

## Chapter 2

# Ethics and Business Decision Making

## INTRODUCTION

Among the concepts examined in this chapter are the nature of business ethics and the relationship between ethics and the law. Because of this relationship, a careful study of business law will help your students to understand what is and what is not considered by society to be ethical behavior in business. Throughout the text, the relation between particular laws and the broad, underlying ethical premises on which they rest is discussed.

This chapter also presents issues that are involved in determining business ethical responsibility. Business ethics involves the application of ethical standards to business activities.

Ultimately, the goal of this chapter is to provide students with basic tools for analyzing ethical and social responsibility issues in a business context. Exactly how to decide these issues is something each person must do alone, on the basis of his or her own convictions. Questions students must ask themselves include: (1) What are their ethical criteria? (2) How would they apply those criteria in a particular situation? (3) How can they best adapt their standards to the kinds of ethical and social responsibility issues that they will face in the business world?

### ADDITIONAL RESOURCES—



### VIDEO SUPPLEMENTS



The following video supplements relate to topics discussed in this chapter—

#### PowerPoint Slides

To highlight some of this chapter's key points, you might use the Lecture Review PowerPoint slides compiled for Chapter 2.

#### Business Law Digital Video Library

The Business Law Digital Video Library at [www.cengage.com/blaw/dvl](http://www.cengage.com/blaw/dvl) offers a variety of videos for group or individual review. Clips on topics covered in this chapter include the following.

- Ask the Instructor

**Ethics: Business Ethics an Oxymoron?**—Businesses that act ethically can and do succeed in the marketplace. Like all human activity, business is dependent upon at least a basic set of moral standards. And in the long run, since unethical conduct is detrimental to relationships and reputation, ethical corporate conduct can be a competitive advantage.

- Real World Legal

**Pharzime Corporation, Scene 1**—A marketing vice president at a pharmaceutical company tries to gain the support of a vice president of regulatory affairs for his marketing strategy for a new drug use. The scene considers the pressure of patent expiration, the regulatory approval process, and legal and ethical strategies for new drug use.

**Pharzime Corporation, Scene 2**—A new pharmaceutical sales rep confides his anxiety about an aggressive marketing strategy for off-label uses of an FDA-approved drug. A veteran sales rep assures him that the strategy is appropriate. The scene addresses corporate culture, whistleblowing, and the legality and ethics of marketing drugs for off-label use.

**Pharzime Corporation, Scene 3**—A pharmaceutical sales rep meets with a doctor to introduce new uses of a patented drug and to invite the doctor to serve as an advisor regarding the drug's potential new uses. The legal issues include the ethics and legality of marketing strategies and the relationship between pharmaceutical companies and the medical profession.

- LawFlix

**Breaking Away**—Others do get ahead by cheating (Scene in which the Italian racing team switches his gears on a hill, gesture rudely, then uses their tire pump to get him out of the race).

**Hooziers**—Lines you would not cross; individual safety (Scene in the quarter finals in which a player's stitches are pulled, and the coach tells the doctor to patch the player up, against the doctor's advice.)

## CHAPTER OUTLINE

### I. Business Ethics

Ethics is the study of what constitutes right and wrong behavior. Ethics focuses on morality and the application of moral principles in everyday life.

#### A. WHAT IS BUSINESS ETHICS?

Business ethics focuses on what constitutes ethical behavior in the world of business. Business ethics is not a separate kind of ethics.

#### B. WHY IS BUSINESS ETHICS IMPORTANT?

An understanding of business ethics is important to the long-run viability of a business, the well being of its officers and directors, and the welfare of its employees.

## ANSWER TO CHAPTER OBJECTIVE/FOR REVIEW QUESTION NO. 1

What is business ethics, and why is it important? Ethics is the study of what constitutes right or wrong behavior—the fairness, justness, rightness, or wrongness of an action. Business ethics focuses on what constitutes ethical behavior in the world of business. An understanding of business ethics is important to the long-run viability of a business firm and to the well being of the firm’s officers, managers, and employees. A business firm also owes duties to a variety of “stakeholders” whom the firm’s decisions and activities may affect significantly.

## C. THE MORAL MINIMUM

The minimal acceptable standard for ethical business behavior is compliance with the law. But the law does not, and cannot, codify all ethical requirements. An action that is legal may not be ethical.



## ANSWER TO VIDEO QUESTION NO. 2



In Scene 2, a new sales rep discusses the company's off-label marketing strategy with a veteran sales rep. Is it unethical or illegal for a sales rep to represent that he is a doctor when he has a doctorate in chemistry but is not actually a physician? Explain. The man has a doctorate degree, but he is not a medical doctor (physician). Although he may not be lying, he is clearly misrepresenting an important fact (about being a doctor) with the intent of getting appointments with busy physician-clients so that he can sell Gensol. It is clearly unethical and possibly illegal (fraud—see Chapter 14).

## D. SHORT-RUN PROFIT MAXIMIZATION

In the short run, unethical behavior may cause profits to increase. In the long run, however, such behavior may lead to costly lawsuits, settlements and other payments, and bad publicity, undercutting profits.



## ANSWER TO VIDEO QUESTION NO. 1



In Scene 1, employees discuss whether to market their company's drug as a treatment for other conditions—even though it has only been approved the drug for treating epilepsy. One employee argues that marketing the drug for more than the one treatment will increase the company's short-term profits and that obtaining approval for the other treatments will take too long. What theory describes this perspective? Short-term profit maximization is the theory discussed in this chapter that describes the man's perspective. Some people argue that a corporation's only goal should be profit maximization, which would be reflected in a higher market value. If all firms strictly adhered to the goal of profit maximization, resources would flow to where they are most highly valued by society. But there is an important difference between short- and long-term profit maximization. In the short run, a company may increase its profits by continuing to sell a product, even though, it knows that the product is defective or otherwise unsuitable for a particular use. In the long run, though, because of lawsuits, large settlements, and bad publicity, such unethical conduct will cause profits to suffer. Thus, business ethics is consistent only with long-term profit maximization. An overemphasis on short-term profit maximization is the most common reason that ethical problems occur in business.

## CASE SYNOPSIS—

## Case 2.1: United States v. Skilling

Enron Corp, was an international, multi-billion dollar enterprise comprised of four businesses that

bought and sold energy, owned energy networks, and bought and sold bandwidth capacity. Jeffrey Skilling—Enron’s president and chief operating officer, and a member of its board of directors—became Enron’s chief executive officer in February 2001. In August, he resigned. Four months later, Enron crashed into bankruptcy. An investigation uncovered a conspiracy to deceive investors about Enron’s finances to ensure that its stock price remained high. Skilling was convicted in a federal district court of various crimes, including conspiring to commit fraud to deprive Enron and its shareholders of the “honest services” of its employees. He was sentenced to 292 months’ imprisonment and three years’ supervised release, and ordered to pay \$45 million in restitution. The U.S. Court of Appeals for the Fifth Circuit affirmed the conviction. Skilling appealed.

The U.S. Supreme Court vacated the lower court’s ruling. The honest-services fraud statute applies only in bribery and kickback cases. The doctrine originated in prosecutions on bribery allegations, and the “vast majority” of honest-services fraud cases have involved bribery or kickback schemes in violation of a fiduciary duty. Because Skilling was not alleged to have engaged in such schemes, the statute does not apply here. The Court remanded, however, for review of the other “objects of the conspiracy” for which Skilling was convicted—“money-or-property wire fraud and securities fraud.”

.....

#### Notes and Questions

Skilling later argued that his statements to the financial analysts at the conference in January 2001 were “merely harmless puffery.” What distinguishes harmful statements from “harmless puffery”? In this case, the distinction lies in Skilling’s statements meeting the test for fraud—misrepresentations, intended to deceive, on which the injured parties justifiably relied to their detriment. Here, too, these and his other statements were specific, not vague, and definite, not suggestive or exaggerated. Puffery would have been a boast that “we’re the best company in the world” or “we’ll be making money when our competitors have gone out of business.”

Would it be ethical for a company official to wear an executive’s “hat” to sanction fraudulent schemes and an employee’s “hat” to perpetuate them? No. A corporate official cannot set company policy to approve a fraudulent scheme that he or she then executes. The effect would be to exonerate a wrongdoer for sanctioning his or her own illegal and unethical conduct. This would itself be unethical and illegal. The proper question in the legal context is whether a superior directs the misconduct.

Suppose that a basketball coach at State University (SU) engages in a scheme to obtain credits and scholarships for the players in violation of the rules of the National Collegiate Athletic Association (NCAA). Charged with conspiracy to commit fraud, the coach argues that he did not break the law because his intent was not to harm, but to help, SU by ensuring a successful basketball team. Should the coach be exonerated? No. The court should conclude that the coach’s intent was irrelevant. If SU had been aware the coach was cheating—activity that the coach kept secret—it would likely have changed its conduct to recruit players who satisfied NCAA requirements.

### ANSWER TO “THE ETHICAL DIMENSION” QUESTION IN CASE 2.1

During Skilling's tenure at Enron, the mood among the employees was upbeat because the company's future prospects appeared "rosy." Among other things, many employees invested all their pension funds in Enron stock. Is there anything unethical about this situation? Discuss. The lack of ethics in the situation stems from Skilling's use of deceit to create it. Whether or not such conduct supports a criminal conviction—although given the number of federal crimes, it is a distinct possibility—a "rosy" business is bound to collapse like a house of cards and harm all of its stakeholders if its "success" is founded on falsity.

#### ADDITIONAL CASES ADDRESSING THIS ISSUE —

Recent cases involving convictions for criminal conspiracies to commit fraud in business contexts include the following.

- **United States v. Anderson**, 580 F.3d 639 (7th Cir. 2009): The nominal president of a company, with authority over its finances, met weekly with one of the men running it to discuss operations and knew that it was misleading customers, supporting a conviction for wire fraud, mail fraud, and conspiracy.
- **United States v. Maxwell**, 579 F.3d 1282 (11th Cir. 2009): A fraudulent scheme to obtain construction contracts set aside for socially and economically disadvantaged companies resulted in a conviction for mail fraud, wire fraud, and conspiracy to commit mail and wire fraud.
- **United States v. Ware**, 577 F.3d 442 (2d Cir. 2009): The defendant issued, edited, or approved press releases with false and misleading statements about companies in which he held stock; sold the stock for substantial profits following the releases when the price rose; and was convicted for securities fraud and conspiracy to commit securities fraud and wire fraud.
- **United States v. Brockenborough**, 575 F.3d 726 (D.C. Cir. 2009): A scheme to obtain real property for a deflated price supported a conviction for wire fraud and conspiracy to commit wire fraud, in circumstances that included a forged deed and the defendant's impersonation of a U.S. marshal.
- **United States v. Carbo**, 572 F.3d 112 (3d Cir. 2009): A private contractor was convicted of conspiracy to commit honest services mail fraud, in connection with a scheme to conceal conflicts of interest in the awarding of government contracts by a municipal official.
- **United States v. Stephens**, 571 F.3d 401 (5th Cir. 2009): A conviction for conspiracy, wire fraud, and identity theft was based on a scheme to obtain donations for hurricane relief through a bogus Web site purporting to be a charitable organization.
- **United States v. Wyatt**, 561 F.3d 49 (1st Cir. 2009): A scheme to facilitate sizable loans to high-risk borrowers and retain substantial escrow payments from the borrowers led to a conviction for conspiracy to commit wire fraud.
- **United States v. Lewis**, 557 F.3d 601 (8th Cir. 2009): The secretive receipt of a \$1.4 million payment from a charitable organization that the recipient knew was misrepresenting its deteriorating financial condition led to a conviction for mail fraud, wire fraud, bank fraud, conspiracy, and money laundering.

## E. "GRAY AREAS" IN THE LAW

The legality of an action is not always clear. Because there are many laws regulating business, it is possible to violate one without realizing it. There are also many "gray areas" in which it is difficult to predict how a court will rule. In some contexts, the test may be whether a consequence was "foreseeable." Or a case may involve cyberspace and it may not be clear how a court will apply an existing law in that context. The best course is to act responsibly and in good faith.

## F. THE IMPORTANCE OF ETHICAL LEADERSHIP

Management must set and apply ethical standards to which they are committed. Employees will likely follow their example.

## CASE SYNOPSIS—

## Case 2.2: Mathews v. B and K Foods, Inc.

Dianne Mathews was a manager for B and K Foods, Inc., when she was terminated. She filed for unemployment compensation but B and K objected. At an employment commission hearing, the chief executive of B and K testified that it was company policy to pay employees who worked through their lunch breaks. To be paid, a person turned in a "no lunch" sheet. Mathews, however, turned in "no lunch" sheets when she ran personal errands. Mathews admitted knowing the policy and occasionally abusing it. She claimed that a former manager had told her it was okay. The unemployment commission disqualified her receipt of benefits. She appealed.

A state intermediate appellate court affirmed. "Work-related misconduct" must involve a willful violation of the rules or standards of the employer." Mathews was familiar with B and K's policy and violated it. The court also noted that Mathews was responsible for subordinates.

## Notes and Questions

How does the behavior in this case betray a lack of ethics? The court indicated that Mathews was not only responsible to her superiors and the company for her "theft" of time and money. She was also responsible by her example for the conduct of her subordinates. If Mathews's testimony before the employment commission was truthful, her former manager—who initially sanctioned her time sheets—was similarly responsible for Mathews's violation of company policy. The employer, too, might have engaged in less than ethical conduct if it tolerated Mathews's violations for long without at least showing disapproval. Each of these instances would demonstrate dishonesty.

Does it seem likely that an employer would expend the time and effort to deny an ex-employee unemployment compensation because he or she ran a personal errand on company time? Sometimes an employer seizes on a concrete violation of company policy to discipline or discharge an employee who exhibits general disregard for the employer or the policies. A single incident may be only the "tip of the iceberg" in the parties' relationship. Or a cited occurrence may be a coded reference for other acts. For

example, an employee who uses company time to run his or her own business might be discharged for running a “personal errand.”

**ANSWER TO “WHAT IF THE FACTS WERE DIFFERENT?”  
QUESTION IN CASE 2.2**

Suppose that Mathews had not admitted to knowing about the “no lunch” sheet policy. Would the result in this case have been different? Why or why not? The court appears to have relied on Mathews’s own testimony that she knew about the “no lunch” sheet policy as evidence that she engaged in “willful misconduct.” Even without this testimony, however, B and K might still have been able to meet its burden of proof if it could have presented actual “no lunch” sheets submitted by Mathews on this and other occasions. This evidence, plus the fact that she was responsible for “no lunch” sheets turned in by employees under her supervision, would have been sufficient to show that Mathews knew about the policy.

1. **Attitude of Top Management**  
Ethical conduct can be furthered by not tolerating unethical behavior, setting realistic employee goals, and periodic employee review.
2. **Behavior of Owners and Managers**  
Those who actively foster unethical or illegal conduct encourage it in others.

CASE SYNOPSIS—

**Case 2.3: Krasner v. HSH Nordbank AG**

David Krasner worked for HSH Nordbank AG, an international commercial bank. Krasner twice complained to HSH’s human resources department, alleging that his supervisor Roland Kiser was violating the firm’s ethics policy. Specifically, Krasner charged that Kiser was “creating a personal conflict of interest” and an unprofessional environment by advancing Melissa Campfield’s career at the expense of others who were more senior and qualified. HSH investigated and found no violation of its ethics policy or the law. Krasner filed a suit in a federal district court against his employer and supervisor. The defendants filed a motion to dismiss.

The court dismissed the suit. Of course, gender discrimination with respect to “compensation, terms, conditions, or privileges of employment” is prohibited. But Krasner did not complain that he was subject to discrimination because of his gender. He objected to what he perceived as “a demeaning view of women in the workplace” and the “egregious effects of Kiser’s favoritism” towards Campbell on himself. He did not claim, however, that “a female supervisor in his position would not have experienced exactly the same consequences.

.....



## Notes and Questions

Krasner brought this suit in a federal court under a federal law. Could he now sue the defendants in a state court if he thought that he had been fired in violation of a state law? Krasner could now sue the defendants in a New York state court if he had a cause of action other than gender-based discrimination. (Very likely, if the federal court dismissed his discrimination case, he probably would not fare any better under state antidiscrimination laws.) Depending on his employment relationship with his employer and New York state laws governing employment, he might have a cause of action for breach of an actual or implied employment contract or for wrongful termination of the employment relationship.

Why did the court conclude that Krasner did not have a valid claim for “hostile environment” discrimination? The court stressed that although Krasner may have been subjected to a hostile working environment from his perspective, under Title VII he was not discriminated against because of that environment. In other words, he did not suffer the hostile environment because of his gender, and that was the crucial factor.

## ANSWER TO “WHAT IF THE FACTS WERE DIFFERENT?” IN CASE 2.3

Assume that a female employee experienced the same type of treatment that Krasner faced. Would the female employee succeed in a Title VII claim of gender-based discrimination? Why or why not? A female employee with identical complaints to those of Krasner probably would fare no better than Krasner did in trying to satisfy the primary requirement for a case of gender-based discrimination: that the discrimination occurred, in fact, because of the gender of the complainant. In contrast, if a woman had suffered some adverse employment action, such as being demoted or not being promoted, because she refused to give sexual favors to a supervisor, she would definitely have a cause of action for gender-based discrimination.

## G. CREATING ETHICAL CODES OF CONDUCT

Most large corporations have codes of conduct that indicate the firm’s commitment to legal compliance and to the welfare of those who are affected by corporate decisions and practices.

## 1. Providing Ethics Training to Employees

Large firms may emphasize ethics with training programs.

## ANSWER TO CHAPTER OBJECTIVE/FOR REVIEW QUESTION NO. 2

How can business leaders encourage their companies to act ethically? Ethical leadership is important to create and maintain an ethical workplace. Managers can set standards, and apply those standards to themselves and their firm’s employees.

## 2. The Sarbanes-Oxley Act and Web-Based Reporting Systems

The Sarbanes-Oxley Act of 2002 requires firms to set up confidential systems for employees to report suspected illegal or unethical financial practices.

## II. Ethical Transgressions by Financial Institutions

Businesses' ethical failures and mistakes underscore the need for ethical responsibility in business.

### A. CORPORATE STOCK BUYBACKS

If the management of a company believes that its stock price is low, or below “fair value,” the company’s funds can be used to buy shares, boosting their price. This benefits corporate executives who have stock options through which they can buy shares at a potentially lower price and sell at the higher price. This is not illegal, but can have the appearance of impropriety.

### B. STARTLING EXECUTIVE DECISIONS AT AMERICAN INTERNATIONAL GROUP

A business’s decision to overextend its reach risks failure and, with an ill-timed expenditure of company funds, can create an appearance of a lack of ethics. For example, an insurance company’s issuance of policies to guarantee financial contracts—or to protect against any risk—can lead to the company’s failure if too many of the insured events occur. And its executives’ simultaneous spending of company funds on an expensive conference can appear improper.

### C. EXECUTIVE BONUSES

Commissions and bonuses are sometimes based on criteria that seem to ignore the consequences of the conduct that they reward. For example, a commission may be paid on the purchase of a risky asset—such as a loan with a significant possibility of default—even if the risk materializes. The text cites the subprime mortgage crisis of 2007. Despite dropping profits and looming problems, financial firms that had invested heavily in subprime mortgages paid considerable bonuses to their employees in 2007.

## III. Approaches to Ethical Reasoning

Ethical reasoning is the process by which an individual examines a situation according to his or her moral convictions or ethical standards. Fundamental ethical reasoning approaches include the following.

### A. DUTY-BASED ETHICS

#### 1. Religious Ethical Standards

Religious standards provide that when an act is prohibited by religious teachings, it is unethical and should not be undertaken, regardless of the consequences. Religious standards also involve compassion (“Do unto others as you would have them do unto you”).

#### 2. Kantian Ethics

Immanuel Kant believed that people should be respected because they are qualitatively different from other physical objects. Kant’s **categorical imperative** is that individuals should evaluate their actions in light of what would happen if everyone acted the same way.

ADDITIONAL BACKGROUND—

### Immanuel Kant, Critic of Pure Reason

A professor of logic and metaphysics at the University of Königsberg, where he had been educated, Immanuel Kant (1724-1804) devoted much effort to his philosophical works, including *Critique of Pure Reason*, *Critique of Practical Reason*, *Critique of Judgment*, and *Foundations of the Metaphysics of Morals*. Kant believed that reality can be perceived only to the extent that it complies with the aptitude of the mind that is doing the perceiving. Only phenomena, or things that can be experienced, can be understood; everything else is unknown. Applying this theory to metaphysics, Kant saw God, freedom, and immortality as incomprehensible because they can only be studied through contemplation. Their existences cannot be proven, Kant concluded, but they are of immeasurable importance in moral philosophy, because morality cannot exist without belief in God, freedom, and immortality. In 1793, when Kant published his views on religion in *Religion within the Limits of Reasons Alone*, the government prohibited him from writing further on the subject. Kant's ideas influenced many later philosophers, including George Hegel and Friedrich von Schiller. Kant led a quiet and regular life in Königsberg. According to German poet Heinrich Heine, the residents of the town set their watches by Kant's daily walks.

#### 3. The Principle of Rights

According to the principle that persons have rights (to life and liberty, for example), a key factor in determining whether a business decision is ethical is how that decision affects the rights of others, including employees, customers, and society. One question is which rights take priority.

#### B. OUTCOME-BASED ETHICS: UTILITARIANISM

Utilitarianism is a theory developed by Jeremy Bentham and advanced by John Stuart Mill. It focuses on the consequences of an action, not its nature or a set of moral values or religious beliefs. An action is morally correct, or "right," when it produces the greatest amount of good for the greatest number of individuals. Applying this theory requires (1) a determination of who will be affected; (2) a cost-benefit analysis—an assessment of the negative and positive effects of alternatives on those affected; and (3) a choice among alternatives that will produce maximum societal utility (the greatest positive benefits for the greatest number of individuals).

### ANSWER TO CHAPTER OBJECTIVE/FOR REVIEW QUESTION NO. 3

How do duty-based ethical standards differ from outcome-based ethical standards? Duty-based ethical standards are derived from religious precepts or philosophical principles. Outcome-based ethical standards focus on the consequences of an action, not on the nature of the action or on a set of pre-established moral values or religious beliefs.

#### ADDITIONAL BACKGROUND—

### Jeremy Bentham, Founder of Utilitarianism

Jeremy Bentham (1748-1832) achieved prominence as a philosopher, jurist, reformer, and founder of utilitarianism. Bentham was educated at Oxford and admitted to the bar but did not practice law. Instead he pursued legal, political, and social reform, applying principles of ethical philosophy in his efforts. Bentham believed that the greatest happiness for the greatest number is the basis of morality. Happiness and pleasure were the same, and included social, intellectual, and moral as well as physical pleasures. Each pleasure has certain characteristics, including intensity and duration, and Bentham devised a scale of measurement to judge the worth of a pleasure or pain. Each person strives to do what makes him or her happiest. The happiness of an individual and the general welfare are complementary; the achievement of the greatest amount of happiness is the goal of morality. Bentham also believed that the purpose of law was to maximize total happiness within the limitations of government. Bentham applied these views to reform legislation and achieved great advances in prison reform, criminal law, health control, civil service, and insurance.

Bentham was also active in codifying laws. In 1816, he attempted to persuade President James Madison to adopt a code of laws devised by Bentham that included all pertinent rules and case precedents added as illustrations of the utilization of the legal theory involved. Madison rejected the idea, but twenty years later, Bentham's theories were adopted by reformers with the goal of formulating a code of American law.

Bentham has been much praised for the application of his philosophy in the area of legal reform. An essential part of legal utilitarianism is reliance on the free market and individual initiative. Bentham also believed in majority rule and the implementation of as much democracy as possible. He assumed that businesslike rationality could solve all human problems. On the other hand, Bentham has been much criticized for his failure to account for or to understand any human emotion other than rational self-interest. As John Stuart Mill pointed out in a famous essay, Bentham seemed not to understand honor, personal dignity, artistic passion, or human desires for perfection, order, power, and action. "Knowing so little of human feelings," Mill wrote, Bentham "knew still less of the influences by which those feelings are formed . . . and no one . . . who . . . ever attempted to give a rule to all human conduct, set out with a more limited conception of either of the agencies by which human conduct is or of those by which it should be influenced."

#### C. CORPORATE SOCIAL RESPONSIBILITY

The question of corporate social responsibility concerns the extent to which a corporation should act ethically and be accountable to society in that regard.

1. Stakeholder Approach

Stakeholders include employees, customers, creditors, suppliers, and the community within which a business operates. It is sometimes said that duties to these groups should be weighed against the duty to a firm's owners.

2. Corporate Citizenship

Corporations are sometimes urged to actively promote social goals. Some argue that this should be pursued as a "way of doing business" rather than as a special program. Some suggest that such activities should be relevant and significant to a firm's stakeholders. This focus can help a firm retain its employees, especially altruistic younger workers.

ADDITIONAL BACKGROUND—

### Ethics, Calvinism, and the Search for Profits

Historically, the pursuit of profit was suspect because it pits self-interest against community-oriented interests. In the sixteenth century, with the spread of Calvinism, which valued hard work and regarded business success as evidence of God's grace, business activity became more respectable. Calvinism grew out of the theological doctrines of French Protestant reformer John Calvin (1509-1564).

Calvin—whose name is an adapted form of Jean Cauvin—was familiar with the writings of Plato, Seneca, and St. Augustine. In a speech written to be delivered in an inaugural ceremony at the University of Paris in 1533, Calvin expressed radical theological views. Forced to flee France, Calvin settled in Geneva, Switzerland. Calvin's works include *Institutes of the Christian Religion*.

Calvin's theology is the foundation of the Presbyterian, or non-Lutheran, churches, recognizing only the Bible as the authority in questions of religious belief. Its premises include

- The total depravity of man resulting from Adam's fall.
- The absolute power of God's will.
- Because no human has a will of his or her own, the superiority of faith to good deeds.
- The possibility of Christian salvation through God's grace alone.
- The predestination of those few who are to be saved. Because no one knows whether he or she is to be saved, however, everyone must lead lives according to religious tenets.

Calvin's Protestant ethics stressed hard work, self-denial, and an organization of one's life to serve God. The development of Protestant ethics was a motivating force for the rise of capitalism, because it encouraged hard work even when there was no need for it. Material success as a result of work was interpreted as a sign of faith and possible salvation.

With the Industrial Revolution, the pursuit of profit was firmly united with the welfare of society by the economic theory of capitalism. Profit is good, so the theory goes, because it shows that resources are being put to highly valued uses. The search for profit is not always in society's best interest, so the criticism goes, because of market imperfections—the lack of competition in some markets, the difficulty of obtaining perfect information about products and consumer desires, and costs and benefits that are

either unknown or unaccounted for (pollution, for example). Today a socially responsible firm modifies the ethics of capitalism with other ethical standards and looks at more than simply profits. In making business decisions, social responsibility involves three basic considerations: an act's profitability, its legality, and whether it is ethically justifiable.

Striking the right balance between making profits and being ethically responsible is not easy. Usually some profits must be sacrificed in the process. Optimum profits are the maximum profits that can be realized while staying within legal and ethical limits.

#### IV. Making Ethical Decisions

The goal is to ensure that all corporate actors think more broadly about how their decisions and actions will affect other employees, shareholders, customers, and the community. Guidelines include—

- **The law:** Is the action you are considering legal?
- **Business rules and procedures:** Is the action you are considering consistent with company policies and procedures?
- **Social values:** Is your proposed action consistent with the “spirit” of the law, even if it is not specifically prohibited?
- **Your conscience:** How does your conscience regard your plan? Could your plan survive the glare of publicity?
- **Promises to others:** Will your action satisfy your commitments to others, inside and outside the firm?
- **Heroes:** How would your hero regard your action?

#### ANSWER TO CHAPTER OBJECTIVE/FOR REVIEW QUESTION NO. 4

What are six guidelines that an employee can use to evaluate whether his or her actions are ethical? Guidelines for evaluating whether behavior is ethical can be found in the law, business rules and procedures, social values, an individual's conscience, an individual's promises and obligations to others, and personal or societal heroes. An action is most likely ethical if it is consistent with the law, or at least the “spirit” of the law, as well as company policies, and if it can survive the scrutiny of one's conscience and the regard of one's heroes without betraying one's commitments to others.

#### V. Practical Solutions to Corporate Ethics Questions

A practical method to investigate and solve ethics problems might include five steps—

- **Inquiry:** Identify the parties, specify the problem, and list the relevant ethical principles.
- **Discussion:** Put together a list of action options and resolution goals.
- **Decision:** Come to a consensus decision on an action plan.
- **Justification:** Attach reasons to each proposed action and ask whether the corporate stakeholders will accept those reasons.
- **Evaluation:** Consider whether the solution satisfies corporate, community, and individual values.

## VI. Business Ethics on a Global Level

There are important ethical differences among, and within, nations. Some countries, for example, largely reject any role for women professionals, which may cause difficulties for American women conducting business transactions in those countries.

### A. MONITORING THE EMPLOYMENT PRACTICES OF FOREIGN SUPPLIERS

Concerns include the rights and the treatment of foreign workers who make goods imported and sold in the United States by U.S. firms. Should a U.S. firm refuse to deal with certain suppliers or make arrangements to monitor their workplaces to make sure that the workers are not being mistreated?

#### ENHANCING YOUR LECTURE—



9

#### GOOGLE CHINA

8 8



Doing business on a global level can sometimes involve serious ethical challenges. Consider the ethical firestorm that erupted when Google, Inc., decided to market “Google China.” This version of Google’s widely used search engine was especially tailored to the Chinese government’s censorship requirements. To date, the Chinese government has maintained strict control over the flow of information in that country. The government’s goal is to stop the flow of “harmful information.” Web sites that offer pornography, government criticism, or information on other sensitive topics, such as the Tiananmen Square massacre in 1989, are censored—that is, they cannot be accessed by Web users. Government agencies enforce the censorship and encourage citizens to inform on one another. Thousands of Web sites are shut down each year, and the sites’ operators are subject to potential imprisonment.

Google’s Code of Conduct opens with the company’s informal motto: “Don’t be evil.” Yet critics of Google’s actions question whether Google is following this motto. Human rights groups have come out strongly against Google’s behavior, maintaining that the company is seeking profits in a lucrative marketplace at the expense of assisting the Communist Party in suppressing free speech. And in February 2006, Democratic congressman Tom Lantos, the only Holocaust survivor serving in Congress, stated that the “sickening collaboration” of Google and three other Web companies (Cisco Systems, Microsoft Corporation, and Yahoo!, Inc.) with the Chinese government was “decapitating the voice of dissidents” in that nation.<sup>a</sup>

#### GOOGLE’S RESPONSE

Google defends its actions by pointing out that its Chinese search engine at least lets users know which sites are being censored. Google China includes the links to censored sites, but when a user tries to access a link, the program states that it is not accessible. Google claims that its approach is essentially the “lesser of two evils”: if U.S. companies did not cooperate with the Chinese government, Chinese residents would have less user-friendly Internet access. Moreover, Google asserts that providing Internet access, even if censored, is a step toward more open access in the future because technology is, in itself, a revolutionary force.

THE CHINESE GOVERNMENT'S DEFENSE

The Chinese government emphasizes that its censorship of the Internet is no different from the controls placed on information access by other national governments. As an example, it cites France, which bans access to any Web sites selling or portraying Nazi paraphernalia. The United States itself prohibits the dissemination of certain types of materials, such as child pornography, over the Internet. Furthermore, the U.S. government monitors Web sites and e-mail communications to protect against terrorist threats. How, ask Chinese officials, can other nations point their fingers at China for pursuing a common international practice?

FOR CRITICAL ANALYSIS

Do you agree with the assumption made by Google that technological advances and the desire of the Chinese people to embrace liberty will overcome, in time, the current limitations imposed by the Chinese government?

---

a. "As cited in Tom Ziller, Jr., "Web Firms Questioned on Dealings in China," The New York Times, February 16, 2006.



**B. THE FOREIGN CORRUPT PRACTICES ACT**

Side payments to government officials in exchange for favorable business contracts are not unusual in some countries, nor are they considered to be unethical.

**ANSWER TO CRITICAL ANALYSIS QUESTION IN THE FEATURE—  
ONLINE DEVELOPMENTS**

How might online attacks actually help corporations in the long run? (Hint: Some online criticisms might be accurate.) If the gripes are legitimate concerns about ethical behavior, the attacks might be said to help, because if a company acts on the complaints, the unethical performance may cease. If the gripes are only an airing of vague dissatisfaction that may or may not relate to a company's ethical conduct, however, the company has nothing to act on, and the attacks would not be helpful. Either way, there does not appear to be much that a company can do to prevent such complaints, as long as they are not defamatory or otherwise in violation of the law.

**1. Prohibition against the Bribery of Foreign Officials**

In the United States, the Foreign Corrupt Practices Act (FCPA) in 1977 prohibits U.S. businesspersons from bribing foreign officials to secure advantageous contracts.

**2. Accounting Requirements**

Accountants, in particular, may be subject to penalties for making false statements in records or accounts.

**3. Penalties for Violations**

Business firms may be fined up to \$2 million. Individuals can be fined up to \$100,000 (the firm cannot pay the fine) and imprisoned up to five years.

**ANSWER TO CHAPTER OBJECTIVE/FOR REVIEW QUESTION NO. 5**

What types of ethical issues might arise in the context of international business transactions? The most common types of issues to arise in an international context are those created by the different ethical standards and practices among different cultures and nations. These may include employment policies, the treatment of women and minorities, and (less likely) situations involving bribes.

**TEACHING SUGGESTIONS**

1. To emphasize the relation between law and ethics, emphasize their distinction by discussing the theory of civil disobedience. Ethics are created by moral values. Whether to obey the law is itself an ethical question. Some individuals may choose to ignore the law if their ethical principles conflict with it. If

there is a conflict between a law and an ethic, should an individual disobey the law, or should an individual obey the law even if he or she thinks it would be unethical to do so? Is there a higher law than what society provides in a particular place at a particular time?

2. Ethical standards are subjective. They are derived from personal religious beliefs or philosophical assumptions concerning the nature of goodness, fairness, rightness, or justice. Each of us decides what we believe in and how to act on those beliefs. Have students give examples of their own ethical standards and explain how they arrived at those standards.

3. There are a number of hypotheticals that could be used to introduce this chapter's subject matter. Have students imagine that they own a company at which there is an opening at a beginning level. There are two applicants—one, the students' personal friend and the other, a member of the opposite sex (or of a minority). The latter individual is more qualified for the job than the friend. Ask the students to suppose that in spite of whatever profit the most qualified person might generate, they would rather have their friend on the job. State that in this hypothetical, hiring the friend would violate the law against discrimination. Would the students hire the friend in violation of the law?

Other hypotheticals involving employment might be used. For example, would students, as owners of a business, offer a prospective employee a lower salary if (1) the employee indicated during the interview that she expected a lower salary than they had been prepared to offer based on other companies' salaries for similar positions? (2) paying the lower salary would violate no law? (3) the position was unique within the company (so that there were not other employees with whom she could compare pay)?

4. To introduce social responsibility, a hypothetical involving a violation of the law could be given, but a violation as to which there is no risk of being caught. For example, have students suppose that as businesspersons they will have an opportunity to make more money by meeting with competitors and fixing prices, conduct which is illegal. For this hypothetical, tell them that the authorities will not discover that the prices have been fixed. In fact, the price rise could be small—pennies per item—but the increases in net profit could be considerable. Is price-fixing fair? Ethical? Socially responsible? Does it make any difference what the extra profit is used for? If the students imagine that they need the money, would price-fixing be wrong? Would their answers be different if there was an even chance that they would be caught? Why?

5. It might be pointed out that in a capitalist system it is essential that accurate information be disseminated to avoid any wasting of assets. Partly for this reason, an independent check on an enterprise's management by auditors benefits everyone with an interest in the business.

6. Suggest that students apply the same type of analytical reasoning to ethical problems that they apply to considering and deciding legal issues.

### Cyberlaw Link

Should ethical standards be adapted to deal with the new forms of social disruption made possible by the Internet (for example, data theft, hacking, virus implanting, and invasion of privacy)? What new ethical standards, if any, are needed to resolve problems online?

## DISCUSSION QUESTIONS

1. How does a law come to be an expression of an ethical principle? A law is what society deems proper behavior. An ethical value is also an expression of what is considered appropriate conduct. When people wish to enforce or change an ethical value, they often politicize the issue, urging politicians to create or amend a law. When the law changes, it more effectively represents the ethic that served as the impetus for its change.
2. What are reasons for unethical business behavior? Employers or owners who condone it. The belief that it won't be discovered. The corporate structure, which can insulate individuals from responsibility for their acts through its distance from the acts' consequences and the collectivity (impersonality?) of corporate decision making. Lack of clarity as to what ethical standards are appropriate and acceptable in the business context.
3. In negotiating a business deal, is "strategic misrepresentation" permissible? Do you have to disclose everything? These questions concern the ethical conflict inherent in a business context. From a duty-based ethics viewpoint, in an absolute sense, it would be unethical not to disclose information on which the negotiator knows the other side might hinge its decisions. In contrast, a negotiator owes an ethical duty to negotiate in the best interests of whomever he or she is negotiating for. When one ethical duty conflicts with another, a decision has to be made as to which duty is more fundamental. Frequently, questions faced by businesspersons do not have clear-cut answers, but involve choices between arguably equally good alternatives.

It has been suggested that business is a game and deception is an important element of negotiation, just as poker is a game in which bluffing plays an important part. The better an individual is at deception, the more successful he or she will be at negotiation. Those who do not anticipate deceit are fooling themselves. One of the problems with this suggestion is that there is no stated point at which deception is no longer acceptable. By comparison, in poker, it is acceptable to attempt to confuse other players as to the cards you have been dealt but it is not acceptable to bribe the dealer to deal you better cards. Also, if deception were widely practiced, the expense of protecting against it would increase for business and society.

4. Why would a corporation prefer to be seen as ethical? Consumers may be less willing to buy products of companies that appear to be unethical. Investors may prefer to invest in a firm that is perceived as ethically responsible. Suppliers may prefer to do business with ethical firms. In other words, socially responsible activities can improve profits.
5. Does a company have a duty to act in socially or politically beneficial ways? There is no agreement as to whether a company has a duty to act in a beneficial way. In deciding whether to do so, a company should consider the appropriateness and feasibility of an activity, the extent to which it will help the company, and whether expected gains will justify expected costs. Management must be prepared to explain its decision to shareholders and the public.
6. How does a corporation's investment in a political or social agenda affect its duty to its shareholders? People invest in business to make a profit, and a company's shareholders may have such a variety of political and social views that the company's pursuing a particular political or social goal may be divisive. Diverting corporate funds reduces the amount available for dividend payments. Diverting other resources reduces what is available

to produce goods and services for sale. Investors may also be less likely to invest in a company that engages in behavior seen as unethical out of fear of consumer hostility toward the company.

7. To whom might a corporation owe a duty? A corporation may owe a duty to its shareholders, its employees and their families, its customers, and society as a whole. What must a corporation do if it finds itself subject to conflicting duties? There is no law that says which of these duties comes first or how much weight should be given to each in the balance. When there is no conflict between duties, the question of how best to fulfill a single duty involves trade-offs. When these duties overlap, a balance must be struck. Determining which duty takes precedence involves difficult trade-offs.

8. Because business controls so much wealth and power, what duty does it arguably have to society? It has been argued that business owes a duty to society to use its wealth and power in beneficial ways—promoting human rights, striving for equal treatment of minorities in the workplace, acting to safeguard the environment, and eschewing profits from activities that society deems unethical. Generally, business has been responsive to social needs, donating to programs that benefit society.

9. Do businesses have an ethical duty to use enhanced security measures to protect confidential customer information? Why or why not? For example, if an employer allowed its employee to store customers' unencrypted personal information on a laptop outside of the office, would this violate any ethical duty? Yes, because the information has been entrusted to their care and the theft of such information is well known. Also, from an ethical standpoint, in terms of profit, customers may be less willing to do business with a firm that does not protect such information. No, so long as the firm that possesses the data does not itself misuse it, because any theft or other misuse that might occur would be an illegal and unethical act on the part of its perpetrator, not the possessor.

## ACTIVITY AND RESEARCH ASSIGNMENTS

1. Suggest that students research the basis for their personal ethical standards. How well (or poorly) do these bases coincide with the law as they know it? Is there a code of human conduct so basic that everyone would agree to follow it?
2. Have students research the conflict that seems to exist between the Judeo-Christian and Islamic ethics, between the Western and Arabic cultures. Is the apparent gap bridgeable? Do we in fact have a common ethics? Do our ethics at least derive from a common source?
3. Ask students to discover exactly how a value can become a law. What does the lobbying process involve? Do your students believe that good customs actually do become law? What factors distinguish good from bad customs?
4. Have students choose an employer and discover as much as they can about the people who work for the employer. What are the job categories and what percentages of each are held by women and minorities? How does the employer determine wages? How flexible is the employer's policy?
5. Some business firms publish annual reports concerning their socially responsible activities. Critics of these reports call them advertising ploys. Suggest that students obtain and read one or more of the reports. What

activities do these firms consider socially responsible? What influence might the reporting of these activities have on the firms' management? Are firms that issue these reports likely to increase these activities?

## ANSWERS TO ESSAY QUESTIONS IN *STUDY GUIDE TO ACCOMPANY THE LEGAL ENVIRONMENT TODAY, SEVENTH EDITION*

1. What is ethics? Ethics is the study of what constitutes right and wrong behavior. Ethics is involved in the answers to such questions as: What is fair? What is just? What is the right thing to do? Ethics is not an abstract or static concept—values and moral convictions influence a thousand everyday actions and decisions.
2. What is the difference between legal and ethical standards? How are legal standards affected by ethical standards? Legal standards are greatly affected by ethical standards, and there are areas common to both. Killing another human being, for example, is rarely sanctioned by law and is commonly prohibited by religious and secular beliefs. Legal and ethical standards are not the same, however. The law does not codify all ethical requirements. An action might be legal but unethical. Compliance with the law does not always equate with ethical behavior.

### REVIEWING—



## ETHICS AND BUSINESS DECISION MAKING



Isabel Arnett is the chief executive officer (CEO) of Tamik, Inc., a pharmaceutical company that manufactures a vaccine called Kafluk, which supposedly provides some defense against bird flu. The company began marketing Kafluk throughout Asia. After numerous media reports that bird flu may soon become a worldwide epidemic, the demand for Kafluk increased, sales soared, and Tamik earned record profits. Tamik's CEO, Arnett, then began receiving disturbing reports from Southeast Asia that in some patients, Kafluk had caused psychiatric disturbances, including severe hallucinations, and heart and lung problems. Arnett was informed that six children in Japan had committed suicide by jumping out of windows after receiving the vaccine. To cover up the story and prevent negative publicity, Arnett instructed Tamik's partners in Asia to offer cash to the Japanese families whose children had died in exchange for their silence. Arnett also refused to authorize additional research within the company to study the potential side effects of Kafluk. Ask your students to answer the following questions, using the information presented in the chapter.

1. In this scenario, it is not clear that the other corporate officers and Tamik's board of directors were aware of the actions of its CEO, Arnett. How might an integrated corporate governance system ensure that all parties were informed of Arnett's conduct? To ensure that potentially unethical behavior does not escape the attention of those in control of the corporation, Tamik should set up an ethics committee that is separate from the various corporate departments and reports potentially unethical behavior directly to

those in control of the corporation.

2. Would a person who adheres to the principle of rights theory consider it ethical for Arnett not to disclose potential safety concerns and to refuse to perform additional research on Kafluk? Why or why not? A principle of rights adherent would likely conclude Arnett's conduct was unethical. Those who adhere to the rights theory believe that a key factor in determining whether a business decision is ethical is how that decision affects others. These others include not only the firm's owners (shareholders) and employees, but also the consumers of the firm's products or services, and society as a whole. In this situation, Arnett clearly did not take into account the potential affect on persons outside the corporation—consumers and society as a whole. If she had considered the affect that Kafluk might have on consumers and society, then Arnett would at least have allowed the company to perform additional research on the safety and risks associated with Kafluk.

3. If, during the same period, Kafluk prevented one thousand Asian people who were exposed to bird flu from dying, would Arnett's conduct in this situation be ethical under a utilitarian model of ethics? Why or why not? Utilitarians believe that an action is morally correct when, among the people that it affects, it produces the greatest good to the greatest number. Arnett's decision to continue marketing Kaflux most clearly affected those persons who received the vaccine. Because Kaflux positively affected more persons (preventing fifty deaths), than it allegedly had a negative affect on (twelve children who supposedly committed suicide after experiencing severe hallucinations), Arnett's conduct likely would be considered ethical.

4. Did Tamik or Arnett violate the Foreign Corrupt Practices Act in this scenario? Why or why not? Because Tamik did not attempt to pay off any Japanese government officials and only paid the injured families a cash settlement, the corporation did not violate the Foreign Corrupt Practices Act.



#### LINKING THE LAW TO MANAGERIAL ACCOUNTING—



### MANAGING A COMPANY'S REPUTATION



Valuable company resources are used to create and publish corporate social responsibility reports. Under what circumstances can a corporation justify such expenditures? Clearly, very small businesses cannot even think about spending resources to create corporate social responsibility reports. In general, also, corporations that are not publicly traded will not spend resources creating corporate social responsibility reports. In other words, unless a company has to file with the Securities and Exchange Commission, there is typically little reason to spend resources on social responsibility reports. Publicly held corporations, in contrast, once they are relatively large, will find that there is some payoff to creating and distributing on a wide basis social responsibility reports. A positive, well-received reputation may help in recruiting better employees. It may create a more positive environment for the corporations' stock price. Finally, being known as a "good corporate citizen" certainly cannot hurt when a company is

under investigation by regulators.



EXAMPREP—



ISSUE SPOTTERS



1. Delta Tools, Inc., markets a product that under some circumstances is capable of seriously injuring consumers. Does Delta owe an ethical duty to remove this product from the market, even if the injuries result only from misuse? Why or why not? Maybe. On the one hand, it is not the company's "fault" when a product is misused. Also, keeping the product on the market is not a violation of the law, and stopping sales would hurt profits. On the other hand, suspending sales could reduce suffering and could prevent negative publicity that might result if sales continued.

2. Acme Corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees. Does this raise an ethical conflict between Acme's employees? Between Acme and its employees? Between Acme and its shareholders? Explain your answers. When a corporation decides to re-pond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees, an ethical conflict is raised between the firm and its employees and between the firm and its shareholders (not between the employees). This dilemma arises directly out of the effect of such a decision on the firm's profits. With respect to the employees and the shareholders, the firm arguably has an obligation to stay in business. If adjusting pay differences among employees increases profitability, then staying in business is not an issue, and the dilemma is easily resolved in favor of "doing the right thing."

