Chapter 2

DEFINING BUSINESS ETHICS

CHAPTER OBJECTIVES

- After exploring this chapter, you will be able to:
  1. Define the term *business ethics*.
  2. Identify an organization's stakeholders.
  3. Discuss the position that *business ethics* is an oxymoron.
  4. Summarize the history of business ethics.
  5. Identify and propose a resolution for an ethical dilemma in your work environment.
  6. Explain how executives and employees seek to justify unethical behavior.

BUSINESS ETHICS

- **Business ethics** involves the application of standards of moral behavior to business situations.
  - Two distinct perspectives
    - A *descriptive* summation of the customs, attitudes, and rules that are observed within a business. As such, we are simply documenting what ***is*** happening
    - A *normative* (or *prescriptive*) evaluation of the degree to which the observed customs, attitudes, and rules can be said to be ethical. Here we are more interested in recommending what ***should*** *be* happening
  - Business ethics are not a separate set of moral standards or ethical concepts from general ethics.

"STAKEHOLDERS"

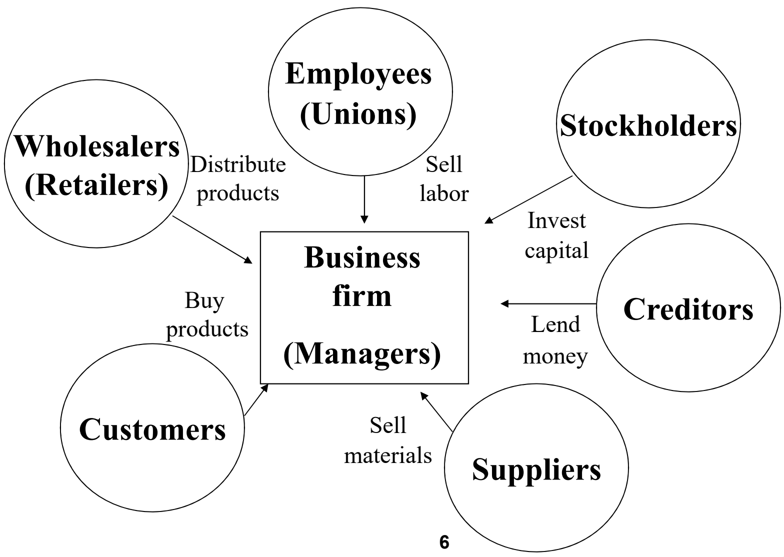
- The decisions made within a business firm will affect many more people than only an individual.
- Ethically responsible business decision-making must move beyond a narrow concern with stockholders, and consider the impact that decisions will have on a wide range of stakeholders.
- A **business stakeholder** will be anyone who affects or is affected by decisions made within the firm.
- Failure to consider these additional stakeholders will have a detrimental impact on those stakeholders, stockholders, and on the firm's long-term sustainability.

Stakeholder theory

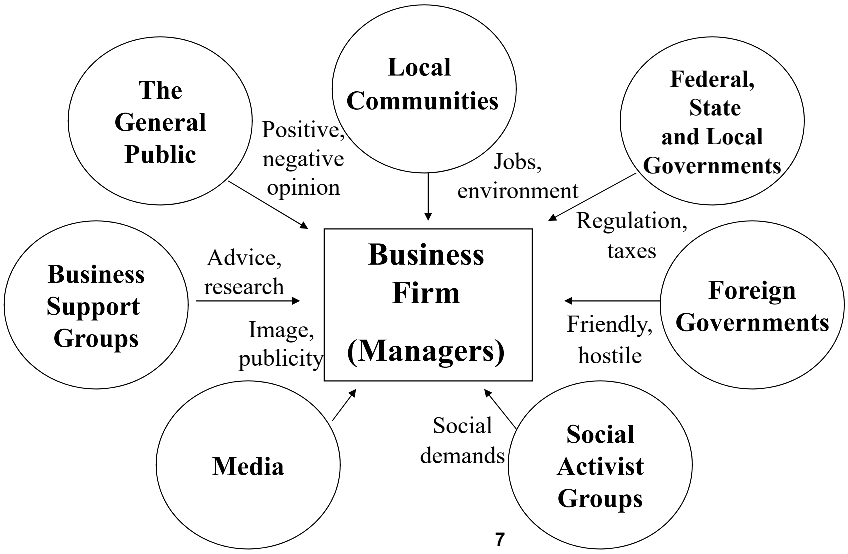
- For any organisation there are a number of definable groups who have an interest, or a stake, in the actions of that organisation, i.e. owners, employees, suppliers, creditors, etc (*see Figures in the next slides*). **Stakeholder theory** deals with three issues:
  - What responsibilities or duties does an organisation owe to its stakeholders? The fact that a stakeholder group may have a legitimate interest does not, of itself, mean that the organisation owes anything to it.
  - How should an organisation decide between its obligations to two or more stakeholders if they demand incompatible things from an organisation? What criteria should the organisation use when deciding which stakeholder group's wishes it should prioritise? (i.e. lobby groups, parties, common interest groups, etc)
  - What legitimate interests justify a group of people being regarded as a stakeholder in an organisation?

❖ The subject matter of business ethics is an attempt to answer these three questions. In the next section we consider four different answers, that are given in modern western, capitalist societies.

Relations between a business firm and its primary (or market) stakeholders



Relations between a business firm and some of its other (secondary or non-market) stakeholders



Stakeholder interests in the organization

Stakeholders	*Interest in the Organization*
Stockholders or Shareholders	• Growth in the value of company stock • Dividend income
Employees	• Stable employment at a fair rate of pay • A safe and comfortable working environment
Customers	• "Fair exchange"—a product or service of acceptable value and quality for the money spent • Safe and reliable products
Suppliers/vendor partners	• Prompt payment for delivered goods • Regular orders with an acceptable profit margin
Retailers/wholesalers	• Accurate deliveries of quality products on time and at a reasonable cost • Safe and reliable products
Federal government	• Tax revenue • Operation in compliance with all relevant legislation
Creditors	• Principal and interest payments • Repayment of debt according to the agreed schedule
Community	• Employment of local residents • Economic growth • Protection of the local environment

Stakeholder impact from unethical behavior

Stakeholders	Interest in the Organization
Stockholders or Shareholders	• False and misleading financial information on which to base investment decisions • Loss of stock value • Cancellation of dividends
Employees	• Loss of employment • Not enough money to pay severance packages or meet pension obligations
Customers	• Poor service quality (as WorldCom struggled to combine the different operating and billing systems of each company they acquired, for example)
Suppliers/vendor partners	• Delayed payment for delivered goods and services • Unpaid invoices when the company declared bankruptcy
Federal government	• Loss of tax revenue • Failure to comply with all relevant legislation
Creditors	• Loss of principal and interest payments • Failure to repay debt according to the agreed schedule
Community	• Unemployment of local residents • Economic decline

An Ethical Crisis: Is Business Ethics an Oxymoron? (1 of 2)

- Over the last two decades, the ethical track record of many organizations would lead us to believe that no ethical policies or procedures have been in place
- **<u>Corporate Governance</u>**
  - The system by which business corporations are directed and controlled.
    - Corporate governance appears to be at the lowest level in business history:
      - Several prominent organizations (e.g., Enron, WorldCom, Lehman Brothers, and Bear Stearns) have been found to have hidden the true state of their precarious finances from their stakeholders.
      - Others—Adelphia, Tyco, and Merrill Lynch— have been found to have senior officers who appeared to regard the organization's funds as their personal bank accounts.
      - Financial reports are released that are then restated at a later date.
      - Products are rushed to market that have to be recalled due to safety problems at a later date.
      - Organizations are being sued for monopolistic practices, race and gender discrimination, and environmental contamination.

An Ethical Crisis: Is Business Ethics an Oxymoron? (2 of 2)

- CEO salary increases far exceed those of the employees they lead.
- CEO salaries have increased while shareholder returns have fallen.
- CEOs continue to receive bonuses while the stocks of their companies underperform the market average and thousands of employees are being laid off.

▪ Many observers believe that the business world lacks any sense of ethical behavior and refer to business ethics as an **oxymoron**.

- **Oxymoron**
  - ➢ The combination of two contradictory terms, such as "deafening silence" or "jumbo shrimp."
- **Code of ethics**
  - ➢ A company's written standards of ethical behavior that are designed to guide managers and employees in making the decisions and choices they face every day.
    - A code of ethics can serve dual purpose:
      - » As a message to the organization's stakeholders, the code should represent a clear corporate commitment to the highest standards of ethical behavior.
      - » As an internal document, the code should represent a clear guide to managers and employees in making the decisions and choices they face every day.

HISTORY OF BUSINESS ETHICS (1 of 2)

Decade	*Ethical Climate*	*Major Ethical Dilemmas*	*Business Ethics Developments*
1960s	Social unrest. Antiwar sentiment. Employees have an adversarial relationship with management. Values shift away from loyalty to an employer to loyalty to ideas. Old values are cast aside.	• Environmental issues. • Increased employee–employer tension. • Civil rights issues dominate. • Honesty. • The work ethic changes. • Drug use escalates.	• Companies begin establishing codes of conduct and values statements. • Birth of social responsibility movement. • Corporations address ethics issues through legal or personnel departments.
1970s	Defense contractors and other major industries riddled by scandal. The economy suffers through recession. Unemployment escalates. There are heightened environmental concerns. The public pushes to make businesses accountable for ethical shortcomings.	• Employee militancy (employee versus management mentality). • Human rights issues surface (forced labor, substandard wages, unsafe practices). • Some firms choose to cover rather than correct dilemmas.	• Ethics Resource Center (ERC) founded (1977). • Compliance with laws highlighted. • Federal Corrupt Practices Act passed in 1977. • Values movement begins to move ethics away from compliance orientation to being "values centered."
1980s	The social contract between employers and employees is redefined. Defense contractors are required to conform to stringent rules. Corporations downsize and employees' attitudes about loyalty to the employer are eroded. Health care ethics emphasized.	• Bribes and illegal contracting practices. • Influence peddling. • Deceptive advertising. • Financial fraud (savings and loan scandal). • Transparency issues arise.	• ERC develops the U.S. Code of Ethics for Government Service (1980). • ERC forms first business ethics office at General Dynamics (1985). • Defense Industry Initiative established. • Some companies create ombudsman positions in addition to ethics officer roles. • False Claims Act (government contracting).

HISTORY OF BUSINESS ETHICS (2 of 2)

1990s	Global expansion brings new ethical challenges. There are major concerns about child labor, facilitation payments (bribes), and environmental issues. The emergence of the Internet challenges cultural borders. What was forbidden becomes common.	• Unsafe work practices in Third World countries. • Increased corporate liability for personal damage (cigarette companies, Dow Chemical, etc.). • Financial mismanagement and fraud.	• Federal Sentencing Guidelines (1991). • Class action lawsuits. • Global Sullivan Principles (1999). • *In re Caremark* (Delaware Chancery Court ruling re board responsibility for ethics). • IGs requiring voluntary disclosure. • ERC establishes international business ethics centers. • Royal Dutch/Shell International begins issuing annual reports on its ethical performance.
2000s		• Cyber crime. • Privacy issues (data mining). • Financial mismanagement. • International corruption. • Loss of privacy—employees versus employers. • Intellectual property theft.	• Business regulations mandate stronger ethical safeguards (Federal Sentencing Guidelines for Organizations; Sarbanes-Oxley Act of 2002). • Anticorruption efforts grow. • Shift to emphasis on corporate social responsibility and integrity management. • Formation of International ethics centers to serve the needs of global business. • OECD Convention on Bribery (1997–2000).

DOING THE RIGHT THING

❖ When an employee observes unethical behavior (e.g., fraud, theft, incentives paid under the table to suppliers) the extent of guidance available to them is typically a series of clichés:

- Consult the Company Code of Ethics
- Do what's right for the Organizations Stakeholders
- Do what's legal
- Do what you think is best ('use your best judgment')
- Do the right thing.

Resolving Ethical Dilemmas (1 of 2)

❖ **Ethical dilemma:** A situation in which there is no obvious right or wrong decision, but rather a right or right answer.

❖ <u>Resolution</u> of an ethical dilemma can be achieved by first reorganizing the type of conflict you are dealing with. **<u>Types of conflict</u>**:

- *Truth versus Loyalty*
  - Do you tell the truth or remain loyal to the person or organization that is asking you not to reveal that truth?
- *Short-Term versus Long-Term*
  - Does your decision have a short-term consequence or a longer-term consequence?
- *Justice versus Mercy*
  - Do you perceive this issue as a question of dispensing Justice or Mercy? (and which one are you more comfortable with?).
- *Individual versus Community*
  - Will your choice impact one individual or a wider group or community?

❖ In the types of conflict scenarios, both sides are right to an extent, but since you can't take both actions, you are required to select the better or higher right based on the personal resolution process

Resolving Ethical Dilemmas (2 of 2)

❖ Once a decision is reached as to the type of conflict being faced, there are **<u>three resolution principles</u>** available:

- *Ends-based*: Which decision provides the greatest good for the greatest number of people?
- *Rules-based*: What would happen if everyone made the same decision as you?
- *The Golden Rule*: Do unto others as you would have them do unto you.

• The resolution principles do not offer a perfect solution or resolution to the problem because one can't predict how another individual might act given a certain scenario

JUSTIFYING UNETHICAL BEHAVIOR

- Ask how do supposedly intelligent and presumably experienced executives and employees manage to commit acts that end up inflicting such harm on their companies, colleagues, customers, and vendor partners?
  - Saul Gellerman identified "four commonly held rationalizations that can lead to misconduct."

1. A belief that the activity is within reasonable ethical and legal limits – that is, that it is not "really" illegal or immoral.
2. A belief that the activity is in the individual's or the corporation's best interests – that the individual would somehow be expected to undertake the activity.
3. A belief that the activity is "safe" because it will never be found out or publicized; the classic crime-and-punishment issue of discovery.
4. A belief that because the activity helps the company, the company will condone it and even protect the person who engages in it.

- **<u>Review Questions</u>**

1. Answer the following:
   (a) Define the term stakeholder
   (b) Briefly discuss the issues the stakeholder theory addresses
   (c) List the primary stakeholders of a business and explain through examples their relations with an organization.
2. What is an ethical dilemma? Briefly discuss how ethical dilemmas can be resolved.