on this matter? Everyone else seems fine with the arrangement. Why should Sophie have a problem? If Sophie pads her accounts, then she will have to continue padding her accounts for the rest of her employment. Is she willing to do this? If Sophie does not pad her accounts, then all tips will come out of Sophie’s pocket. In addition, her sales manager may ask why her expense account is lower than all the other sales reps’. Sophie’s co-workers may view her as a troublemaker if she speaks up. How do students feel about this issue? Would they report their actual expenses or would they pad their expense accounts?

LECTURE OUTLINE

I. Business Ethics Defined

A. Business ethicsis a complicated and controversial topic. Highly visible business ethics issues influence the public’s attitudes toward business and can destroy trust.

1. The field of business ethics concerns questions about whether specific business practices are acceptable.

2. Business ethics is controversial, and there is no universally accepted approach for resolving ethical issues.

3. Values and judgments play a critical role in the making of ethical decisions.

B. **Morals** refer to a person’s personal philosophies about what is right or wrong.

C. **Business ethics** comprises organizational principles, values, and norms that may originate from individuals, organizational statements, or from the legal system that primarily guide individual and group behavior in the world of business.

D. **Principles** are specific and pervasive boundaries for behavior that should not be violated.

E. **Values** are enduring beliefs and ideals that are socially enforced.

1. Investors, employees, customers, interest groups, the legal system, and the community often determine whether a specific action is right or wrong and ethical or unethical.

F. Some special aspects must be considered when applying ethics to business.

1. Businesses must earn a profit to survive, but these profits should not come from misconduct.

2. To be successful businesses must address the needs and desires of stakeholders.

II. Why Study Business Ethics?

A. A Crisis in Business Ethics

1. Ethical misconduct is a major business concern, and organizations are under greater scrutiny than ever by stakeholders.

2. There is no doubt negative publicity associated with major misconduct lowered the public’s trust in certain business sectors.

3. Decreased trust leads to a reduction in customer satisfaction and customer loyalty, which in turn can negatively impact the firm or industry.

B. Specific Issues

1. Misuse of company resources, abusive behavior, harassment, accounting fraud, conflicts of interest, defective products, bribery, and employee theft are all problems cited as evidence of declining ethical standards in business and in other areas like government or sports. Misconduct can occur in any organization.

2. Regardless of an individual’s beliefs about a particular action, if society judges it to be unethical or wrong, new legislation usually follows.

3. Whether correct or not, that judgment directly affects a company’s ability to achieve its business goals

C. The Reasons for Studying Business Ethics

1. Studying business ethics is valuable for several reasons.

a. Business ethics is not merely an extension of an individual’s own personal ethics—an individual’s personal values and moral philosophies are only one factor in the ethical decision-making process.

b. Being a good person with sound personal ethics is not sufficient to handle the ethical issues that arise in a business organization.

c. Business strategy decisions involve complex and detailed discussions. A high level of personal moral development may not prevent an individual from violating the law in an organizational context.

d. The morals people learn from family, religion, and school may not provide specific guidelines for complex business decisions.

2. Studying business ethics helps businesspeople begin to identify ethical issues, recognize the approaches available to resolve them, learn about the ethical decision-making process and ways to promote ethical behavior, and begin to understand how to cope with conflicts between personal values and organizational values.

III. The Development of Business Ethics

A. Before 1960: Ethics in Business

1. Before 1960, the United States went through several phases questioning the concept of capitalism.

a. In the 1920s, the progressive movement sought to provide citizens with a “living wage,” or income sufficient for education, recreation, health, and retirement.

b. In the 1930s, the New Deal specifically blamed business for the country’s economic woes. Businesses were asked to work more closely with the government to raise family income.

c. By the 1950s, the New Deal had evolved into the Fair Deal, defining such matters as civil rights and environmental responsibility as ethical issues that businesses had to address.

2. Until 1960, ethical issues related to business were discussed within the domain of theology or philosophy.

a. Catholic social ethics included concern for morality in business, workers’ rights, and living wages; for humanistic values; and for improving the conditions of the poor.

b. The Protestant~~s~~ work ethic encouraged individuals to be frugal, to work hard, and to attain success in the capitalistic system.

c. Religious traditions provided a foundation for the future field of business ethics, with the first book on business ethics published in 1937 demonstrating the necessity of the ethical treatment of different stakeholders.

B. The 1960s: The Rise of Social Issues in Business

1. American society turned to causes such as consumerism. An antibusiness attitude developed as critics attacked the perceived vested interests that controlled both the economic and political sides of society—the so-called military-industrial complex.

2. The 1960s saw the decay of inner cities and the growth of ecological problems.

3. The rise of consumerism—activities undertaken by independent individuals, groups, and organizations to protect their rights as consumers—began, and President John F. Kennedy outlined a **Consumers’ Bill of Rights** (the right to safety, the right to be informed, the right to choose, and the right to be heard).

4. The modern consumer movement has roots in 1965 and Ralph Nader’s *Unsafe at Any Speed.* His group fought successfully for consumer-protection legislation.

5. President Johnson’s Great Society told the business community that the U.S. government’s responsibility was to provide the citizen with some degree of economic stability, equality, and social justice. Activities that could destabilize the economy or discriminate against any class of citizens began to be viewed as unethical and unlawful.

C. The 1970s: Business Ethics as an Emerging Field

1. Business professors began to teach and write about **corporate social responsibility**, an organization’s obligation to maximize its positive impact on stakeholders and to minimize its negative impact.

2. Philosophers applied ethical theory and philosophical analysis to structure the discipline of business ethics.

3. As social demands grew, many businesses realized that they had to address ethical issues more directly.

4. The Foreign Corrupt Practices Act, passed under Jimmy Carter, made it illegal for U.S. businesses to bribe government officials of other countries.

5. Major business ethics issues emerged by the late 1970s, such as bribery, deceptive advertising, price collusion, product safety, and ecology.

6. Academic researchers sought to identify ethical issues and to describe how businesspeople might choose to act in particular situations.

D. The 1980s: Business Ethics Reaches Maturity

1. Business ethics became a legitimate field of study. Membership in business ethics organizations increased, while centers of business ethics provided publications, courses, conferences, and seminars.

a. Stakeholder theory, pioneered by R. Edward Freeman, had a major impact on strategic management and corporations’ views of their responsibilities.

b. Many firms established ethics and social policy committees to address ethical issues.

2. The **Defense Industry Initiative on Business Ethics and Conduct** (DII) was developed to guide corporate support for ethical conduct. The DII includes six principles:

a. Development and distribution of understandable, detailed codes of conduct.

b. Provision of ethics training and development of communication tools to support the periods between training.

c. Creation of an open atmosphere in which employees feel comfortable reporting violations, without fear of retribution.

d. Performance of extensive internal audits and development of effective internal reporting and voluntary disclosure plans.

e. Preservation of the integrity of the defense industry.

f. Adoption of a philosophy of public accountability.

3. The Reagan/Bush era ushered in the belief that self-regulation, rather than regulation by government, was in the public’s best interest. The rules of business were changing at a phenomenal rate because of less regulation.

E. The 1990s: Institutionalization of Business Ethics

1. The Clinton administration continued to support self-regulation and free trade, although it strengthened regulation in some areas like health-related social issues.

2. The **Federal Sentencing Guidelines for Organizations (FSGO),** which were based on the six principles of the Defense Industry Initiative, codified into law incentives to reward organizations for taking action, such as developing effective internal legal and ethical compliance programs, in order to prevent misconduct.

a. The guidelines mitigate penalties for businesses that strive to minimize misconduct and establish high ethical and legal standards.

b. Under the FSGO, if a company lacks an effective ethical compliance program and its employees violate the law, it can incur severe penalties.

c. The guidelines focus on firms taking action to prevent and detect business misconduct in cooperation with government regulation.

d. Chapters 4 and 8 will provide more detail on the FSGO’s role in business ethics programs.

F. The Twenty-First Century of Business Ethics

1. New evidence emerged in the early 2000s that more than a few business executives and managers had not fully embraced the public’s desire for high ethical standards.

2. To address a loss of confidence in financial reporting and corporate ethics, Congress passed the **Sarbanes-Oxley Act** in 2002, the most far-reaching change in organizational control and accounting regulations since the Securities and Exchange Act of 1934. The law:

a. Made securities fraud a criminal offense and stiffened penalties for corporate fraud.

b. Created an accounting oversight board that requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reports to investors and other interested parties.

c. Requires top executives to sign off on their firms’ financial reports, risking fines and jail if they misrepresent their companies’ financial positions.

d. Requires company executives to disclose stock sales immediately and prohibits companies from giving loans to top managers.

3. Amendments to the **FSGO** require a business’s governing authority to be well informed about its ethics program with respect to content, implementation, and effectiveness.

4. President Obama has led the passage of legislation to stimulate an economic recovery from the greatest recession the world has experienced since the 1930s. The legislation focused on social concerns.

5. To address lingering issues related to the financial crisis, the **Dodd-Frank Wall Street Reform and Consumer Protection Act** represents the most sweeping financial legislation since Sarbanes-Oxley Act and possibly since the Great Depression.

6. Around the world, the basic assumptions of capitalism are under debate in the wake of the most recent financial industry meltdown and global recession. Widespread government intervention is worrisome to free-market capitalists.

IV. Developing Organizational and Global Ethical Cultures

A. Compliance and ethics initiatives in organizations are designed to help establish appropriate conduct and core values.

1. The ethical component of a corporate culture relates to the values, beliefs, and established and enforced patterns of conduct that employees use to identify and respond to ethical issues.

B. The term **ethical culture** is acceptable behavior as defined by the company and industry. The goal of an ethical culture is to minimize the need for enforced compliance of rules and maximize the use of principles that contribute to ethical reasoning in difficult or new situations.

C.Globally, businesses are working more closely together to establish standards of acceptable behavior. Many companies demonstrate their commitment to acceptable conduct by adopting globally recognized principles, such as the United Nations’ Global Compact.

1. Companies that choose to abide by ISO 19600—a global compliance management standard—can use it to improve their approaches to compliance management, which can reassure stakeholders of their commitment toward ethics and compliance.

2. The UN Global Compact—a set of ten principles concerning human rights, labor, the environment, and anti-corruption—is meant to create openness and alignment among business, government, society, labor, and the United Nations.

V. The Benefits of Business Ethics

A. The field of business ethics is rapidly changing as more firms recognize the benefits of improving ethical conduct and the link between business ethics and financial performance.

B. Among the rewards for being more ethical and socially responsible in business are increased efficiency in daily operations, greater employee commitment, increased investor willingness to entrust funds, improved customer trust and satisfaction, and better financial performance.

C. Ethics Contributes to Employee Commitment

1. Employee commitment comes from employees who believe their future is tied to that of the organization and their willingness to make personal sacrifices for that organization.

a. The more a company is dedicated to taking care of its employees, the more likely it is that the employees will take care of the organization.

b. Issues that may foster the development of an ethical climate for employees include the absence of abusive behavior, a safe work environment, competitive salaries, and the fulfillment of all contractual obligations toward employees, as well as social programs such as stock ownership plans and community service.

2. Employees’ perception of their firm as having an ethical environment leads to performance-enhancing outcomes within the organization.

a. An organization with a strong, ethical corporate culture helps to increase group creativity, decrease turnover, and increase job satisfaction.

b. Trusting relationships within an organization between both managers and their subordinates and upper management contribute to greater decision-making efficiencies.

c. When companies are viewed as highly ethical by their employees, they were six times more likely to keep their workers.

3. Research indicates that the ethical climate of a company matters to employees.

D. Ethics Contributes to Investor Loyalty

1. Investors today are increasingly concerned about the ethics, social responsibility, and the reputation of companies in which they invest.

a. Investors recognize that an ethical climate provides a foundation for efficiency, productivity, and profits, while negative publicity, lawsuits, and fines can lower stock prices, diminish customer loyalty, and threaten a company’s long-term viability.

b. Investors look at the bottom line for profits or the potential for increased stock prices or dividends, and for any potential flaws in the company’s performance, conduct, and financial reports.

c. Gaining investors’ trust and confidence is vital to sustaining the financial stability of the firm.

E. Ethics Contributes to Customer Satisfaction

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

a. By focusing on customer satisfaction, a company continually deepens the customer’s dependence on the company, and as the customer’s confidence grows, the firm gains a better understanding of how to serve the customer.

b. Successful businesses provide an opportunity for customer feedback, which can engage the customer in cooperative problem solving.

2. Research indicates that a majority of consumers prefer companies that give back to society in a socially responsible manner.

3. A strong organizational ethical environment usually focuses on the core value of placing customers’ interests first.

a. An ethical climate that focuses on customers incorporates the interests of all employees, suppliers, and other interested parties in decisions and actions.

F. Ethics Contributes to Profits

1. A company cannot nurture and develop an ethical organizational climate unless it has achieved adequate financial performance in terms of profits.

a. Ethical conduct toward customers builds a strong competitive position that has been shown to positively affect business performance and product innovation.

b. Research has shown that the world’s most ethical companies tends to outperform other publicly traded companies

c. Companies perceived by their employees as having a high degree of honesty and integrity have a much higher average total return to shareholders than do companies perceived as having a low degree of honesty and integrity.

2. Ethics is becoming part of management’s efforts to achieve competitive advantage.

VI. Our Framework for Studying Business Ethics

A. Part One provides an overview of business ethics and explores the development and importance of this critical business area, as well as the role of various stakeholder groups in social responsibility and corporate governance.

B. Part Two focuses on ethical issues and the institutionalization of business ethics—such as business issues that create ethical decision making in organizations and the institutionalization of business ethics—and includes both mandatory and voluntary societal concerns.

C. Part Three explores the ethical decision-making process and then at both individual and organizational factors that influence decisions.

D. Part Four explores systems and processes associated with implementing business ethics into global strategic planning.

1. The more you know about how individuals make decisions, the better prepared you will be to cope with difficult ethical decisions.

2. It is your job to make the final decision in an ethical situation that affects you. Sometimes that decision may be right; sometimes it may be wrong.

**DEBATE ISSUE: TAKE A STAND**

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This issue deals with whether ethical companies are more profitable. Those who argue that ethical businesses are more profitable could point to the different studies showing a positive correlation between ethics and profitability, the goodwill gained from ethical conduct, and the additional customer confidence associated with an ethical company. The opposition might point out that some dishonest companies have gotten away with only small penalties for misconduct and that companies must be more concerned with obtaining profits than spending time worrying about ethics.

# “Resolving Ethical Business Challenges” NOTES

The instructor may wish to ask which students see this as an ethical issue and which see it as a legal issue. Is there a difference of opinion between business and nonbusiness-major students? The instructor can add additional pressures through providing different scenarios such as assuming that Lael had personally encountered sexual harassment in the past, has financial difficulties and needs this job to pay off student loans, learns that Nikhil is very sick and will soon be leaving the company or that Nikhil’s father condoned his actions, etc.

The instructor may wish to discuss where the line is between loyalty to the company and loyalty to the staff you manage. Given the nature of the franchise Best East Motels operates under, Nikhil is breaking the agreement set out in the franchise employee handbook. It should be reported, but to whom? However, if Lael goes public with the harassment allegations, the family could lose its franchise.

Lael knew that putting pressure on the female employees to report on the behavior of the boss’s son was problematic. Lael also felt it would not be appropriate taking her concerns to Nikhil personally about these allegations. If Lael reports the information to the owner, it would become an official allegation. This could affect the motel’s reputation and image in the community, and she would be responsible for it. This example illustrates that uncovering an unethical act is the first step, but following through with the right action may be more difficult. These situations can be extraordinarily difficult for employees, particularly ones who have limited experience upon which to draw. It is in situations like these that a clear code of conduct and a strong ethics and compliance program will minimize the opportunity for misconduct.