CHAPTER 3

EMERGING BUSINESS ETHICS ISSUES

CLEMENT, MATHEW S191TS

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CHAPTER OBJECTIVES

- To define ethical issues in the context of organizational ethics
- To examine ethical issues as they relate to the basic values of honesty, fairness, and integrity
- To delineate misuse of company resources, abusive and intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy as business ethics issues
- To examine the challenge of determining an ethical issue in business

CHAPTER OUTLINE

Recognizing an Ethical Issue

Honesty

Fairness

Integrity

Ethical Issues and Dilemmas in Business

Misuse of Company Resources

Abusive or Intimidating Behavior

Lying

Conflicts of Interest

Bribery

Corporate Intelligence

Discrimination

Sexual Harassment

Environmental Issues

Fraud

Consumer Fraud

Financial Misconduct

Insider Trading

Intellectual Property Rights

Privacy Issues

The Challenge of Determining an Ethical Issue in Business

AN ETHICAL DILEMMA*

As Jackie sat waiting to talk to the president of Sing & Dance Records (SDR), she started to wonder whether the meeting would destroy her musical career before it even got started. Because she was an up-and-coming star recently hired by SDR and didn't know the unwritten rules of the company, the chain-of-command philosophy, and the employees and studio musicians around her very well, the wait was making her more and more uneasy. Given how well things had started, it was painful for her to recall the circumstances that had led her to this place.

Jackie had been lured to SDR after winning third place in a national talent competition. Considering how long some performers wait to land at a major record label, if they ever do so at all, she had attracted SDR's attention remarkably quickly. Jackie had a sultry voice and she wrote her own music. Music industry insiders expected big things from her soon. The opportunity at SDR seemed like a dream come true. The possibility of a lucrative recording contract, the chance to be close to her old neighborhood, and a romantic encounter with

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Curtis (her future manager at SDR) made it nearly impossible for Jackie to say no.

In the beginning, Curtis had been very charming. He convinced Jackie to work with SDR by telling her about the label's industry connections, the bands it represented, and the resources it employed to boost its performers. Curtis had helped her find a nice house, had assisted with her move, and eventually had become more than her manager. As the months slipped by their relationship became close to the point where they began to discuss living together. Then Jackie started hearing rumors about Curtis and Leslie.

Leslie, who had come to SDR six months before Jackie, worked in the record label's legal department, and in a just a few months, she had become head of that department amidst rumors that Curtis had helped her get the promotion because of their personal relationship. The rumors became so intense that Jackie confronted Curtis and discovered that the stories were true. Devastated, Jackie ended her relationship with Curtis in a heated confrontation, but the professional aspect of their relationship proved more difficult to untangle.

Because of Curtis's contacts in the music industry and at SDR, Jackie couldn't afford to drop him as her manager. Days passed with little contact between the two of them, and then one afternoon Curtis stopped by the recording studio. He apologized for his behavior, and Jackie accepted his apology. But when he visited the next day, he began to make sexual advances toward Jackie. She made a joke of it to defuse the situation, but several days later he repeated the same behavior and made several suggestive remarks to her just out of earshot of her band members.

Jackie's face turned red as she said, "Curtis, you pig, you've crossed the line. Do that again, and I'll report you to Legal!"

A few more weeks went by, and then Jackie got a phone call in the studio from Curtis in which he made even more sexually suggestive comments. Every few days, he would stop by or call and remind her of some private experience they had had together. He would taunt her, saying, "Jackie, you know you want it."

Eventually, Jackie went to SDR's legal department to complain formally about Curtis, his sexual advances, and the hostile environment that he had created. The person she met with at Legal was Leslie.

After Jackie had described the situation in detail, she said, "Leslie, I need you to help me. I can't lay the vocal tracks down for my album because what he's doing shakes me up so much. He's undermining my position with my fellow musicians, he's not sharing my album with the label executives, and at the same time he's telling me that I could change all of that if I wanted to!"

Leslie responded, "Jackie, I've heard what you've said, but I have had people come to me with some very disturbing reports about you, too. For example, you and Curtis were supposedly sleeping together, and he is your manager. If that was the case, you should have reported it immediately, but you didn't. You have no tangible evidence except for your word. Even if I believed you, the allegations that you had been sexually active with Curtis could be construed as making all of what you've said mutual or consensual. If that was the case, I would have to discipline you because of this label's superior–employee ethics code, and a letter would go into your permanent file that could ruin your chances of working at another major record label for years to come. From my perspective, we can call this an informal and confidential meeting that is not to be repeated, or you can continue this formally and take your chances. It's your call, Jackie, but you should know that I am disinclined to support your accusations."

In shock, Jackie mumbled a thank-you to Leslie and left her office. The next day Curtis stopped by, smiled, and said, "Your album's status review is next week, and it doesn't look good. I've told you before that it's all about who you know in the music industry, and I have friends at all the majors."

Jackie said, "Curtis, why are you doing this to me? I'm not in love with you anymore. We have no future together. Doesn't that tell you something?"

Curtis smiled and said, "It tells me that you're not interested in a permanent relationship, which is good, because neither am I. And you know that if you want your album to be pitched to the radio stations, or if you want to headline your own tour someday, it all starts with me."

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So now here Jackie was, waiting to meet with the president of the record label. As she got up from her chair, she weighed her alternatives and what had led her here. She knew that each record label had its own individual code of ethics, but she hadn't known the reality of the code at SDR until it was too late.

QUESTIONS | EXERCISES

1. Keeping in mind the facts and timeline of this situation, discuss Jackie's situation in terms of its legal and ethical issues.
2. Discuss Jackie's alternatives and the possible professional and private outcomes of her situation.
3. Is Curtis in violation of sexual harassment and/or sexual discrimination laws in the United States?
4. Certainly Curtis has damaged Jackie's performance level; however, has he also created a legally hostile work environment?

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

Stakeholders' ethical concerns determine whether specific business actions and decisions are perceived as ethical or unethical. In the case of the government, community, and society, what was merely an ethical issue can soon become a legal debate and eventually law. Most ethical conflicts in which there are perceived dangers turn into litigation. Additionally, stakeholders often raise ethical issues when they exert pressure on businesses to make decisions that serve their particular agendas, as when corporate shareholders demand that managers make decisions that boost short-term earnings, thus maintaining or increasing the value of the stock they own in that firm. For example, some U.K. stakeholders believe that Kraft Foods acted irresponsibly when it purchased confectioner Cadbury PLC. Before purchasing Cadbury, Kraft told the Summerdale community that the company would not cut the plant's 400 jobs. The company repeated the pledge on the day it bought Cadbury. The following week, Kraft announced it would close the plant. The community charged Kraft with reneging on its promises and blatantly telling falsehoods to mollify the community's fears.[1]

People make ethical decisions only after they recognize that a particular issue or situation has an ethical component; therefore, a first step toward understanding business ethics is to develop ethical issue awareness. Ethical issues typically arise because of conflicts among individuals' personal moral philosophies and values, the values and culture of the organizations in which they work, and the values of the society in which they live. The business environment presents many potential ethical conflicts. A company's efforts to achieve its organizational objectives may clash with its employees' attempts to fulfill their own personal goals. Similarly, consumers' need for safe and quality products may inhibit a manufacturer's ability to earn adequate profits. The desire of an oil company like BP or Chevron to create a profitable and dependable supply of oil and gas may conflict with the needs of many stakeholders. The fact that BP repeatedly placed profits over the safety of employees and the environment culminated in the 2010 *Deepwater Horizon* explosion, which released 206.2 million gallons of oil into the Gulf of Mexico.[2] Chevron continues to fight an order to pay $8.6 billion to clean up oil pollution in the Ecuadorian rainforest after local residents won a lawsuit against the company.[3]

In this chapter, we consider some of the ethical issues that are emerging in business today, including how these issues arise from the demands of specific stakeholder groups. In the first half of the chapter, we explain certain universal ethical concepts that pervade business ethics, such as honesty, fairness, and integrity. The second half of the chapter explores a number of emerging ethical issues, including misuse of company resources, abusive and

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intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, financial misconduct, insider trading, intellectual property rights, and privacy. We also examine the challenge of determining an ethical issue in business. Because of the global financial meltdown, there are certain practices and products that have or will become issues and will either be defined as illegal or unethical in the coming years. It is important that you understand that what was once a legal activity can become an ethical issue, resulting in well-known practices becoming illegal.

RECOGNIZING AN ETHICAL ISSUE

Although we have described a number of relationships and situations that may generate ethical issues, in practice it can be difficult to recognize specific ethical issues. Failure to acknowledge such obscured ethical issues is a great danger in any organization, particularly if business is treated as a game in which ordinary rules of fairness do not apply. Sometimes people who take this view are willing to do things that are not only unethical but also illegal so that they can maximize their own positions or boost the profits of their organizations. Those involved in the marketplace have an additional set of values related to profit, increased revenue, earnings per share, sales, return on assets, and/or return on investment that they must address. All or part of these objectives come into play within business and impact what people choose to do and how they justify their actions. In one's home life, one does not have the profit motive with which to contend. To be clear, businesspeople do not have a unique set of values from others; rather, the values they have are weighted differently when doing business activities because of the additional responsibilities associated with the marketplace.

Business decisions, like personal decisions, involve an unsettled situation or dilemma. Just because an activity is considered an ethical issue does not mean the behavior is necessarily unethical. An ethical issue is simply a situation, a problem, or even an opportunity that requires thought, discussion, or investigation before a decision can be made. And because the business world is dynamic, new ethical issues are emerging all the time. Table 3.1 defines specific ethical issues identified by employees in the National Business Ethics Survey (NBES). Abusive behavior and lying to employees are personal in nature, but these activities are sometimes committed by individuals in the belief that they are furthering organizational goals. Falsifying time or expenses, safety violations, and abuse of company resources are issues that directly relate to the firm's agenda. Table 3.1 compares the percentage of employees who observed specific types of misconduct over the past two National Business Ethics Surveys.

Employees could engage in more than one form of misconduct; therefore, each type of misconduct represents the percentage of employees who witnessed that particular act. Although Table 3.1 documents many types of ethical issues that exist in organizations, it is impossible to list every conceivable ethical issue. Any type of manipulation or deceit, or even just the absence of transparency in decision making, can create harm to others. For example, collusion is a secret agreement between two or more parties for a fraudulent, illegal, or deceitful purpose. "Deceitful purpose" is the relevant phrase in regard to business ethics, as it suggests trickery, misrepresentation, or a strategy designed to lead others to believe something less than the whole truth.

TABLE 3.1 Specific Types of Observed Misconduct

Behavior	2009 (%)	2007 (%)
Company resource abuse	23	n/a
Abusive behavior	22	21
Lying to employees	19	20
E-mail or Internet abuse	18	18
Conflicts of interest	16	22
Discrimination	14	12
Lying to outside stakeholder	12	14
Employee benefit violations	11	n/a
Health or safety violations	11	15
Employee privacy breach	10	n/a
Improper hiring practices	10	10
Falsifying time or expenses	10	n/a

Source: From 2009 National Business Ethics Survey: An Inside View of Private Sector Ethics, Copyright © 2009, Ethics Resource Center (ERC). Used with permission of the ERC, 2345 Crystal DR. Ste 201, Arlington, VA 22202, www.ethics.org.

Honesty

Honesty refers to truthfulness or trustworthiness. To be honest is to tell the truth to the best of your knowledge without hiding anything. Confucius defined several levels of honesty. The shallowest is called *Li,* which relates to the superficial desires of a person. A key aspect of *Li* is a striving to convey feelings that outwardly are or appear to be honest, but that are ultimately driven by self-interest. The second level is *Yi,* or righteousness, where a person does what is right based on reciprocity. The deepest level of honesty is called *Ren,* and it is based on an understanding of and empathy toward others. The Confucian version of Kant's Golden Rule is to treat your inferiors as you would want your superiors to treat you. As a result, virtues such as familial honor and reputation for honesty become paramount.

Issues related to honesty also arise because business is sometimes regarded as a game governed by its own rules rather than those of society as a whole. Author Eric Beversluis suggests that honesty is a problem because people often reason along these lines:

1. Business relationships are a subset of human relationships that are governed by their own rules, which, in a market society, involve competition, profit maximization, and personal advancement within the organization.
2. Business can therefore be considered a game people play, comparable in certain respects to competitive sports such as basketball or boxing.
3. Ordinary rules and morality do not hold in games like basketball or boxing. (What if a basketball player did unto others as he would have them do unto him? What if a boxer decided it was wrong to try to injure another person?)
4. Logically, then, if business is a game like basketball or boxing, ordinary ethical rules do not apply.[4]

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This type of reasoning leads many people to conclude that anything is acceptable in business. Indeed, several books have compared business to warfare—for example, *The Guerrilla Marketing Handbook* and *Sun Tsu: The Art of War for Managers*. The common theme in these books is that surprise attacks, guerrilla warfare, and other warlike tactics are necessary to win the battle for consumer dollars. An example of this mentality at work can be seen in Larry Ellison, the CEO of Oracle. Ellison's warlike mentality is demonstrated by his decision to sell PeopleSoft's technology and let most of its 8,000 employees go. PeopleSoft CEO Craig Conway stated that "Ellison has followed a page straight out of Genghis Khan." Indeed, Ellison has frequently quoted the thirteenth-century Mongol warlord, saying things such as, "It's not enough that we win; everyone else must lose."[5] Ellison was ordered to donate $100 million to charity and pay another $22 million to the attorneys who sued him for alleged stock-trading abuses. Ellison argues that he acted in good faith and in the best interests of Oracle and Oracle's shareholders.[6]

This business-as-war mentality may foster the idea that honesty is unnecessary in business. In addition, an intensely competitive environment creates the potential for companies to engage in questionable conduct. For example, as competition in the market for beer intensified, MillerCoors and Anheuser-Busch increasingly created advertising and offered products that appealed to younger consumers, even though marketing to minors under the age of 21 is illegal.

Many argue, however, that business is not in fact a game like basketball or boxing; because people are not economically self-sufficient, they cannot withdraw from the game of business. Therefore, business ethics must not only make clear what rules apply in the game of business, but must also develop rules appropriate to the involuntary nature of participation in it.

Because of the economic motive, many in business are tempted to engage in the opposite of honesty—dishonesty. *Dishonesty* can be broadly defined as a lack of integrity, incomplete disclosure, and an unwillingness to tell the truth. Lying, cheating, and stealing are actions usually associated with dishonest conduct. The causes of dishonesty are complex and relate to both individual and organizational pressures. Many employees lie to help achieve performance objectives. For example, they may be asked to lie about when a customer will receive a purchase. Lying can be defined as (1) untruthful statements that result in damage or harm; (2) "white lies," which do not cause damage but instead function as excuses or a means of benefitting others; and (3) statements that are obviously meant to engage or entertain without malice. These definitions will become important in the remainder of this chapter.

> **"Dishonesty can be broadly defined as a lack of integrity, incomplete disclosure, and an unwillingness to tell the truth."**

Fairness

Fairness is the quality of being just, equitable, and impartial. Fairness clearly overlaps with concepts of justice, equity, equality, and morality. There are three fundamental elements that seem to motivate people to be fair: equality, reciprocity, and optimization. In business, **equality** is about how wealth or income is distributed between employees within a company, a country, or across the globe.

Reciprocity is an interchange of giving and receiving in social relationships. Reciprocity occurs when an action that has an effect upon another is reciprocated with an action that has an approximately equal effect. Reciprocity is the return of favors that are approximately

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equal in value. For example, reciprocity implies that workers be compensated with wages that are approximately equal to their effort. An ethical issue regarding reciprocity for business is the amount CEOs and other executives are paid in relation to their employees. Is a 263 to 1 pay ratio an example of ethical reciprocity? That is the wage differential between a CEO and an average worker in the United States.[7]

Optimization is the trade-off between equity (that is, equality or fairness) and efficiency (that is, maximum productivity). Discriminating on the basis of gender, race, or religion is generally considered to be unfair because these qualities have little bearing upon a person's ability to do a job. The optimal way to hire is to choose the employee who is the most talented, most proficient, most educated, and most able. Ideas of fairness are sometimes shaped by vested interests. One or both parties in the relationship may view an action as unfair or unethical because the outcome was less beneficial than expected.

Integrity

Integrity is one of the most important and oft-cited elements of virtue, and refers to being whole, sound, and in an unimpaired condition. In an organization, it means uncompromising adherence to ethical values. Integrity is connected to acting ethically; in other words, there are substantive or normative constraints on what it means to act with integrity. An organization's integrity usually rests on its enduring values and unwillingness to deviate from standards of behavior.

At a minimum, businesses are expected to follow all applicable laws and regulations. In addition, organizations should not knowingly harm customers, clients, employees, or even other competitors through deception, misrepresentation, or coercion. Although businesspeople often act in their own economic self-interest, ethical business relations should be grounded in honesty, integrity, fairness, justice, and trust. Buyers should be able to trust sellers; lenders should be able to trust borrowers. Failure to live up to these expectations or to abide by laws and standards destroys trust and makes it difficult, if not impossible, to continue business exchanges.[8] These virtues become the glue that holds business relationships together, making everything else more effective and efficient.

ETHICAL ISSUES AND DILEMMAS IN BUSINESS

As mentioned earlier, stakeholders define a business's ethical issues. An **ethical issue** is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several actions that must be evaluated as right or wrong, ethical or unethical. An **ethical dilemma** is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several wrong or unethical actions. There is not a right or ethical choice in a dilemma, only less unethical or illegal choices as perceived by any and all stakeholders.

A constructive next step toward identifying and resolving ethical issues is to classify the issues that are relevant to most business organizations. Table 3.2 reflects the most important ethical issues to shareholders. In this section, we classify ethical issues in relation to misuse of company resources, abusive or intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy issues.

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TABLE 3.2 Shareholder Issues

1.	Better interaction and positioning with shareholders
2.	Protest votes in director elections
3.	Long-term value creation
4.	Risk oversight and review risk management processes
5.	Expanding roles for women
6.	Cost reduction risks in response to the economic crisis and social responsibility
7.	Compensation, new disclosure rules, and public image
8.	Financial regulatory reform
9.	Compliance, risk, and governance processes
10.	Economic recovery and the U.S. fiscal outlook

Source: Rick Lash, "Leadership Trends for 2010," *Bloomberg Businessweek*, February 16, 2010, http://www.businessweek.com/managing/content/feb2010/ca20100211_634699_page_2.htm (accessed April 29, 2011); Gary Larkin, "Top 10 Issues Facing Directors in 2010," *The Conference Board*, January 8, 2010, http://tcbblogs.org/governance/2010/01/08/top-10-issues-facing-directors-in-2010/ (accessed April 29, 2011).

Misuse of Company Resources

Although different companies have different viewpoints and policies with regard to the use of company resources, the misuse of these resources has been identified by the Ethics Resource Center as the leading form of observed misconduct in organizations. Very often the enforcement of company policies in this area can be lax as employees find that their coworkers believe they are entitled to certain company resources. Misconduct can range from unauthorized use of equipment and computers to embezzling of company funds. In the retail arena, internal employee theft is a much larger problem than customer shoplifting. Time theft costs can be difficult to measure but are estimated to cost companies hundreds of billions of dollars annually. It is widely believed that the average employee "steals" 4.25 hours per week with late arrivals, leaving early, long lunch breaks, inappropriate sick days, excessive socializing, and engaging in personal activities such as online shopping and watching sports while on the job.[9] All of these activities add up to lost productivity and profits for the employer.

Using company computers for personal business is one of the most common ways employees misuse company resources. While it may not be acceptable for employees to sit in the lobby chatting with relatives or their stock brokers, these same employees can go online and do the same thing, possibly unnoticed by others. Typical examples of using a computer to abuse company time include sending personal emails, shopping, downloading music, doing personal banking, surfing the Internet for information about sports or romance, or visiting social networking sites such as Facebook. It has been found that March Madness, the NCAA basketball tournament, is one of the most significant periods during which employees engage in time theft. Many firms block websites where employees can watch sports events.

Because misuse of company resources is such a widespread problem, many companies, such as Boeing, have implemented official policies delineating the acceptable use of company resources. Boeing's policy states that the use of company resources is acceptable when it does not result in "significant added costs, disruption of business processes, or any other disadvantage to the company."[10] This policy further states that the use of company resources for noncompany purposes is only acceptable when an employee receives explicit permission to

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do so. This kind of policy is in line with that of many companies, particularly larger firms that can easily lose millions of dollars and thousands of hours of productivity to these activities.

Abusive or Intimidating Behavior

Abusive or **intimidating behavior** is the most common ethical problem for employees, but what does it mean to be abusive or intimidating? These terms can refer to many things—physical threats, false accusations, being annoying, profanity, insults, yelling, harshness, ignoring someone, and unreasonableness—and their meaning can differ from person to person. It is important to understand that within each term there is a continuum. For example, behavior that one person might define as yelling could be another's definition of normal speech. The lack of civility in our society has been a concern, and it is as common in the workplace as elsewhere. The productivity level of many organizations has been damaged by time spent unraveling problematic relationships.

Is it abusive behavior to ask an employee to complete a project rather than be with a family member or relative in a crisis situation? What does it mean to speak profanely? Is profanity only related to specific words or terms that are, in fact, common in today's business world? If you are using words that seem acceptable to you but that others consider profanity, have you just insulted, abused, or disrespected them?

Within the concept of abusive behavior or intimidation, intent should be a consideration. If the employee was trying to convey a compliment, then he or she probably simply made a mistake. What if a male manager asks his female subordinate if she has a date for tonight because she is dressed so nicely? When does the way a word is said (voice inflection) become important? There is also the problem of word meanings by age and within cultures. Is it okay to say "honey" to an employee, fellow employee, employee friend, and/or your superior, and does it depend on gender or location? For example, if you were to call a friend that worked with you "honey" in southern Illinois, Arkansas, or Kentucky, do you have the same acceptability factor as you would in northern Illinois, Michigan, or Minnesota? Does abusive behavior vary by gender? It is possible that the term *honey* could be acceptable speech in some environments, and be construed as being abusive or intimidating in other situations. The fact that we live in a multicultural environment and do business and work with many different cultural groups and nationalities adds to the depth of the ethical and legal issues that may arise.

Bullying is associated with a hostile workplace where someone (or a group) considered a target is threatened, harassed, belittled, verbally abused, or overly criticized. Bullying may create what is referred to as a "hostile environment," but the concept of a hostile environment is generally associated instead with sexual harassment. Regardless, bullying can cause psychological damage that may result in health-endangering consequences to the target. For example, workplace bullying is strongly associated with sleep disturbances. The more frequent the bullying, the higher the risk of sleep disturbance. Other physical symptoms include depression, fatigue, increased sick days, and stomach problems.[11] As Table 3.3 indicates, bullies can use a mix of verbal, nonverbal, and manipulative threatening expressions to damage workplace productivity. Bullying happens more than people realize. One in three American workers has been the victim of bullying, and 20 percent of bullying is technically harassment, which is illegal. Additionally, corporate bullies often target employees who excel at their jobs and are popular with their coworkers.[12]

> "Bullying can cause psychological damage that may result in health-endangering consequences to the target."

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TABLE 3.3 Actions Associated with Bullies

1. Spreading rumors to damage others
2. Blocking others' communication in the workplace
3. Flaunting status or authority to take advantage of others
4. Discrediting others' ideas and opinions
5. Use of e-mails to demean others
6. Failing to communicate or return communication
7. Insults, yelling, and shouting
8. Using terminology to discriminate by gender, race, or age
9. Using eye or body language to hurt others or their reputations
10. Taking credit for others' work or ideas

Source: Cathi McMahan, "Are You a Bully?" *Inside Seven,* California Department of Transportation Newsletter, June 1999, 6.

The concept of bullying in the workplace is now considered a legal issue. Some suggest that employers take the following steps to minimize workplace bullying:

- They should have policies in place that make it clear that bullying behaviors will not be tolerated.
- The employee handbook should emphasize that workers must treat each other with respect.
- Employers should encourage employees who feel bullied to report the conduct, and handle complaints much as discriminatory harassment complaints are handled.[13]

Employees should ask the following questions to determine whether or not bullying is occurring at their workplace:

- Is your boss asking obviously impossible things from you without training, and stating that the completed work is never good enough?
- Are surprise meetings called without your knowledge?
- Have others at work told you to stop working, talking, or socializing with them?
- Are you never left alone to do your job without interference?
- Do people feel justified screaming or yelling at you in front of others, and are you punished if you scream back?
- Do human resource officials tell you that your harassment isn't illegal, and that you have to work it out between yourselves?
- Do many people in your organization verify that your torment is real, but do nothing about it?[14]

Bullying can also occur between companies that are in intense competition. Even respected companies such as Intel have been accused of monopolistic bullying. One of Intel's competitors, Advanced Micro Devices (AMD), claimed in a lawsuit that Intel used financial incentives and threats in order to stop AMD from gaining market share. AMD alleged that Intel was preventing the company from being competitive through practices

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such as paying computer makers rebates for using Intel chips and selling chips below cost. Intel reached an agreement with AMD to pay $1.25 billion to end all legal disputes, antitrust litigation, and patent license suits.[15] However, Intel's actions landed it in trouble in the European Union, where courts found the company guilty of antitrust violations and anticompetitive behavior regarding AMD. Intel was fined a record $1.45 billion, a penalty it continues to fight in court.[16] In many cases, the alleged misconduct can have not only monetary and legal implications but can also threaten reputation, investor confidence, and customer loyalty.

Lying

Earlier in this chapter, we discussed the definitions of **lying** and how lying relates to distorting the truth. We mentioned three types of lies, one of which is joking without malice. The other two can become very troublesome for businesses: lying by commission and lying by omission. *Commission lying* is creating a perception or belief by words that intentionally deceive the receiver of the message; for example, lying about being at work, expense reports, or carrying out work assignments. Commission lying also entails intentionally creating "noise" within the communication that knowingly confuses or deceives the receiver. *Noise* can be defined as technical explanations that the communicator knows the receiver does not understand. It can be the intentional use of communication forms that make it difficult for the receiver to actually hear the true message. Using legal terms or terms relating to unfamiliar processes and systems to explain what was done in a work situation facilitate this type of lie.

Lying by commission can involve complex forms, procedures, contracts, words that are spelled the same but have different meanings, or refuting the truth with a false statement. Forms of commission lying include puffery in advertising. For example, saying that a product is "homemade" when it is made in a factory is lying. "Made from scratch" in cooking technically means that all ingredients within the product were distinct and separate and were not combined prior to the beginning of the production process. One can lie by commission by showing a picture of the product that does not reflect the actual product. This happens frequently in business. For example, many fast-food chains purchase iceberg lettuce for their products but use romaine lettuce in their advertising because they feel it is prettier or more appealing than shredded iceberg lettuce.

Omission lying is intentionally not informing others of any differences, problems, safety warnings, or negative issues relating to the product, service, or company that significantly affect awareness, intention, or behavior. A classic example of omission lying is the tobacco manufacturers' decades-long refusal to allow negative research about the effects of tobacco to appear on cigarettes and cigars. Another example is the behavior of FreeCreditReport.com, a company that promotes itself as a way for consumers to check their credit scores. Many customers do not realize that FreeCreditReport.com is a credit-monitoring service that costs $14.95 per month and that they will be charged if they do not cancel the service within 30 days. When lying damages others, it can be the focus of a lawsuit. For example, prosecutors and civil lawsuits often reduce misconduct to lying about a fact, such as financial performance, that has the potential to damage others. CEOs at AIG, Lehman Brothers, Fannie Mae, and Freddie Mac were scrutinized to see if they had told the truth about the financial conditions of their companies.

The point at which a lie becomes unethical in business is based on the context of the statement and its intent to distort the truth. A lie becomes illegal if it is determined by the courts to have damaged others. Some businesspeople may believe that one must lie a little or that the occasional lie is sanctioned by the organization. The question you need to ask is whether lies are distorting openness and transparency and other values that are associated with ethical behavior.

Conflicts of Interest

A **conflict of interest** exists when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group. The three major bond rating agencies—Moody's, Standard & Poor's, and Fitch Ratings—analyze financial deals and assign letters (such as AAA, B, CC) to represent the quality of bonds and other investments. Prior to the financial meltdown, these rating agencies had significant conflicts of interest. The agencies earned as much as three times more for grading complex products than for corporate bonds. They also competed with each other for rating jobs, which contributed to lower rating standards. Additionally, the companies who wanted the ratings were the ones paying the agencies. Because the rating agencies were highly competitive, investment firms and banks would "shop" the different agencies for the best rating. Conflicts of interest were inevitable.

> "To avoid conflicts of interest, employees must be able to separate their private interests from their business dealings."

To avoid conflicts of interest, employees must be able to separate their private interests from their business dealings. Organizations must also avoid potential conflicts of interest when providing products. The U.S. General Accounting Office has found conflicts of interest when the government has awarded bids on defense contracts. The conflicts of interest usually relate to hiring friends, relatives, or retired military officers to enhance the probability of getting a contract.[17]

Bribery

Bribery is the practice of offering something (usually money) in order to gain an illicit advantage. The key issue regarding whether or not something is considered bribery is whether the act is illicit or contrary to accepted morality or convention. Bribery is therefore defined as an unlawful act, but it can also be a business ethics issue because it can be defined differently in varying situations and cultural environments. For example, there is something called active corruption or **active bribery,** meaning that the person who promises or gives the bribe commits the offense. **Passive bribery** is an offense committed by the official who receives the bribe. It is not an offense, however, if the advantage was permitted or required by the written law or regulation of the foreign public official's country, including case law.

Small **facilitation payments** made to obtain or retain business or other improper advantages do not constitute bribery payments for U.S. companies in some situations. Such payments are often made to induce public officials to perform their functions, such as issuing licenses or permits. In the United Kingdom, these facilitation payments are illegal. In most developed countries, it is generally recognized that employees should not accept bribes, personal payments, gifts, or special favors from people who hope to influence the outcome of a decision. However, bribery is an accepted way of doing business in other countries, which creates challenging situations for global businesses. Bribes have been associated with the downfall of many managers, legislators, and government officials. The

World Bank estimates that more than $1 trillion is paid annually in bribes, adding more than 10 percent to the cost of doing business in certain countries.[18]

When a government official accepts a bribe, it is usually from a business that seeks some favor—perhaps a chance to influence legislation that affects it. Giving bribes to legislators or public officials, then, is a business ethics issue. Under the U.S. Foreign Corrupt Practices Act (FCPA), it is illegal for individuals, firms, or third parties doing business in American markets to "make payments to foreign government officials to assist in obtaining or retaining business."[19] Since 2007, companies have paid billions of dollars in fines to the Department of Justice for bribery violations. The law does not apply only to American firms, but to all firms transacting business within the United States. For instance, in 2010 Alcatel-Lucent, a French telecommunications company, paid $137 million to settle U.S. charges that it had bribed foreign government officials.[20]

Corporate Intelligence

Many issues related to corporate intelligence have surfaced in the last few years. Defined broadly, **corporate intelligence** is the collection and analysis of information on markets, technologies, customers, and competitors, as well as on socioeconomic and external political trends. There are three distinct types of intelligence models: a passive monitoring system for early warning, tactical field support, and support dedicated to top-management strategy.

Corporate intelligence (CI) involves an in-depth discovery of information from corporate records, court documents, regulatory filings, and press releases, as well as any other background information about a company or its executives. Corporate intelligence is a legitimate inquiry into meaningful information that can be used in staying competitive. Corporate intelligence, like other areas in business, can be abused if due diligence is not taken to maintain legal and ethical methods of discovery. Computers, LANs (local-area networks), and the Internet have made the theft of trade secrets very easy. Proprietary information like secret formulas, manufacturing schematics, merger or acquisition plans, and marketing strategies all have tremendous value.[21] Today, theft of trade secrets costs companies as much as $300 billion per year.[22] If discovered, corporate espionage can lead to heavy fines and prison sentences. For instance, former engineer Xiang Dong Yu was sentenced to 70 months in prison and fined $12,500 for allegedly stealing trade secrets from Ford Motor Co. The U.S. Attorney's office claimed that Yu had copied 4,000 documents containing confidential information before he left the company.[23] A lack of security and proper training allows one to use a variety of techniques to gain access to a company's vital information. Some techniques for accessing valuable corporate information include physically removing hard drives and copying the information they contain to other machines, hacking, dumpster diving, social engineering, bribery, and hiring away key employees.

Hacking is considered one of the top three methods for obtaining trade secrets. Currently, there are thousands of websites that offer free downloadable and customizable hacking tools that require no in-depth knowledge of protocols or Internet protocol addressing. Hacking has three categories: system, remote, and physical. **System hacking** assumes that the attacker already has access to a low-level, privileged-user account. **Remote hacking** involves attempting to remotely penetrate a system across the Internet. A remote hacker usually begins with no special privileges and tries to obtain higher level or administrative access. Several forms of this type of hacking include unexpected input, buffer overflows, default configurations, and poor system administrator practices. Remote hacking activity against businesses and financial institutions is increasing, with

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hackers even penetrating the computer network of the company that runs the Nasdaq Stock Market.[24] **Physical hacking** requires that the CI agent enter a facility personally. Once inside, he or she can find a vacant or unsecured workstation with an employee's login name and password. Next, the CI agent searches for memos or unused letterheads and inserts the documents into the corporate mail system. CI agents could also gain physical access to a server or telephone room, look for remote-access equipment, note any telephone numbers written on wall jacks, and place a protocol analyzer in a wiring closet to capture data, user names, and passwords.

Social engineering is another popular method of obtaining valuable corporate information. The basic goals are the same as hacking. **Social engineering** is the tricking of individuals into revealing their passwords or other valuable corporate information. Tactics include casual conversations with relatives of company executives and sending e-mails claiming to be a system administrator and asking for passwords under the guise of "important system administration work." Another common social engineering trick is **shoulder surfing,** in which someone simply looks over an employee's shoulder while he or she types in a password. **Password guessing** is another easy social engineering technique. If a person can find out personal things about someone, he or she might be able to use that information to guess a password. For example, a child's name, birthdays, anniversaries, and Social Security numbers are all common passwords and are easy to guess.

Dumpster diving is messy but very successful for acquiring trade secrets. Once trash is discarded onto a public street or alley, it is considered fair game. Trash can provide a rich source of information for any CI agent. Phone books can give a hacker names and numbers of people to target and impersonate. Organizational charts contain information about people who are in positions of authority within the organization. Memos provide small amounts of useful information and assist in the creation of authentic-looking fake memos.

Whacking is wireless hacking. To eavesdrop on wireless networks, all a CI agent needs is the right kind of radio and to be within range of a wireless transmission. Once tapped into a wireless network, an intruder can easily access anything on both the wired and wireless networks because the data sent over networks are usually unencrypted. If a company is not using wireless networking, an attacker can pose as a janitor and insert a rogue wireless access node into a supposedly secure hard-wired network.

Phone eavesdropping is yet another tool for CI agents. A person with a digital recording device can monitor and record a fax line. By playing the recording back an intruder can reproduce an exact copy of a message without anyone's knowledge. Even without monitoring a fax line, a fax sent to a "communal" fax machine can be read or copied. By picking up an extension or by tapping a telephone, it is possible to record the tones that represent someone's account number and password using a tape recorder. The tape recording can then be replayed over the telephone to gain access to someone else's account.

Discrimination

Although a person's racial and sexual prejudices belong to the domain of individual ethics, racial and sexual discrimination in the workplace create ethical issues within the business world. **Discrimination** on the basis of race, color, religion, sex, marital status, sexual orientation, public assistance status, disability, age, national origin, or veteran status is illegal in the United States. Additionally, discrimination on the basis of political opinions or affiliation with a union is defined as harassment. Discrimination remains a significant ethical issue in business despite decades of legislation attempting to outlaw it.

A company in the United States can be sued if it (1) refuses to hire an individual, (2) maintains a system of employment that unreasonably excludes an individual from employment, (3) discharges an individual, or (4) discriminates against an individual with respect to hiring, employment terms, promotion, or privileges of employment as they relate to the definition of discrimination. Between 75,000 and 100,000 charges of discrimination are filed annually with the **Equal Employment Opportunity Commission** (EEOC).[25]

Race, gender, and age discrimination are major sources of ethical and legal debate in the workplace. Once dominated by European American men, the U.S. workforce today includes significantly more women, African Americans, Hispanics, and other minorities, as well as disabled and older workers. These groups have traditionally faced discrimination and higher unemployment rates and been denied opportunities to assume leadership roles in corporate America. For example, there are only six African American chairs/CEOs of Fortune 500 companies.[26]

Another form of discrimination involves discriminating against individuals on the basis of age. The **Age Discrimination in Employment Act** specifically outlaws hiring practices that discriminate against people between the ages of 49 and 69, as well as those that require employees to retire before the age of 70. The act prohibits employers with 20 or more employees from making employment decisions, including decisions regarding the termination of employment, on the basis of age or as a result of policies requiring retirement after the age of 40. Despite this legislation, charges of age discrimination persist in the workplace. Age discrimination complaints filed with the EEOC have increased 17 percent since the start of the recession, and the number of unemployed older workers increased 330 percent between 2000 and 2010.[27] Given the fact that nearly one-third of the nation's workers will be 55 years old or over by 2016, many companies need to change their approach toward older workers.[28]

To help build workforces that reflect their customer base, many companies have initiated **affirmative action programs,** which involve efforts to recruit, hire, train, and promote qualified individuals from groups that have traditionally been discriminated against on the basis of race, gender, or other characteristics. Such initiatives may be imposed by federal law on an employer that contracts or subcontracts for business with the federal government, as part of a settlement agreement with a state or federal agency, or by court order.[29] For example, Safeway, a chain of supermarkets, established a program to expand opportunities for women in middle- and upper-level management after settling a sex-discrimination lawsuit.[30] However, many companies voluntarily implement affirmative action plans in order to build a more diverse workforce. Although many people believe that affirmative action requires the use of quotas to govern employment decisions, it is important to note that two decades of Supreme Court rulings have made it clear that affirmative action does not permit or require quotas, reverse discrimination, or favorable treatment of unqualified women or minorities. To ensure that affirmative action programs are fair, the Supreme Court has established standards to guide their implementation: (1) There must be a strong reason for developing an affirmative action program; (2) affirmative action programs must apply only to qualified candidates; and (3) affirmative action programs must be limited and temporary and therefore cannot include "rigid and inflexible quotas."[31]

Discrimination can also be an ethical issue in business when companies use race or other personal factors to discriminate against specific groups of customers. Many companies have been accused of using race to deny service or to charge higher prices to certain ethnic groups. For example, four airlines settled lawsuits alleging discrimination against passengers of perceived Arab, Middle Eastern, or Southeast Asian descent. United, American, Continental, and Delta all denied any violations but agreed to spend as much as $1.5 million to train staff on respecting civil rights.[32]

Sexual Harassment

Sexual harassment is a form of sex discrimination that violates Title VII of the Civil Rights Act of 1964. Title VII applies to employers with 15 or more employees, including state and local governments. **Sexual harassment** can be defined as any repeated, unwanted behavior of a sexual nature perpetrated upon one individual by another. It may be verbal, visual, written, or physical and can occur between people of different genders or those of the same gender. Displaying sexually explicit materials "may create a hostile work environment or constitute harassment, even though the private possession, reading, and consensual sharing of such materials is protected under the Constitution."[33] The EEOC receives between 11,000 and 14,000 charges of sexual harassment annually.[34]

Even the United Nations, an organization whose mission is to protect human rights globally, has dealt with a series of sexual harassment cases. Many U.N. employees who have made or faced accusations claim that the system is poorly equipped to handle complaints, resulting in unfair, slow, and arbitrary rulings. For example, one employee who claimed she was harassed for years in Gaza saw her superior cleared by one of his colleagues.[35]

To establish sexual harassment, an employee must understand the definition of a **hostile work environment,** for which three criteria must be met: the conduct was unwelcome; the conduct was severe, pervasive, and regarded by the claimant as so hostile or offensive as to alter his or her conditions of employment; and the conduct was such that a reasonable person would find it hostile or offensive. To assert a hostile work environment, an employee need not prove that it seriously affected his or her psychological well-being nor that it caused an injury; the decisive issue is whether the conduct interfered with the claimant's work performance.[36]

Sexual harassment includes unwanted sexual approaches (including touching, feeling, or groping) and/or repeated unpleasant, degrading, or sexist remarks directed toward an employee with the implied suggestion that the target's employment status, promotion, or favorable treatment depend on a positive response and/or cooperation. It can be regarded as a private nuisance, unfair labor practice, or, in some states, a civil wrong (tort) that may be the basis for a lawsuit against the individual who made the advances and against the employer who did not take steps to halt the harassment. The law is primarily concerned with the impact of the behavior and not its intent. An important facet of sexual harassment law is its focus on the victim's reasonable behaviors and expectations.[37] However, the definition of "reasonable" varies from state to state, as does the concept of expectations. In addition, an argument used by some in defense of what others term sexual harassment is the freedom of speech granted by the First Amendment.

> "An important facet of sexual harassment law is its focus on the victim's reasonable behaviors and expectations."

The key ethical issues associated with sexual harassment are dual relationships and unethically intimate relationships. A **dual relationship** is defined as a personal, loving, and/or sexual relationship with someone with whom you share professional responsibilities. **Unethical dual relationships** are those where the relationship could potentially cause a direct or indirect conflict of interest or a risk of impairment to professional judgment.[38] Another important factor in these cases is intent. If the sexual advances in any form are considered mutual, then consent is created. The problem is that unless the employee or employer gets something in writing before the romantic action begins, consent can always be questioned, and when it comes to sexual harassment, the alleged perpetrator must prove mutual consent.

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To avoid sexual misconduct or harassment charges a company should take at least the following steps:

1. *Establish a statement of policy* naming someone in the company as ultimately responsible for preventing harassment at the company.
2. *Establish a definition of sexual harassment* that includes unwelcome advances, requests for sexual favors, and any other verbal, visual, or physical conduct of a sexual nature; that provides examples of each; and that reminds employees that the list of examples is not all-inclusive.
3. *Establish a nonretaliation policy* that protects complainants and witnesses.
4. *Establish specific procedures for prevention* of such practices at early stages. However, if a company puts these procedures in writing, they are expected by law to train employees in accordance with them, measure their effects, and ensure that the policies are being enforced.
5. *Establish, enforce, and encourage* victims of sexual harassment to report the behavior to authorized individuals.
6. *Establish a reporting procedure.*
7. *Make sure that the company has timely reporting requirements to the proper authorities.* Usually, there is a time limitation (ranging from six months to a year) to file a complaint for a formal administrative sexual charge. However, the failure to meet a shorter complaint period (for example, 60 to 90 days) so that a rapid response and remediation may occur and to help to ensure a harassment-free environment could be a company's defense against charges that it was negligent.

Once these steps have been taken, a training program should identify and describe forms of sexual harassment and give examples, outline the grievance procedures, explain how to use the procedures and discuss the importance of them, discuss the penalty for violation, and train employees about the essential need for a workplace that is free from harassment, offensive conduct, or intimidation. A corporation's training program should cover such issues as how to spot sexual harassment; how to investigate complaints, including proper documentation; what to do about observed sexual harassment, even when no complaint has been filed; how to keep the work environment as professional and nonhostile as possible; how to teach employees about the professional and legal consequences of sexual harassment; and how to train management to understand follow-up procedures on incidents.

Environmental Issues

Environmental issues are becoming significant concerns within the business community. The environment involves our physical surroundings, including the natural world and its resources. As the Earth's population continues to grow, reaching more than 7 billion people, our use of natural resources to satisfy needs such as food, shelter, transportation, and especially energy for a mobile society presents increasingly urgent questions. Our interaction with plant and animal species—particularly wildlife habitats—has become an area of critical concern. Environmental concerns are creating ethical issues for individuals, organizations, and public policymakers. The desire for sustainable business means that social responsibility, ethics, and special initiatives must be used to implement effective changes.

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In Appendix A, we define sustainability from a strategic business perspective as the potential for the long-term well-being of the natural environment, including all biological entities, as well as for mutually beneficial interactions among nature and individuals, organizations, and business strategies.

Air pollution refers to gases and particulates in the air that can linger or be carried long distances by surface winds. Air pollution has three types of sources: stationary sources such as factories and power plants; mobile sources such as cars, trucks, planes, and trains; and natural sources such as windblown dust and volcanic eruptions. The **Kyoto Protocol**, one example of the world's growing concern about global warming, is an international treaty on climate change committed to reducing emissions of carbon dioxide and five other greenhouse gases and to engaging in emissions trading if member signatories maintain or increase emissions of these gases. The objective is to stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous climate changes. Most scientists believe that concentrations of greenhouse gases and other air pollutants are contributing to the gradual heating of the earth, a process known as global warming. Some current estimates indicate that, if these objectives are not successfully and completely implemented, the predicted global temperature increase could be between 1.4°C to 5.8°C. Possible massive tidal surges and extreme weather patterns are in store for our planet in the future if countries do not restrict specific gases emanating from business activities. The United States is one of the only countries not to sign the protocol.

Water pollution results from the dumping of raw sewage and toxic chemicals into rivers and oceans, from oil and gasoline spills, and from the burial of industrial wastes in the ground where they may filter into underground water supplies. Fertilizers and pesticides used in farming and grounds maintenance also drain into water supplies with each rainfall. When these chemicals reach the oceans, they encourage the growth of algae that use up all the nearby oxygen, thus killing the sea life. According to the Environmental Protection Agency (EPA), more than one-third of the nation's rivers, lakes, and coastal waters are not safe for swimming or fishing as a result of contaminated runoff. Pollutants come from a variety of sources, and many of them have unknown side effects on people and wildlife.

Buildings are rarely considered major pollution sources. Yet 33 percent of major U.S. energy consumption, 33 percent of major greenhouse gas emissions, and 30 percent of raw material use are the result of buildings.[39] Two competitive certification groups authorize schools, houses, and commercial buildings as "green." These two rival groups, Green Globes and Leadership in Energy and Environmental Design (LEED), are vying for leadership in government adoption of environmental rules that determine whether a building can be called green. There is concern about stakeholder relationships between the two groups. Green Globes is led by a former timber company executive and received much of its seed money from timber and wood products companies. LEED is a nonprofit organization with fewer ties to business interests. Already two states, Maryland and Arkansas, have adopted Green Globes as an alternative to LEED, giving officials an alternative for government-funded construction. The Clinton Presidential Library in Little Rock as well as 7 World Trade Center, the first tower rebuilt near Ground Zero in New York, were certified by Green Globes.[40]

Waste management, the disposal of waste in an environmentally responsible manner, appears to be growing globally. American consumers are the world's biggest producers of trash; they contribute an average of 222 million tons of waste annually, which strains limited landfill space.[41] One waste management technique is **recycling.** Recycling is the reprocessing of materials, especially steel, aluminum, paper, glass, rubber, and some plastics

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for reuse. Consumers currently consider recycling to be the most important thing they can do to live “greener” lives, as Figure 3.1 demonstrates. However, the recycling process itself uses large amounts of energy. An even bigger problem for the future is that, as the world becomes more capitalistic, more people will buy more things using plastics that are made from oil and that do not degrade easily. Businesses and consumers need to make drastic changes to cut back on energy consumption and waste.

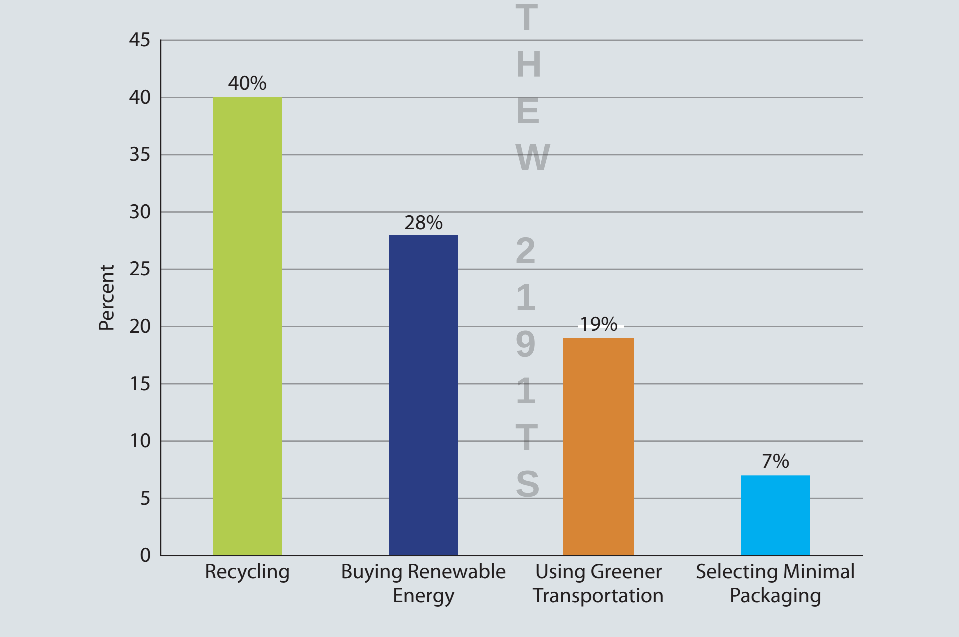
With concerns about pollution growing, many countries and businesses are moving toward sources of **alternative energy**. Although all energy sources require energy and give rise to some degree of pollution from manufacture of the technology, alternative energy sources are considered “green” because they are perceived to lower carbon emissions and create less pollution. Examples of alternative energies include wind power, solar power, geothermal power, hydropower, biofuels, and nuclear power.

Wind power, advocated by some high-profile individuals such as oil tycoon T. Boone Pickens, is gaining widespread support in the United States and has already taken off in several European countries. For instance, one-fifth of Denmark’s electricity needs are supplied by wind farms.[42] Because the United States is home to the Great Plains—one of the greatest sources of wind energy in the world—experts believe that wind energy could meet as much as 20 percent of the nation’s energy needs.

Solar power, another popular alternative energy source, uses light and heat from the sun to generate electricity. Some California Walmarts already use solar energy to power their stores, and the Obama administration pledged to add solar panels to the roof of the White House to set an example for the rest of the country.[43]

Geothermal power comes from the natural heat inside the Earth, which is extracted by drilling into steam beads. One bonus of geothermal energy is that it can provide a constant

FIGURE 3.1 Consumers’ Favorite Green Practices



Source: “Environmentally Friendly Choices,” *USA Today Snapshots*, March 3, 2009, from Green Seal and Enviromedia Social Marketing survey of 1,000 adults by Opinion Research Corp.

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supply of energy every day. Some IKEA stores have started to use geothermal power to meet their energy needs.

Hydropower uses moving water or steam as a source of power. Although water is a renewable resource, hydropower disrupts aquatic life through the creation of dams. The Three Gorges Dam in China has resulted in reducing greenhouse gases for the country, although there are other environmental issues associated with the dam.[44]

Biofuels are fuels derived from organic materials like corn, sugarcane, vegetable oil, algae, and even trash. Although biofuels have been successful in places like Brazil, they remain controversial in the United States. While Brazil uses biofuels made largely from sugarcane, American biofuels are produced from corn. Some people believe that corn-based ethanol is raising the prices and diminishing the quantity of a critical food supply.

Nuclear power is a controversial form of alternative energy. Some organizations have specifically classified nuclear power as green energy because it is pollution free and because uranium is an abundant resource. However, environmental organizations claim that nuclear energy is inefficient, does not cut CO_2 emissions, and creates harmful nuclear waste. The 2011 nuclear crisis in Japan increased stakeholder concerns about the safety of nuclear power. However, nuclear energy is France's main source of power and has reduced the country's nitrogen oxide and other emissions by 70 percent.[45]

Many firms use environmentally friendly practices to demonstrate their commitment to social responsibility. Many companies make contributions to environmental protection organizations, sponsor cleanup events, promote recycling, redesign manufacturing processes to reduce waste and pollution, use more alternative energy sources, and generally reevaluate the effects of their products on the natural environment. Some companies are even becoming involved politically. For example, Exxon Mobil's CEO, Rex Tillerson, encouraged the U.S. Congress to enact a tax on greenhouse gas emissions in order to fight global warming.[46] Companies that do not recognize the potential impact of green programs on future profits and corporate reputation may pay later.

Fraud

When an individual engages in deceptive practices to advance his or her own interests over those of his or her organization or some other group, he or she is committing fraud. In general, **fraud** is any purposeful communication that deceives, manipulates, or conceals facts in order to create a false impression. Fraud is a crime and convictions may result in fines, imprisonment, or both. Global fraud costs organizations more than $2.9 trillion a year; the average company loses about 5 percent of annual revenues to fraud and abuses committed by its own employees.[47] Table 3.4 indicates what senior executives view as the biggest risks to companies. In recent years, accounting fraud has become a major ethical issue, but as we will see, fraud can also relate to marketing and consumer issues as well.

Accounting fraud usually involves a corporation's financial reports, in which companies provide important information on which investors and others base decisions that may involve millions of dollars. If the documents contain inaccurate information, whether intentionally or not, then lawsuits and criminal penalties may result. Dell agreed to pay $100 million to settle Securities and Exchange Commission charges concerning alleged accounting fraud. The company said that their growing profit margins were due to reduced costs, but records showed that Dell executives had discussed "cooking the books" to hit the company's financial goals. The SEC stated that if Dell had honestly reported to investors, almost every quarterly statement would have shown a loss.[48]

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TABLE 3.4 Fraud and Misconduct Risk

Misappropriation of assets (e.g. theft of cash, inventory, or intellectual property)	35%
Other illegal or unethical acts (e.g. bribery, corruption, market rigging, or conflicts of interest)	31%
Fraudulent financial reporting (e.g. intentional misstatement of revenue, assets, or liabilities)	14%
All three are an equal threat	20%

Source: "The 2007 Oversight Systems Report on Corporate Fraud," Ethics World, http://www.ethicsworld.org/ethicsandemployees/PDF%20links/Oversight_2007_Fraud_Survey.pdf (accessed March 12, 2009).

The field of accounting has changed dramatically over the last decade. The profession used to have a club-type mentality, and those who became certified public accountants (CPAs) were not concerned about competition. Now CPAs advertise their skills and short-term results in an environment in which competition has increased and overall billable hours have significantly decreased because of technological innovations. Additionally, accountants are permitted to charge performance-based fees rather than hourly rates, a rule change that encouraged some large accounting firms to promote tax-avoidance strategies for high-income individuals because the firms can charge 10 to 40 percent of the amount of taxes saved.[49]

Pressures on accountants today include time, reduced fees, client requests to alter opinions concerning financial conditions or lower tax payments, and increased competition. Other issues that accountants face daily involve compliance with complex rules and regulations, data overload, contingent fees, and commissions. An accountant's life is filled with rules and data that have to be interpreted correctly, and because of such pressures and the ethical predicaments they spawn, problems within the accounting industry are on the rise.

As a result, accountants must abide by a strict code of ethics that defines their responsibilities to their clients and to the public interest. The code also discusses the concepts of integrity, objectivity, independence, and due care. Despite the standards that the code provides, the accounting industry has been the source of numerous fraud investigations in recent years. Congress passed the Sarbanes–Oxley Act in 2002 to address many of the issues that could create conflicts of interest for accounting firms auditing public corporations. The law generally prohibits accounting firms from providing both auditing and consulting services to the same firm. Additionally, the law specifies that corporate boards of directors must include outside directors with financial knowledge on the company's audit committee.

Marketing fraud—the process of dishonestly creating, distributing, promoting, and pricing products—is another business area that generates potential ethical issues. False or misleading marketing communications can destroy customers' trust in a company. Lying, a major ethical issue involving communication, is a potentially significant problem. In both external and internal communications, it causes ethical predicaments because it destroys trust. The SEC charged three former executives at IndyMac Bancorp with fraud for misleading investors. The executives were accused of hiding information about IndyMac's financial condition during the recession. The executives did not receive any financial benefit because of their actions, but did not disclose important information to their investors in the hope of returning the failing bank to profitability.[50] Misleading marketing can also cost consumers hard-earned money.

False or deceptive advertising is a key issue in marketing communications. One set of laws common to many countries concerns deceptive advertising—that is, advertisements

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that are not clearly labeled as advertisements. In the United States, Section 5 of the Federal Trade Commission (FTC) Act addresses deceptive advertising. Abuses in advertising can range from exaggerated claims and concealed facts to outright lying, although improper categorization of advertising claims is the critical point. Courts place false or misleading advertisements into three categories: puffery, implied falsity, and literal falsity.

Puffery can be defined as exaggerated advertising, blustering, and boasting upon which no reasonable buyer would rely and is not actionable under the Lanham Act. For example, in a lawsuit between two shaving products companies, the defendant advertised that the moisturizing strip on its shaving razor was "six times smoother" than its competitors' strips, while showing a man rubbing his hand down his face. The court rejected the defendant's argument that "six times smoother" implied that only the moisturizing strip on the razor's head was smoother. Instead, the court found that the "six times smoother" advertising claim implied that the consumer would receive a smoother shave from the defendant's razor as a whole, a claim that was false.[51]

Implied falsity means that the message has a tendency to mislead, confuse, or deceive the public. Advertising claims that use implied falsity are those that are literally true but imply another message that is false. In most cases, accusations of implied falsity can be proved only through time-consuming and expensive consumer surveys, the results of which are often inconclusive. An example of implied falsity might be a company's claim that its product has twice as much of an ingredient in its product, implying that it works twice as well, when in reality the extra quantity of the ingredient has no effect over performance. The characterization of an advertising claim as **literally false** can be divided into two subcategories: *tests prove* (*establishment claims*), in which the advertisement cites a study or test that establishes the claim; and *bald assertions* (*nonestablishment claims*), in which the advertisement makes a claim that cannot be substantiated, as when a commercial states that a certain product is superior to any other on the market. Another form of advertising abuse involves making ambiguous statements in which the words are so weak or general that the viewer, reader, or listener must infer the advertiser's intended message. These "weasel words" are inherently vague and enable the advertiser to deny any intent to deceive. The verb *help* is a good example (as in expressions such as "helps prevent," "helps fight," "helps make you feel").[52] Consumers may view such advertisements as unethical because they fail to communicate all the information needed to make a good purchasing decision or because they deceive the consumer outright.

Labeling issues are even murkier. For example, the Federal Drug Administration (FDA) now regulates tobacco and has banned all flavored cigarettes. Several weeks after the new cigarette rules went into effect, a California importer started selling Djarum-brand clove "kreteks" from Indonesia. Kreteks are the shape and size of cigarettes and have cigarette filters. However, importers argue the product is a "cigar" because the wrapper is a homogenized leaf, the tobacco is air-cured, and the finished product comes in boxes of 12, not 20. If kreteks are defined as cigars, they become legal, but if the FDA calls them cigarettes, then they are illegal.[53]

Advertising and direct sales communication can also mislead consumers by concealing the facts within the message. For instance, a salesperson anxious to sell a medical insurance policy might list a large number of illnesses covered by the policy but fail to mention that it does not include some commonly covered illnesses. Indeed, the fastest-growing area of fraudulent activity is in direct marketing, which uses the telephone and impersonal media to communicate information to customers, who then purchase products via mail, telephone, or the Internet.

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Consumer Fraud

Consumer fraud occurs when consumers attempt to deceive businesses for their own gain. Shoplifting, for example, accounts for 35 percent of the losses at the largest U.S. retail chains, although this figure is still far outweighed by the nearly 43 percent of losses perpetrated by store employees, according to the National Retail Security Survey. Together with vendor fraud and administrative error, retail shrinkage costs U.S. retailers $35.5 billion annually (1.44 percent of total sales).[54]

Consumers engage in many other forms of fraud against businesses, including price tag switching, item switching, lying to obtain age-related and other discounts, and taking advantage of generous return policies by returning used items, especially clothing that has been worn (with the price tags still attached). Such behavior by consumers affects retail stores as well as other consumers who, for example, may unwittingly purchase new clothing that has actually been worn.

Consumer fraud involves intentional deception to derive an unfair economic advantage by an individual or group over an organization. Examples of fraudulent activities include shoplifting, collusion or duplicity, and guile. *Collusion* typically involves an employee who assists the consumer in fraud. For example, a cashier may not ring up all merchandise or may give an unwarranted discount. *Duplicity* may involve a consumer staging an accident in a grocery store and then seeking damages against the store for its lack of attention to safety. A consumer may purchase, wear, and then return an item of clothing for a full refund. In other situations, a consumer may ask for a refund by claiming a defect. *Guile* is associated with a person who is crafty or understands right/wrong behavior but uses tricks to obtain an unfair advantage. The advantage is unfair because the person has the intent to go against the right behavior or result. Although some of these acts warrant legal prosecution, they can be very difficult to prove, and many companies are reluctant to accuse patrons of a crime when there is no way to verify wrongdoing. Businesses that operate with the philosophy that "the customer is always right" have found that some consumers will take advantage of this promise and have therefore modified return policies to curb unfair use.

> "Consumer fraud involves intentional deception to derive an unfair economic advantage by an individual or group over an organization."

Financial Misconduct

The failure to understand and manage ethical risks played a significant role in the financial crisis. The difference between bad business decisions and business misconduct can be hard to determine, and there is a thin line between the ethics of using only financial incentives to gauge performance and the use of holistic measures that include ethics, transparency, and responsibility to stakeholders. From CEOs to traders and brokers, all-too-tempting lucrative financial incentives existed for performance in the financial industry.

The global recession was caused in part by a failure on the part of the financial industry to take appropriate responsibility for its decision to utilize risky and complex financial instruments. Loopholes in regulations and the failures of regulators were exploited. Corporate cultures were built on rewards for taking risks rather than rewards for creating value for stakeholders. Ethical decisions were based more on what was legal rather than what was the right thing to do. Unfortunately, most stakeholders, including the public, regulators, and the mass media, do not always understand the nature of the financial risks taken on by banks and other institutions to generate profits. The intangible nature of financial products makes it difficult to understand complex financial transactions. Problems in the subprime mortgage markets sounded the alarm for the most recent recession.

Ethics issues emerged early in subprime lending, with loan officers receiving commissions on securing loans from borrowers with no consequences if the borrower defaulted on the loan. "Liar loans" were soon developed to create more sales and higher personal compensation for lenders. Lenders would encourage subprime borrowers to provide false information on their loan applications in order to qualify for and secure the loans. Some appraisers provided inflated home values in order to increase loan amounts. In other instances consumers were asked to falsify their incomes to make the loans more attractive to the lending institutions. The opportunity for misconduct was widespread. Top managers and even CEOs were complacent about the wrongdoing as long as profits were good. Congress and President Clinton encouraged Fannie Mae and Freddie Mac to support home ownership among low-income people by giving out home mortgages. Throughout the early 2000s, in an economy with rapidly increasing home values, the culture of unethical behavior was not apparent to most people. When home values started to decline and individuals were "upside down" on their loans (owing more than the equity of the home), the failures and unethical behavior of lending and borrowing institutions became more obvious.

The top executives or CEOs are ultimately responsible for the repercussions of their employees' decisions. Top executives at Merrill Lynch awarded $3.6 billion in bonuses shortly before the company's merger with Bank of America in 2008.[55] A combined $121 million went to four top executives, in spite of the fact that Merrill Lynch had to be rescued from bankruptcy by the government. Two ethics issues are at play in this situation. First, paying out the bonuses at all; and second, rushing their distribution in order to complete the job before Bank of America's takeover. Risk management in the financial industry is a key concern, including paying bonuses to executives who failed in their duties. Unfortunately, at the same time that the industry was focused on its own bottom line, regulatory agencies and Congress were not proactive in investigating early cases of financial misconduct and the systemic issues that led to the crisis. The legal and regulatory systems were more focused on individual misconduct rather than systemic ethical failures.

"The top executives or CEOs are ultimately responsible for the repercussions of their employees' decisions."

This widespread financial misconduct has led to a call for financial reform. The U.S. Treasury Secretary, Timothy Geithner, is trying to change how the government goes about overseeing risk-taking in financial markets. He is pushing for stricter rules on financial management and controls on hedge funds and money market mutual funds. He believes that the United States needs greater openness and transparency, greater oversight and enforcement, and clearer, more commonsense language in its financial system.[56] The Dodd–Frank Wall Street Reform and Consumer Protection Act was passed in 2010 to increase accountability and transparency in the financial industry and to protect consumers from deceptive financial practices. The act established a new Consumer Financial Protection Bureau (CFPB) to protect consumers from unsafe financial products. The CFPB was provided with supervisory power over the credit market. Its responsibility includes making financial products and services easier to understand, curtailing unfair lending and credit card practices, and ensuring the safety of financial products before their launch into the market. The Dodd–Frank Wall Street Reform and Consumer Protection Act also gives federal regulators more power over large companies and financial institutions to prevent them from engaging in risky practices, or becoming "too big to fail." The act also holds CEOs responsible for the behavior of their companies. Large financial firms must retain at least

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half of top executives' bonuses for at least three years. The goal is to tie compensation to the outcomes of the executives' decisions over time.[57] We will discuss the Dodd–Frank Act and the Consumer Financial Protection Bureau in detail in Chapter 4.

Insider Trading

An insider is any officer, director, or owner of 10 percent or more of a class of a company's securities. There are two types of **insider trading:** illegal and legal. *Illegal insider trading* is the buying or selling of stocks by insiders who possess information that is not yet public. This act, which puts insiders in breach of their fiduciary duty, can be committed by anyone who has access to nonpublic material, such as brokers, family, friends, and employees. In addition, someone caught "tipping" an outsider with nonpublic information can also be found liable. To determine if an insider gave a tip illegally the SEC uses the *Dirks test,* which states that if a tipster breaches his or her trust with the company and understands that this was a breach, he or she is liable for insider trading.

Legal insider trading involves legally buying and selling stock in an insider's own company, but not all the time. Insiders are required to report their insider transactions within two business days of the date the transaction occurred. For example, if an insider sold 10,000 shares on Monday, June 12, he or she would have to report the sale to the SEC by Wednesday, June 14. To deter insider trading, insiders are prevented from buying and selling their company stock within a six-month period, thereby encouraging insiders to buy stock only when they feel the company will perform well over the long term.

Insider trading is often done in a secretive manner by an individual who seeks to take advantage of an opportunity to make quick gains in the market. An interview with inside trader Kenneth T. Robinson reveals why individuals may engage in insider trading. Robinson acted as a middleman by taking tips about corporate mergers from a friend and then passing them on to another friend, who bought stock on behalf of all three men. Robinson did this for many years without being caught until he traded in his own name and helped federal authorities connect the dots. Robinson believed that his personal trade would not cause trouble because it was not in the millions of dollars. In other words, he felt that he would never be discovered. He now faces charges of securities fraud and conspiracy. Surveys have revealed that people who get involved in this type of activity often feel superior to others and are blind to the possibility of being discovered or facing consequences.[58]

Intellectual Property Rights

Intellectual property rights involve the legal protection of intellectual property such as music, books, and movies. Laws such as the Copyright Act of 1976, the Digital Millennium Copyright Act, and the Digital Theft Deterrence and Copyright Damages Improvement Act of 1999 were designed to protect the creators of intellectual property. However, with the advance of technology, ethical issues still abound for websites. For example, until it was sued for copyright infringement and subsequently changed its business model, Napster.com allowed individuals to download copyrighted music for personal use without providing compensation to the artists.

A decision by the Federal Copyright Office (FCO) helped lay the groundwork for intellectual property rules in a digital world. The FCO decided to make it illegal for web users to hack through barriers that copyright holders erect around material released online, allowing only two exceptions. The first exception was for software that blocks users from finding obscene or controversial material on the web, and the second was for people who want to bypass malfunctioning security features of software or other copyrighted goods

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they have purchased. This decision reflects the fact that copyright owners are typically being favored in digital copyright issues.[59]

However, digital copyrights continue to be a controversial issue in the United States and across the world, and existing laws are often difficult to enforce. Almost a quarter of all Internet traffic involves copyrighted material, including illegally downloaded or uploaded music, movies, and television shows.[60] As China has grown into an economic powerhouse, the market for pirated goods of all types, from DVDs to pharmaceuticals and even cars, has become a multibillion dollar industry.[61] China's government has thus far proven weak in protecting intellectual property, and the underground market for such pirated goods—which are sold all over the world—has grown at a rapid pace. While intellectual property rights infringement always poses a threat to companies that risk losing profits and reputation, it can also threaten the health and well-being of consumers. For example, illegally produced medications, when consumed by unknowing consumers, can cause sickness and even death. Research on software piracy has shown that high levels of economic well-being and an advanced technology sector are effective deterrents to software piracy.[62] Perhaps as China's economy moves forward piracy will become less of a problem, but for now it poses a major threat.

Privacy Issues

Consumer advocates continue to warn consumers about new threats to their privacy, especially within the health care and Internet industries. As the number of people using the Internet increases, the areas of concern related to its use increase as well. Some **privacy issues** that must be addressed by businesses include the monitoring of employees' use of available technology and consumer privacy. Current research suggests that even when businesses use price discounts or personalized services, consumers remain suspicious. However, certain consumers are still willing to provide personal information despite the potential risks.[63]

A challenge for companies today is meeting their business needs while protecting employees' desire for privacy. There are few legal protections of an employee's right to privacy, which allows businesses a great deal of flexibility in establishing policies regarding employee privacy while using company equipment on company property. From computer monitoring and telephone taping to video surveillance and GPS satellite tracking, employers are using technology to manage their productivity and protect their resources.

Electronic monitoring allows a company to determine whether productivity is being reduced because employees are spending too much time on personal activities. Having this information can enable the company to take steps to remedy the situation. Many employers have policies that govern personal phone and Internet use on company time. Additionally, some companies track everything from phone calls and Internet history to keystrokes and the time employees spend at their desks.[64] One study has found that 42 percent of full-time employees with a company-assigned e-mail account "frequently use" it for personal communications, while another 29 percent "sometimes" do. Another survey found that 89 percent of workers say they have sent e-mail from work to an outside party that contained jokes, gossip, rumors, or disparaging remarks, while 14 percent had sent messages that contained confidential or proprietary information, and 9 percent of respondents admitted to sending sexual, romantic, or pornographic text or images.[65] Instituting practices that show respect for employee privacy but do not abdicate the employer's responsibility helps create a climate of trust that promotes opportunities for resolving employee–employer disputes without lawsuits.

There are two dimensions to consumer privacy: consumer awareness of information collection and a growing lack of consumer control over how companies use the personal information that they collect. For example, many are not aware that Google, Inc., reserves the right to track every time you click on a link from one of its searches.[66] Online purchases and even random web surfing can be tracked without a consumer's knowledge. A survey by the Progress and Freedom Foundation found that 96 percent of popular commercial websites collect personally identifying information from visitors.[67]

Personal information about consumers is valuable not only to businesses but also to criminals. More than 11 million Americans have been victims of identity theft. Personal information is stolen and sold online. Although some of this information comes from sources such as social networking profiles, poorly protected corporate files are another major source. U.S. organizations report hundreds of security breaches annually.[68]

Companies are working to find ways to improve consumers' trust in their websites. For example, an increasing number of websites display an online seal from the Better Business Bureau, available only to sites that subscribe to certain standards. A similar seal is available through TRUSTe, a nonprofit global initiative that certifies those websites that adhere to its principles. (Visit http://e-businessethics.com for more on Internet privacy.)

DEBATE ISSUE TAKE A STAND

Is Google Violating Users' Privacy?

With two billion Google searches a day, Google is the preferred search engine for many consumers. Much of its popularity is due to the superior services it offers. Although Google does not charge for its services, critics point out that Google's services may actually be costing users their right to privacy. Google keeps all of its users' search queries forever, although after 18 months these queries become "anonymized." In other words, they cannot be traced back to the user. Google maintains that it uses these searches responsibly to refine its search engine. It also has privacy disclosures fully visible on its main page. On the other hand, the Third Party Doctrine and the Patriot Act allow the government access to users' Internet information without a judge's oversight for national security purposes. Google has been subpoenaed in the past by investigators for user information. Even anonymized data have been used to track a specific person or computer.[69]

1. Google's storage of user data is legitimate and does not constitute a violation of user privacy.
2. Google should not store users' data as this data can be misused or accessed by the government.

THE CHALLENGE OF DETERMINING AN ETHICAL ISSUE IN BUSINESS

Most ethical issues that concern a business will become visible through stakeholder concerns about an event, activity, or the results of a business decision. The mass media, special interest groups, and individuals, through the use of blogs, podcasts, and other individual-generated media, often generate discussion about the ethical nature of a decision. Another way to determine whether a specific behavior or situation has an ethical component is to ask other individuals in the business how they feel about it and whether they view it as ethically challenging. Trade associations and business self-regulatory groups such as the Better Business Bureau often provide direction for companies in defining ethical issues. Finally, it is important to determine whether the organization has adopted specific policies on the activity. An activity approved of by most members of an organization, if it is also customary in the industry, is probably ethical. An issue, activity, or situation that can withstand open discussion between many stakeholders, both inside and outside the organization, probably does not pose ethical problems.

However, over time, problems can become ethical issues as a result of changing societal values. For instance, products manufactured by Kraft Foods, Inc., such as Kraft

Macaroni and Cheese, Chips Ahoy! cookies, Lunchables, Kool-Aid, Fruity Pebbles, and Oreos, have been staples in almost every home in the United States for decades without becoming subjects of public debate; but when parents, schools, and politicians became more aware that the United States has the most overweight people in the world, things changed.[70] Additionally, since 1980 the rate of obesity in children and adolescents has more than tripled.[71] As a result, Congress proposed legislation focused on the advertising of unhealthy food products to children. Kraft realized that it had encountered an ethical situation regarding the advertising of many of its foods. Some consumer groups might perceive Kraft's $90 million annual advertising budget, which was primarily directed at children, as unethical. Because ignoring the situation could be potentially disastrous, Kraft decided to stop advertising some of its products to children and instead market healthier foods.

Once stakeholders trigger ethical issue awareness and individuals openly discuss it and ask for guidance and the opinions of others, one enters the ethical decision-making process, which we examine in Chapter 5.

SUMMARY

Stakeholders' concerns largely determine whether business actions and decisions are perceived as ethical or unethical. When government, communities, and society become involved, what was merely an ethical issue can quickly become a legal one. Shareholders can unwittingly complicate the ethical conduct of business by demanding that managers make decisions to boost short-term earnings, thus maintaining or increasing the value of their stock.

A first step toward understanding business ethics is to develop ethical issue awareness; that is, to learn to identify which stakeholder issues contain an ethical component. Characteristics of the job, the corporate or local culture, and the society in which one does business can all create ethical issues. Recognizing an ethical issue is essential to understanding business ethics and therefore to creating an effective ethics and compliance program that will minimize unethical behavior. Businesspeople must understand the universal moral constants of honesty, fairness, and integrity. Without embracing these concepts, running a business becomes very difficult.

Fairness is the quality of being just, equitable, and impartial, and it overlaps with concepts of *justice, equity, equality,* and *morality.* The three fundamental elements that motivate people to be fair are equality, reciprocity, and optimization. Equality relates to how wealth is distributed between employees, within a company or a country or globally; reciprocity relates to the return of favors that are approximately equal in value; and integrity relates to a person's character and is made up of two basic parts, a formal relation that one has to oneself and a person's set of terminal, or enduring, values from which he or she does not deviate.

An ethical issue is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several actions that must be evaluated as right or wrong, ethical or unethical. By contrast, an ethical dilemma has no right or ethical solution.

Abusive or intimidating behavior can include physical threats, false accusations, being annoying, profanity, insults, yelling, harshness, ignoring someone, and unreasonableness. Bribery is the practice of offering something (usually money) in order to gain an illicit advantage. A conflict of interest occurs when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group. Corporate intelligence is the collection and analysis of information on markets, technologies, customers, and competitors, as well as on socioeconomic and external political trends. There are three intelligence models: passive, tactical, and top-management. The tools of corporate intelligence are many. One tool is hacking, which can be accomplished through systemic, remote, and physical means; another is social engineering, in which someone is tricked into revealing valuable corporate information. Other techniques include dumpster diving, whacking, and phone eavesdropping.

Another ethical/legal issue is discrimination, which is illegal in the United States when it occurs on the basis of race, color, religion, sex, marital status, sexual orientation, public-assistance status, disability, age, national origin, or veteran status. Additionally, discrimination on the basis of political opinions or affiliation with a union is defined as harassment. Sexual harassment is a form of sex discrimination. To help build workforces that reflect their customer base, many companies have initiated affirmative action programs. Environmental issues such as air, water, and waste are becoming ethical concerns within business. In general, fraud is any purposeful communication that deceives, manipulates, or conceals facts in order to create a false impression. There are several types of fraud: accounting, marketing, and consumer.

An insider is any officer, director, or owner of 10 percent or more of a class of a company's securities. There are two types of insider trading: legal and illegal. Intellectual property rights involve the legal protection of intellectual property such as music, books, and movies. Consumer advocates continue to warn consumers about new threats to their privacy.

IMPORTANT TERMS FOR REVIEW

- honesty
- fairness
- equality
- reciprocity
- optimization
- integrity
- ethical issue
- ethical dilemma
- abusive or intimidating behavior
- lying
- conflict of interest
- bribery
- active bribery
- passive bribery
- facilitation payment
- corporate intelligence
- hacking
- system hacking
- remote hacking
- physical hacking
- social engineering
- shoulder surfing
- password guessing
- dumpster diving
- whacking
- phone eavesdropping
- discrimination
- Equal Employment Opportunity Commission
- Age Discrimination in Employment Act
- affirmative action program
- sexual harassment
- hostile work environment
- dual relationship
- unethical dual relationship
- environmental issues
- air pollution
- Kyoto Protocol
- water pollution
- recycling
- alternative energy
- fraud
- accounting fraud
- marketing fraud
- puffery
- implied falsity
- literally false
- labeling issue
- consumer fraud
- insider trading
- intellectual property rights
- privacy issue

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RESOLVING ETHICAL BUSINESS CHALLENGES*

Joseph Freberg had been with Alcon for 18 months. He had begun his career right out of college with a firm in the Southeast called Cala Industrial, which specialized in air compressors. Because of the quality of his work with Cala he had been lured away to Alcon, located in Omaha, Nebraska, as a sales manager. Joseph's first six months were hard. Working with older salespeople, trying to get a handle on his people's sales territories, and settling into the corporate culture of a new firm took 16-hour days, six days a week. During those six months, he also bought a house, and his fiancée, Ellen, furnished it, deciding almost everything from the color of the rugs to the style of the curtains.

Ellen had taken a brokerage job with Trout Brothers and seemed to be working even more hours than Joseph. But the long days were paying off. Ellen was now starting to handle some large accounts and was being noticed by the "right" crowd in the wealthier areas of Omaha.

Expenditures for the new home had exceeded Joseph and Ellen's anticipated budget, and the plans for their wedding seemed to be getting more and more elaborate. In addition, Ellen was commuting from her apartment to the new home and then to her job, and the commute killed her car. As a result, she decided to lease something that exuded success.

"Ellen, don't you think a Mercedes is a little out of our range? What are the payments?" inquired Joseph.

"Don't worry, darling. When my clients see me in this—and when we start entertaining at the new house once we're married—the payments on the car will seem small compared with all the money I'll be making," Ellen reassured him as she ran her fingers through his hair and gave him a peck on the cheek.

By the time of their wedding and honeymoon, Joseph and Ellen's bank statement looked like a bullfighter's cape—red. "Don't worry, Joseph, everything will turn out okay. You've got a good job. I've got a good job. We're young and have drive. Things will straighten out after a while," said Ellen as she eyed a Rolex in a store window.

After the wedding, things did settle down—to a hectic pace, given their two careers and their two sets of parents 1,000 miles away in either direction. Joseph realized that Alcon was a paternal type of organization, with good benefits and tremendous growth potential. He identified whom to befriend and whom to stay away from in the company. His salespeople seemed to tolerate him, sometimes calling him "Little Joe" or "Joey" because of his age, and they were producing—slowly climbing up the sales ladder to the number-one spot in the company.

While doing some regular checkup work on the sales personnel, Joseph found out that Carl had been giving kickbacks to some of his buyers. Carl's sales volume accounted for a substantial amount of the company's existing clientele sales, and he had been a trainer for the company for several years. Carl also happened to be the vice president's son-in-law. Joseph started to check on the other reps more closely and discovered that, although Carl seemed to be the biggest offender, three of his 10 people were doing the same thing. The next day, Joseph looked into Alcon's policy handbook and found this statement: "Our company stands for doing the right thing at all times and giving our customers the best product for the best prices." There was no specific mention of kickbacks, but everyone knew that kickbacks ultimately reduce fair competition, which eventually leads to reduced quality and increased prices for customers.

Talking to a few of the old-timers at Alcon, Joseph learned that there had been only sporadic enforcement of the "no kickback" policy. It seemed that when times were good it became unacceptable and when times were bad it slipped into the acceptable range. And then there was his boss, Kathryn, the vice president. Joseph knew that Kathryn had a tendency to shoot the bearer of bad news. He remembered a story that he had heard about a sales manager coming in to see Kathryn to explain an error in a bid that one of his salespeople had made. Kathryn called in the entire sales staff and fired the salesperson on the spot. Then, smiling, she told the sales manager: "This was your second mistake, so I hope that you can get a good recommendation from personnel. You have two weeks to find employment elsewhere." From then on, the office staff had a nickname for Kathryn—"Jaws."

In an attempt to solve the problem he was facing, Joseph broached the subject of kickbacks at his monthly meeting with Carl. Carl responded, "You've been in this business long enough to know that this happens all the time. I see nothing wrong with this practice if it increases sales. Besides, I take the money out of my commission. You know that right now I'm trying to pay off some big medical bills. I've also gotten tacit clearance from above, but I wouldn't mention that if I were you." Joseph knew that the chain-of-command structure in the company made it very dangerous to go directly to a vice president with this type of information.

As Joseph was pondering whether to do nothing, to bring the matter into the open and state that it was wrong and that such practices were against policy, or to talk to Kathryn about the situation, his cell phone rang. It was Ellen. "Honey, guess what just happened. Kathryn, your boss, has decided to use me as her new broker. Isn't that fantastic?"

What should Joseph do?

QUESTIONS | EXERCISES

1. What are Joseph's ethical problems?
2. Imagine that you are Joseph. Discuss your options.
3. As Joseph, what other information do you feel you need before making your decision?
4. Discuss in which business areas the ethical problems lie.

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

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Business can be considered a game people play, like basketball or boxing.	**Yes**	**No**
2. Key ethical issues in an organization relate to fraud, discrimination, honesty and fairness, conflicts of interest, and technology.	**Yes**	**No**
3. Only 10 percent of employees observe abusive behavior in the workplace.	**Yes**	**No**
4. Fraud occurs when a false impression exists, which conceals facts.	**Yes**	**No**
5. Putting one's own interests ahead of the organization's is the most commonly observed type of misconduct.	**Yes**	**No**

ANSWERS **1. No.** People are not economically self-sufficient and cannot withdraw from the game of business. **2. Yes.** See pages 00–00 regarding these key ethical issues and their implications for the organization. **3. No.** According to Table 3.1, 21 percent of employees observe abusive behavior in the workplace. **4. No.** Fraud must be purposeful rather than accidental, and exists when deception and manipulation of facts are concealed to create a false impression that causes harm. **5. Yes.** The most observed form of misconduct in Table 3.1 is putting one's own interests ahead of the company.

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CHAPTER 4

THE INSTITUTIONALIZATION OF BUSINESS ETHICS

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CLEMENT, MATHEW 2191TS

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CHAPTER OBJECTIVES

- To distinguish between the voluntary and mandated boundaries of ethical conduct
- To provide specific mandated requirements for legal compliance in specific subject matter areas related to competition, consumers, safety, and the environment
- To specifically address the requirements of the Sarbanes–Oxley legislation and implementation by the Securities and Exchange Commission
- To describe the passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act along with some of its major provisions
- To provide an overview of regulatory efforts that provide incentives for ethical behavior
- To provide an overview of the recommendations and incentives for developing an ethical corporate culture contained in the Federal Sentencing Guidelines for Organizations
- To provide an overview of highly appropriate core practices and their relationship to social responsibility

CHAPTER OUTLINE

Managing Ethical Risk through Mandated and Voluntary Programs

Mandated Requirements for Legal Compliance

Laws Regulating Competition
Laws Protecting Consumers
Laws Promoting Equity and Safety
Laws Protecting the Environment

Gatekeepers and Stakeholders

Accountants
Risk Assessment

The Sarbanes–Oxley Act

Public Company Accounting Oversight Board
Auditor and Analyst Independence
Whistle-Blower Protection
Cost of Compliance

Dodd–Frank Wall Street Reform and Consumer Protection Act

New Financial Agencies
Consumer Financial Protection Bureau
Whistle-Blower Protection

Laws That Encourage Ethical Conduct

Federal Sentencing Guidelines for Organizations

Highly Appropriate Core Practices

Voluntary Responsibilities
Cause-Related Marketing
Strategic Philanthropy
The Importance of Institutionalization in Business Ethics

AN ETHICAL DILEMMA*

Myron had just graduated from West Coast University with both chemistry-pharmacy and business degrees and was excited to work for Producto International (PI). He loved having the opportunity to discover medicinal products around the world. His wife, Quan, was also enthusiastic

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about her job as an import-export agent for a subsidiary of PI.

Producto International was the industry leader, with headquarters in Paris. Worldwide, hundreds of small firms were competing with PI; however, only six had equivalent magnitude. These six had cornered 75 percent of world sales. So many interrelationships had developed that competition had become "managed." However, this did not constitute any illegal form of monopolistic behavior as defined by the European Union.

Myron's first assignment was in India and involved the export of betel nuts to South and perhaps North America. It is estimated that more than 20 million people chew betel nuts in India alone. The betel nut tree is one of the world's most popular plants, and its leaf is used as a paper for rolling tobacco. The betel nut is also mashed or powdered with other ingredients and rolled up in a leaf and sold as candy. Myron quickly found that regular use of the betel nut stains the mouth, gums, and teeth a deep red, which in Asia is desirable.

As Myron was learning more about the betel nut, he came across the following report from the People's Republic of China: "Studies show that the chewing of the spiced betel nut can lead to oral cancer. According to research, 88 percent of China's oral cancer patients are betel nut chewers. Also, people who chew betel nuts and smoke are 90 times more likely to develop oral cancer than nonusers." Myron found that the betel nut primarily affects the central nervous system. It increases respiration while decreasing the workload on the heart (a mild high). Myron also found that demand for it was starting to emerge in the United States as well as in other developed countries.

While Myron was working on the betel nut, David, Myron's boss, also wanted him to work on introducing khat (pronounced "cot") into Asia. Khat is a natural stimulant from a plant grown in East Africa and southern Arabia. Fresh khat leaves, which typically are chewed like tobacco, produce a mild cocaine- or amphetamine-like euphoria. However, the effect is much less intense than that produced by either of those substances, with no reports of a rush sensation or paranoia, for example. Chewing khat produces a strong aroma and generates intense thirst. Casual users claim that khat lifts spirits, sharpens thinking, and, when its effects wear off, generates mild lapses into depression similar to those observed among cocaine users. The body appears to have a physical intolerance to khat due in part to limitations in how much can be ingested by chewing. As a result, reports suggest that there are no physical symptoms accompanying withdrawal. Advocates of khat use claim that it eases symptoms of diabetes, asthma, and disorders of the stomach and the intestinal tract. Opponents claim that khat damages health, suppresses appetite, and prevents sleep. In the United States, khat has been classified as a schedule IV substance by the Drug Enforcement Agency (DEA); freshly picked khat leaves (that is, picked within 48 hours of harvest) are classified as a schedule I narcotic, the most restrictive category used by the DEA.

After doing his research, Myron delivered his report to David and said, "I really think that, given the right marketing to some of the big pharmaceutical companies, we should have two huge revenue makers."

"That's great, Myron, but the pharmaceutical market is only secondary to our primary market—the two billion consumers to whom we can introduce these products."

"What do you mean, David?" Myron asked.

"I mean that these products are grown legally around the world, and the countries we are targeting have no restrictions on these substances," David explained. "Why not tailor the delivery of the product by country? For example, we find out which flavors people want the betel nut in, in North and South America or the Middle East. The packaging and branding will have to change by country. Pricing strategies will need to be developed relative to our branding decisions, and of course quantity usages will have to be calculated. For example, single, multiple, and super-value sizes need to be explored. The same can be done for khat. Because of your research and your business background, I'm putting you on the marketing team for both. Of course, this means that you're going to have to be promoted and at least for a while live in Hong Kong. I know Quan will be excited. In fact, I told her this morning that she would be working on the same project in Hong Kong. Producto International tries to be sensitive to the dual-career family problems that can occur. Plus you'll be closer to relatives. I told Quan that with living allowances and all of the other things that go with international placement, you two should almost triple your salaries! You don't have to thank me, Myron. You've worked hard on these projects, and now you deserve to have some of the benefits."

Myron went back to his office to think about his and Quan's future. He had heard of another employee who had rejected a similar offer, and that person's career had languished at PI. Eventually, that individual left the industry, never to be heard from again.

QUESTIONS | EXERCISES

1. Identify the social responsibility issues in this scenario.
2. Discuss the advantages and disadvantages of each decision that Myron could make.
3. Discuss the issue of marketing products that are legal but have addictive properties.

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

To understand the institutionalization of business ethics, it is important to understand the voluntary and legally mandated dimensions of organizational practices. In addition, there are core practices sometimes called best practices that most responsible firms—those trying to achieve acceptable conduct—embrace and implement. The effective organizational practice of business ethics requires that all three dimensions (legal, voluntary, and core practices) be integrated into an ethics and compliance program. This integration creates an ethical culture that can effectively manage the risks of misconduct. Institutionalization relates to legal and societal forces that provide both rewards and punishment to organizations based on stakeholder evaluations of specific conduct. Institutionalization in business ethics relates to established laws, customs, and expected organizational programs that are considered normative in establishing reputation. This means that deviations from expected conduct are often considered ethical issues and therefore of concern to stakeholders. Institutions provide requirements, structure, and societal expectations that reward and sanction ethical decision making. For example, institutions such as federal regulatory agencies establish rules for appropriate conduct and even suggest core practices for ethical cultures.

In this chapter, we examine the boundaries of ethical conduct and focus on voluntary and core practices and mandated requirements for legal compliance—three important areas in developing an ethical culture. In particular, we concentrate on compliance in specific areas related to competition, consumers, safety, and the environment. We consider the requirements of the Sarbanes–Oxley legislation, its implementation by the Securities and Exchange Commission (SEC), and how its implementation has affected companies. We also examine the Dodd–Frank legislation and its rules affecting the finance industry. We provide an overview of the Federal Sentencing Guidelines for Organizations (FSGO), along with recommendations and incentives for developing an ethical corporate culture. The FSGO, the Sarbanes–Oxley Act and Dodd–Frank legislation, and industry trade associations, as well as societal expectations, support core practices. Finally, we examine voluntary responsibilities and look at how cause-related marketing and strategic philanthropy can be an important core competency in managing stakeholder relationships.

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MANAGING ETHICAL RISK THROUGH MANDATED AND VOLUNTARY PROGRAMS

Table 4.1 provides an overview of the three dimensions of institutionalization. **Voluntary practices** include the beliefs, values, and voluntary contractual obligations of a business. All businesses engage in some level of commitment to voluntary activities to benefit both internal and external stakeholders. Google, Inc., works hard to give its employees a positive work environment through its benefits package. In addition to being a famously great place to work, Google offices offer such amenities as swimming pools, gyms, volleyball courts, ping-pong tables, and dance classes. The company even allows employees to bring their dogs to work.[1] Most firms engage in **philanthropy**—giving back to communities and causes. There is strong evidence to suggest that both the law and a sense of ethics increase voluntary corporate social responsibility practices. In addition, research has demonstrated that when both ethical and legal responsibilities are respected through core practices, economic performance benefits.[2]

Core practices are documented best practices, often encouraged by legal and regulatory forces as well as industry trade associations. The **Better Business Bureau** is a leading self-regulatory body that provides directions for managing customer disputes and reviews advertising cases. Core practices are appropriate and common practices that help ensure compliance with legal requirements and societal expectations. Although these practices are not enforced, there are consequences for not engaging in them when misconduct occurs. For example, the Federal Sentencing Guidelines for Organizations (FSGO) suggest that the governing authority (board of directors) be responsible for and assess an organization's ethical and compliance activities. No reporting or investigation is required by government regulatory bodies, but there are incentives for the firms that effectively implement this recommendation. For example, if misconduct occurs, firms may have opportunities to avoid serious punishment. On the other hand, if the board has made no effort to oversee ethics and compliance, its failure could increase and compound the level of punishment the company will suffer. In this way, in institutionalizing core practices the government provides organizations with the opportunity to structure their own approaches and only takes action if violations occur. **Mandated boundaries** are externally imposed boundaries of conduct, such as laws, rules, regulations, and other requirements. Antitrust and consumer protection laws create boundaries that must be respected by companies.

Organizations need to maintain an ethical culture and manage stakeholder expectations for appropriate conduct. They achieve these ends through corporate governance, compliance, risk management, and voluntary activities. The development of these drivers of an ethical culture has been institutionally supported by government initiatives and the

TABLE 4.1 Voluntary Boundary, Core Practices, and Mandated Boundaries of Ethical Decisions

Voluntary boundary	A management-initiated boundary of conduct (beliefs, values, voluntary policies, and voluntary contractual obligations)
Core practice	A highly appropriate and common practice that helps ensure compliance with legal requirements, industry self-regulation, and societal expectations
Mandated boundary	An externally imposed boundary of conduct (laws, rules, regulations, and other requirements)

Source: Adapted from the "Open Compliance Ethics Group (OCEG) Foundation Guidelines," v1.0, Steering Committee Update, December 2005, Phoenix, AZ.

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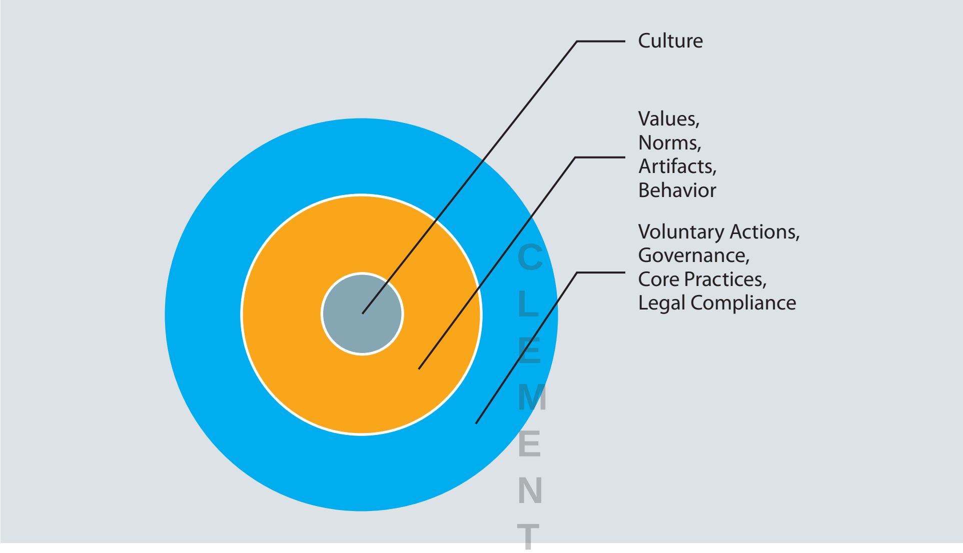
FIGURE 4.1 **Elements of an Ethical Culture**


Culture
Values, Norms, Artifacts, Behavior
Voluntary Actions, Governance, Core Practices, Legal Compliance

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demands of stakeholders. The compliance element represents areas that must conform to existing legal and regulatory requirements. Established laws and regulatory decisions leave limited flexibility to organizations in adhering to these standards. Corporate governance (as discussed in Chapter 2) is structured by a governing authority that provides oversight as well as checks and balances to make sure that the organization meets its goals and objectives for ethical performance. Risk management analyzes the probability or chance that misconduct could occur based on the nature of the business and its exposure to risky events. Voluntary activities often represent the values and responsibilities that firms accept in contributing to stakeholder needs and expectations.

Figure 4.1 depicts the key elements of an organizational culture. These elements include values, norms, artifacts, and behavior. An ethical culture creates an environment in which to structure behavior that is then evaluated by stakeholders. Values are broad and are viewed as long-term enduring beliefs about issues such as integrity, trust, openness, diversity, and individual respect and responsibility. Norms dictate and clarify desirable behaviors through principles, rules, policies, and procedures. For example, norms could provide guiding principles for anti-bribery issues, sustainability, and conflicts of interest. Artifacts are visible, tangible external symbols of values and norms. Websites, codes of ethics, rituals, language, and physical settings are artifacts. These three elements have different impacts on behaviors. Organizational decisions on such issues as governance, codes of ethics, ethics training, and legal compliance are shaped by the ethical culture.

MANDATED REQUIREMENTS FOR LEGAL COMPLIANCE

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Laws regulating business conduct are passed because some stakeholders believe that business cannot be trusted to do

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what is right in certain areas, such as consumer safety and environmental protection. Because public policy is dynamic and often changes in response to business abuses and consumer demands for safety and equality, many laws have been passed to resolve specific problems and issues. But the opinions of society, as expressed in legislation, can change over time, and different courts and state legislatures may take diverging views. For example, the thrust of most business legislation can be summed up as follows: Any practice is permitted that does not substantially lessen or reduce competition or harm consumers or society. Courts differ, however, in their interpretations of what constitutes a "substantial" reduction of competition. Laws can help businesspeople determine what society believes at a certain time, but what is legally wrong today may be perceived as acceptable tomorrow, and vice versa.

Instructions to employees to "just obey the law" are meaningless without experience and effective training in dealing with specific legal risk areas. One area that illustrates the complexity of the law is patents. Large technology companies have begun to aggressively defend their patents in order to maintain their strategic advantages. Lawsuits among direct competitors in hardware and software have shifted to the mobile industry as technology companies fight to come out on top. For example, Nokia accused Apple, Inc., of violating 10 of its patents with the Apple iPhone. Patent issues have become so important that some firms, such as IBM and Qualcomm, have created their own patent licensing businesses.[3]

Laws are categorized as either civil or criminal. **Civil law** defines the rights and duties of individuals and organizations (including businesses). **Criminal law** not only prohibits specific actions—such as fraud, theft, or securities trading violations—but also imposes fines or imprisonment as punishment for breaking the law. The primary difference between criminal and civil law is that the state or nation enforces criminal laws, whereas individuals (generally, in court) enforce civil laws. Criminal and civil laws are derived from four sources: the U.S. Constitution (constitutional law), precedents established by judges (common law), federal and state laws or statutes (statutory law), and federal and state administrative agencies (administrative law). Federal administrative agencies established by Congress control and influence business by enforcing laws and regulations to encourage competition and to protect consumers, workers, and the environment. The Consumer Financial Protection Agency was established after the latest financial crisis, which resulted in many consumers losing their homes. State laws and regulatory agencies also exist to achieve these objectives.

The primary method of resolving conflicts and serious business ethics disputes is through lawsuits in which one individual or organization uses civil laws to take another individual or organization to court. However, businesses often want to avoid lawsuits if possible because of the high costs involved. One example is when Starbucks accused Kraft of breaching the terms of an agreement to sell Starbucks products outside Starbucks cafes. Kraft claimed that the agreement never expired, but Starbucks claimed that Kraft had failed to market its packaged coffee products properly. The firms tried to work out the issues without a costly lawsuit.[4] To avoid lawsuits and maintain the standards necessary to reduce risk and create an ethical culture, both legal and organizational standards must be enforced. When violations of organizational standards occur, the National Business Ethics Survey (NBES) notes that many employees do not feel that their company has a strong ethics program. On the other hand, when managers make it an issue to discuss ethics with their employees, misconduct appears to decline. Figure 4.2 demonstrates how talking about ethics at the highest levels of an organization correlates with a reduction in observed ethical misconduct. It is therefore important for a company to have a functioning ethics program in place long before an ethical disaster strikes.

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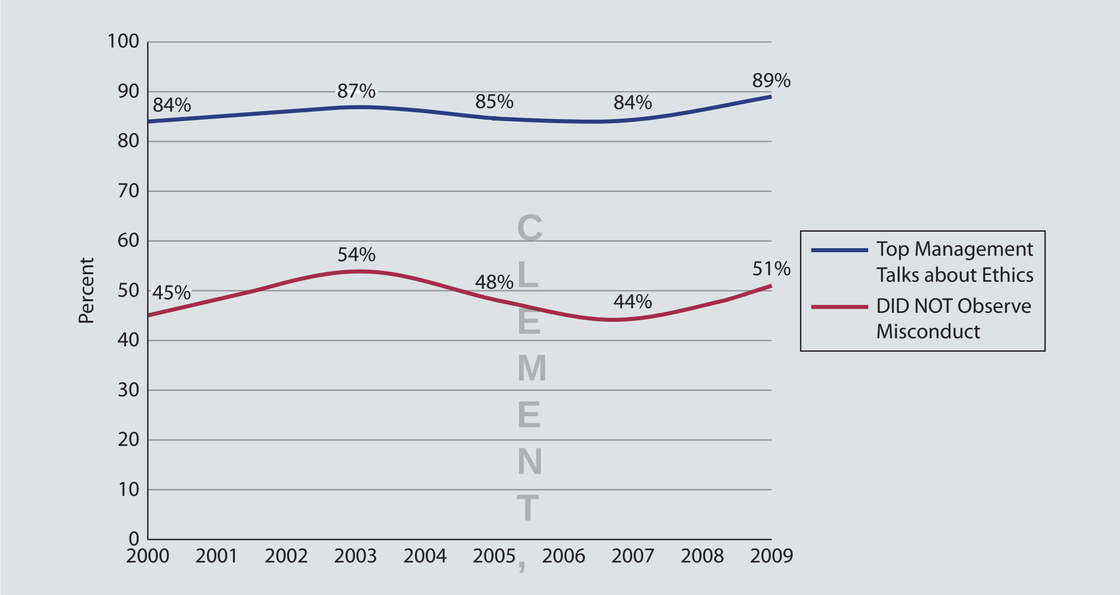
FIGURE 4.2 Percentage of U.S. Workforce Perceiving Top Management Talks about Ethics and NOT Observing Misconduct (NBES Survey 2000–2009)



Source: 2009 National Business Ethics Survey, p. 40.

The role of laws is not so much to distinguish what is ethical or unethical as to determine the appropriateness of specific activities or situations. In other words, laws establish the basic ground rules for responsible business activities. Most of the laws and regulations that govern business activities fall into one of five groups: (1) regulation of competition, (2) protection of consumers, (3) promotion of equity and safety, (4) protection of the natural environment, and (5) incentives to encourage organizational compliance programs to deter misconduct, which we will examine later.

Laws Regulating Competition

The issues surrounding the impact of competition on business's social responsibility arise from the rivalry among businesses for customers and profits. When businesses compete unfairly, legal and social responsibility issues can result. Intense competition sometimes makes managers feel that their company's very survival is threatened. In these situations, managers may begin to see unacceptable alternatives as acceptable, and they may begin engaging in questionable practices to ensure the survival of their organizations. Both Intel and Microsoft have been hit with fines amounting to billions of dollars for alleged antitrust activity in Europe. The European Union is famous for being tough on companies suspected of antitrust activities. For instance, Google came under investigation for allegedly manipulating search engine results so that its paid services were placed higher than those of rivals—a possible violation of the European Union's antitrust laws.[5] Being aware of antitrust laws is important for all large corporations around the world.

Size frequently gives some companies an advantage over others. Large firms can often generate economies of scale (for example, by forcing their suppliers to lower their prices) that allow them to put smaller firms out of business. Consequently, small companies and

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even whole communities may resist the efforts of firms like Walmart, Home Depot, and Best Buy to open stores in their vicinity. These firms' sheer size enables them to operate at such low costs that small, local firms often cannot compete. Some companies' competitive strategies may focus on weakening or destroying a competitor, which can harm competition and ultimately reduce consumer choice. Many countries have laws that restrict such anticompetitive behavior. For instance, China's economic planning agency is attempting to move closer toward international laws by creating new rules against price collusion, which occurs when businesses get together and inflate prices above what they would be if each business priced its products independently.[6] Other examples of anticompetitive strategies include sustained price cuts, discriminatory pricing, and bribery. While the U.S. Justice Department aggressively enforces the Foreign Corrupt Practices Act prohibiting bribery of foreign government officials, the U.K. has even more sweeping antibribery laws. These laws apply to all companies doing business in Britain and prohibit bribes to foreign officials and private businesspeople. Other nations, including China, are taking a tougher stance on bribery and are prosecuting companies caught in the act.[7]

The primary objective of U.S. antitrust laws is to distinguish competitive strategies that enhance consumer welfare from those that reduce it. The difficulty of this task lies in determining whether the intent of a company's pricing policy is to weaken or even destroy a competitor.[8] President Obama has taken a strong position on antitrust violations and reversed the previous administration's policy, which made it more difficult for the government to pursue antitrust violations. The former administration brought a historically low number of antitrust cases to trial.[9] President Obama attempted to follow Europe's model for antitrust cases, which marks a return to a historic norm after eight years of noninterventionism.[10]

Intense competition may also lead companies to resort to corporate espionage. Corporate espionage is the act of illegally taking information from a corporation through computer hacking, theft, intimidation, sorting through trash, and impersonation of organizational members. Estimates show corporate espionage may cost companies nearly $50 billion annually. Unauthorized information collected includes that regarding patents in development, intellectual property, pricing strategies, customer information, unique manufacturing and technological operations, marketing plans, research and development, and future plans for market and customer expansion.[11] Big Lots filed a lawsuit against the research firm Retail Intelligence Group for allegedly inducing store managers to reveal valuable trade secrets. The two companies eventually settled the lawsuit, with Retail Intelligence Group promising that it would no longer contact employees working for Big Lots.[12] Determining an accurate amount for corporate espionage losses is difficult because most companies do not report such losses for fear that the publicity will harm their stock price or encourage further break-ins. Espionage may be carried out by outsiders or by employees—executives, programmers, network or computer auditors, engineers, or janitors who have legitimate reasons to access facilities, data, computers, or networks. They may use a variety of techniques for obtaining valuable information, such as dumpster diving, whacking, and hacking, as discussed in Chapter 3.

Laws have been passed to prevent the establishment of monopolies, inequitable pricing practices, and other practices that reduce or restrict competition among businesses. These laws are sometimes called **procompetitive legislation** because they were enacted to encourage competition and prevent activities that restrain trade (Table 4.2). The Sherman Antitrust Act of 1890, for example, prohibits organizations from holding monopolies in their industry, and the Robinson–Patman Act of 1936 bans price discrimination between retailers and wholesalers.

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TABLE 4.2 Laws Regulating Competition

Sherman Antitrust Act, 1890	Prohibits monopolies
Clayton Act, 1914	Prohibits price discrimination, exclusive dealing, and other efforts to restrict competition
Federal Trade Commission Act, 1914	Created the Federal Trade Commission (FTC) to help enforce antitrust laws
Robinson–Patman Act, 1936	Bans price discrimination between retailers and wholesalers
Wheeler–Lea Act, 1938	Prohibits unfair and deceptive acts regardless of whether competition is injured
Lanham Act, 1946	Protects and regulates brand names, brand marks, trade names, and trademarks
Celler–Kefauver Act, 1950	Prohibits one corporation from controlling another where the effect is to lessen competition
Consumer Goods Pricing Act, 1975	Prohibits price maintenance agreements among manufacturers and resellers in interstate commerce
FTC Improvement Act, 1975	Gives the FTC more power to prohibit unfair industry practices
Antitrust Improvements Act, 1976	Strengthens earlier antitrust laws; gives Justice Department more investigative authority
Foreign Corrupt Practices Act, 1977	Makes it illegal to pay foreign government officials to facilitate business or to use third parties such as agents and consultants to provide bribes to such officials
Trademark Counterfeiting Act, 1980	Provides penalties for individuals dealing in counterfeit goods
Trademark Law Revision Act, 1988	Amends the Lanham Act to allow brands not yet introduced to be protected through patent and trademark registration
Federal Trademark Dilution Act, 1995	Gives trademark owners the right to protect trademarks and requires them to relinquish those that match or parallel existing trademarks
Digital Millennium Copyright Act, 1998	Refines copyright laws to protect digital versions of copyrighted materials, including music and movies
Controlling the Assault of Non-Solicited Pornography and Marketing Act (CAN-SPAM), 2003	Bans fraudulent or deceptive unsolicited commercial e-mail and requires senders to provide information on how recipients can opt out of receiving additional messages
Fraud Enforcement and Recovery Act, 2009	Strengthens provisions to improve the criminal enforcement of fraud laws, including mortgage fraud, securities fraud, financial institutions fraud, commodities fraud, and fraud related to the federal assistance and relief program

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In law, however, there are always exceptions. Under the McCarran–Ferguson Act of 1944, for example, Congress exempted the insurance industry from the Sherman Antitrust Act and other antitrust laws. Insurance companies were allowed to join together to set insurance premiums at specific industry-wide levels. However, even actions that take place under this legal “permission” could still be viewed as irresponsible and unethical if they neutralize competition and if prices no longer reflect the true costs of insurance protection.

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What is legal is not always considered ethical by some interest groups. Major League Baseball has an antitrust exemption dating back to 1922. MLB is the only major sport that has such a sweeping antitrust exemption, although the major effect it has on the game these days is that sports teams cannot relocate without MLB's permission.[13]

Laws Protecting Consumers

Laws that protect consumers require businesses to provide accurate information about their products and services and to follow safety standards (Table 4.3). The first **consumer protection law** was passed in 1906, partly in response to a novel by Upton Sinclair. *The Jungle* describes,

TABLE 4.3 Laws Protecting Consumers

Pure Food and Drug Act, 1906	Prohibits adulteration and mislabeling of foods and drugs sold in interstate commerce
Federal Hazardous Substances Labeling Act, 1960	Controls the labeling of hazardous substances for household use
Truth in Lending Act, 1968	Requires full disclosure of credit terms to purchasers
Consumer Product Safety Act, 1972	Created the Consumer Product Safety Commission to establish safety standards and regulations for consumer products
Fair Credit Billing Act, 1974	Requires accurate, up-to-date consumer credit records
Consumer Goods Pricing Act, 1975	Prohibits price maintenance agreements
Consumer Leasing Act, 1976	Requires accurate disclosure of leasing terms to consumers
Fair Debt Collection Practices Act, 1978	Defines permissible debt collection practices
Toy Safety Act, 1984	Gives the government the power to recall dangerous toys quickly
Nutritional Labeling and Education Act, 1990	Prohibits exaggerated health claims and requires all processed foods to have labels showing nutritional information
Telephone Consumer Protection Act, 1991	Establishes procedures for avoiding unwanted telephone solicitations
Children's Online Privacy Protection Act, 1998	Requires the FTC to formulate rules for collecting online information from children under age 13
Do Not Call Implementation Act, 2003	Directs the FCC and the FTC to coordinate so that their rules are consistent regarding telemarketing call practices including the Do Not Call Registry and other lists, as well as call abandonment
Credit Card Accountability Responsibility and Disclosure Act, 2009	Implemented strict rules on credit card companies regarding topics such as issuing credit to youth, terms disclosure, interest rates, and fees
Dodd–Frank Wall Street Reform and Consumer Protection Act (2010)	Promotes financial reform to increase accountability and transparency in the financial industry, protects consumers from deceptive financial practices, and establishes the Bureau of Consumer Financial Protection

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among other things, the atrocities and unsanitary conditions of the meatpacking industry in turn-of-the-century Chicago. The outraged public response to this book and other exposés of the industry resulted in the passage of the Pure Food and Drug Act. Similarly, Ralph Nader had a tremendous impact on consumer protection laws with his book *Unsafe at Any Speed.* His critique of and attack on General Motors' Corvair had far-reaching effects on cars and other consumer products. Other consumer protection laws emerged from similar processes.

Large groups of people with specific vulnerabilities have been granted special levels of legal protection relative to the general population. For example, children and the elderly have received proportionately greater attention than other groups. American society has responded to research and documentation showing that young consumers and senior citizens encounter difficulties in the acquisition, consumption, and disposition of products. Special legal protection provided to vulnerable consumers is considered to be in the public interest.[14] For example, the Children's Online Privacy Protection Act (COPPA) requires commercial Internet sites to carry privacy policy statements, obtain parental consent before soliciting information from children under the age of 13, and provide an opportunity to remove any information provided by children using such sites. Critics of COPPA argue that children aged 13 and older should not be treated as adults on the web. In a study of children ages 10 to 17, nearly half indicated that they would give their name, address, and other demographic information in exchange for a gift worth $100 or more. Internet safety among children is another major topic of concern. Research has shown that filtering and age verification are not effective in making the Internet safer, and businesses, regulators, and parents are all trying to figure out how to better protect children from dangers ranging from online predators to pornography.[15]

Seniors are another highly vulnerable demographic. New laws have taken aim at financial scams directed at seniors, such as free lunch seminars. The state of Arkansas has taken the lead on this issue, conducting police sweeps of suspected scams, increasing fines, and amending laws to impose increased penalties for those who prey on the elderly. Older people are the most vulnerable group when it comes to financial scams as they rely on their savings for retirement security.[16] The role of the FTC's Bureau of Consumer Protection is to protect consumers against unfair, deceptive, or fraudulent practices. The bureau, which enforces a variety of consumer protection laws, is divided into five divisions. The Division of Enforcement monitors compliance with and investigates violations of laws, including unfulfilled holiday delivery promises by online shopping sites, employment opportunities fraud, scholarship scams, misleading advertising for health care products, high-tech and telemarketing fraud, data security, and financial practices.

The Food and Drug Administration regulates food safety, human drugs, tobacco, dietary supplements, vaccines, veterinary drugs, medical devices, cosmetics, products that give off radiation, and biological products. It has the power to authorize the marketing of these products as well as to ban those deemed unsafe for the public.[17] For example, the FDA was considering a ban against certain drinks that contained alcohol and caffeine. One of these drinks, Four Loko, contained as much alcohol as four cans of 12-ounce beers, which was combined with the equivalent of five cups of coffee. The concern was that these caffeinated alcoholic beverages would slow drinkers' perceptions of how drunk they were getting. The FDA issued warning letters to four manufacturers, who subsequently announced they would discontinue the drinks.[18]

Laws Promoting Equity and Safety

Laws promoting equity in the workplace were passed during the 1960s and 1970s to protect the rights of minorities, women, older persons, and persons with disabilities; other legislation has sought to protect the safety of all workers (Table 4.4). Of these laws, probably

TABLE 4.4 U.S. Laws Promoting Equity and Safety

Equal Pay Act of 1963	Prohibits discrimination in pay on the basis of sex
Equal Pay Act of 1963 (amended)	Prohibits sex-based discrimination in the rate of pay to men and women doing the same or similar jobs
Title VII of the Civil Rights Act of 1964 (amended in 1972)	Prohibits discrimination in employment on the basis of race, color, sex, religion, or national origin
Age Discrimination in Employment Act, 1967	Prohibits discrimination in employment against persons between the ages of 40 and 70
Occupational Safety and Health Act, 1970	Designed to ensure healthful and safe working conditions for all employees
Title IX of Education Amendments of 1972	Prohibits discrimination based on sex in education programs or activities that receive federal financial assistance
Vocational Rehabilitation Act, 1973	Prohibits discrimination in employment because of physical or mental handicaps
Vietnam Era Veterans Readjustment Act, 1974	Prohibits discrimination against disabled veterans and Vietnam War veterans
Pension Reform Act, 1974	Designed to prevent abuses in employee retirement, profit-sharing, thrift, and savings plans
Equal Credit Opportunity Act, 1974	Prohibits discrimination in credit on the basis of sex or marital status
Age Discrimination Act, 1975	Prohibits discrimination on the basis of age in federally assisted programs
Pregnancy Discrimination Act, 1978	Prohibits discrimination on the basis of pregnancy, childbirth, or related medical conditions
Immigration Reform and Control Act, 1986	Prohibits employers from knowingly hiring a person who is an unauthorized alien
Americans with Disabilities Act, 1990	Prohibits discrimination against people with disabilities and requires that they be given the same opportunities as people without disabilities
Civil Rights Act of 1991	Provides monetary damages in cases of intentional employment discrimination

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the most important to business is Title VII of the Civil Rights Act, originally passed in 1964 and amended several times since. Title VII specifically prohibits discrimination in employment on the basis of race, sex, religion, color, or national origin. The Civil Rights Act also created the Equal Employment Opportunity Commission (EEOC) to help enforce the provisions of Title VII. Among other things, the EEOC helps businesses design affirmative action programs. These programs aim to increase job opportunities for women and minorities by analyzing the present pool of employees, identifying areas where women and minorities are underrepresented, and establishing specific hiring and promotion goals, along with target dates for meeting those goals.

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Other legislation addresses more specific employment practices. The Equal Pay Act of 1963 mandates that women and men who do equal work must receive equal pay. Wage differences are allowed only if they can be attributed to seniority, performance, or qualifications. The Americans with Disabilities Act of 1990 prohibits discrimination against people with disabilities. Despite these laws, inequities in the workplace still exist. According to the U.S. Women's Bureau, women earn an average of 80 cents for every dollar that men earn. The disparity in wages is higher for African American women (69 cents for every dollar a white man earns) and Hispanic women (60 cents for every dollar).[19]

Congress has also passed laws that seek to improve safety in the workplace. By far the most significant of these is the Occupational Safety and Health Act of 1970, which mandates that employers provide safe and healthy working conditions for all workers. The **Occupational Safety and Health Administration** (OSHA), which enforces the act, makes regular surprise inspections to ensure that businesses maintain safe working environments.

Even with the passage and enforcement of safety laws, many employees still work in unhealthy or dangerous environments. Safety experts suspect that companies underreport industrial accidents to avoid state and federal inspection and regulation. The current emphasis on increased productivity has been cited as the main reason for the growing number of such accidents. Competitive pressures are also believed to lie behind the increases in manufacturing injuries. Greater turnover in organizations due to downsizing means that employees may have more responsibilities and less experience in their current positions, thus increasing the potential for accidents. Overworked employees are often cited as a primary factor in careless accidents, both in the United States and in other countries. For instance, in Korea cab drivers are often required to work 24-hour shifts. One analysis determined that drowsiness has caused over 27 percent of Korean commercial driver crashes on the highway within a three-year period. Similar findings on the dangers of drowsiness have been reported in the United States.[20]

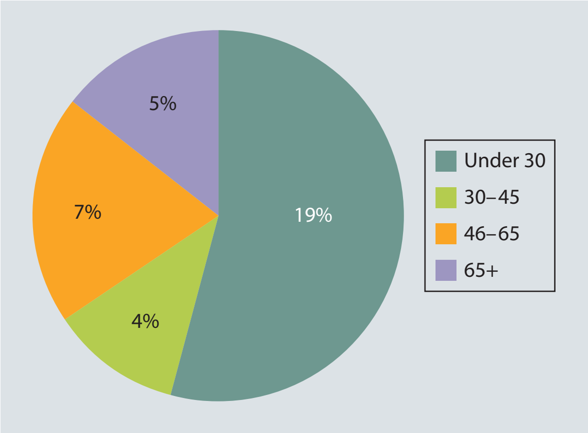
Laws Protecting the Environment

Environmental protection laws have been enacted largely in response to concerns over business's impact on the environment, which began to emerge in the 1960s. **Sustainability** has become a buzzword in recent years, yet many people may not even think about what it means. According to the UN's World Commission on the Environment and Development, sustainable means "meeting the present needs without compromising the ability of future generations to meet their own needs."[21] The environment and sustainability are more important topics than ever. Thirty-five percent of people say that they are more interested in environmental issues than previously and expect companies to be more environmentally responsible than they used to be.[22] Consumer interest in sustainability is so great that many firms have even made being green a competitive issue. For example, General Electric has an Ecomagination report that allows consumers to see all the green measures it has taken. It has also implemented green marketing social media campaigns on YouTube and Flickr to spread awareness of its green initiatives.

Many people have questioned the cost-benefit analyses often used in making business decisions. Such analyses try to take into account all factors in a situation, represent them with dollar figures, calculate the costs and benefits of the proposed action, and

FIGURE 4.3 The Green Consumer

Which Age Groups Are Willing to Pay Significantly More for Green Products?



Base: 2,000 internet users aged 18+

Source: Mintel, Green Marketing—US—April 2010, http://academic.mintel.com.libproxy.unm.edu/sinatra/oxygen_academic/search_results/show&/display/id=482522 (accessed January 23, 2011).

determine whether an action's benefits outweigh its costs. The problem, however, is that it is difficult to arrive at an accurate monetary valuation of environmental damage or physical pain and injury. In addition, people outside the business world often perceive such analyses as inhumane. Figure 4.3 indicates the importance of green products to consumers. Even though not everyone buys green products frequently, 73 percent of American consumers want companies to support environmental causes.[23]

The **Environmental Protection Agency** (EPA) was created in 1970 to coordinate environmental agencies involved in enforcing the nation's environmental laws. The major areas of environmental concern relate to air, water, and land pollution. Large corporations are being encouraged to establish pollution-control mechanisms and other policies favorable to the environment. Otherwise, these companies could deplete resources and damage the health and welfare of society by focusing only on their own economic interests. For example, 3M voluntarily stopped making Scotchguard, a successful product for 40 years with $300 million in sales, after tests showed that it did not decompose in the environment.[24]

Increases in toxic waste in the air and water, as well as noise pollution, have prompted the passage of a number of laws (Table 4.5). Many environmental protection laws have resulted in the elimination or modification of goods and services. For instance, leaded gasoline was phased out during the 1990s by the EPA because catalytic converters, which reduce pollution caused by automobile emissions and are required by law on most vehicles, do not work properly with leaded gasoline. Increased Corporate Average Fuel Economy (or CAFE) standards are forcing companies to figure out ways for their cars to get better gas mileage. For many carmakers, a major part of this strategy involves increased production and sales of hybrid vehicles, as well as improving electric car and hydrogen fuel-cell technology.

The harmful effects of toxic waste on water life and on leisure industries such as resorts and fishing have raised concerns about proper disposal of these wastes. Few disposal sites meet EPA standards, so businesses must decide what to do with their waste until disposal sites become available. Some firms have solved this problem by illegal or unethical measures: dumping toxic wastes along highways, improperly burying drums containing toxic chemicals, and discarding hazardous waste at sea. However, trying to pinpoint who is responsible for environmental degradation is not always easy, especially when it involves different countries. For example, an Ecuadorian judge ordered the gas giant Chevron to pay $9.5 billion to clean up oil pollution in the Ecuadorian rainforest. The original lawsuit was filed in 1993 by 30,000 plaintiffs against Texaco, which was acquired by Chevron in 2001. This could mean that Chevron is liable for the damages, but Chevron claims that a 1998 agreement that Texaco signed with Ecuador absolves it of liability. Additionally, Chevron officials are crying foul, claiming that the government colluded with the plaintiffs in the ruling. Chevron appealed to U.S. courts to block

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TABLE 4.5 Laws Protecting the Environment

Clean Air Act, 1970	Established air-quality standards; requires approved state plans for implementation of the standards
National Environmental Policy Act, 1970	Established broad policy goals for all federal agencies; created the Council on Environmental Quality as a monitoring agency
Coastal Zone Management Act, 1972	Provides financial resources to the states to protect coastal zones from overpopulation
Federal Water Pollution Control Act, 1972	Designed to prevent, reduce, or eliminate water pollution
Noise Pollution Control Act, 1972	Designed to control the noise emission of certain manufactured items
Federal Insecticide, Fungicide and Rodenticide Act, 1972	Provides federal control of pesticide distribution, sale, and use
Endangered Species Act, 1973	Provides a program for the conservation of threatened and endangered plants and animals and the habitats in which they are found
Safe Drinking Water Act, 1974	Established to protect the quality of drinking water in the United States; focuses on all waters actually or potentially designed for drinking use, whether from above ground or underground sources; establishes safe standards of purity and requires all owners or operators of public water systems to comply with primary (health-related) standards
Energy Policy and Conservation Act, 1975	Requires auto dealers to have "gas mileage guides" in their showrooms
Toxic Substances Control Act, 1976	Requires testing and restricts use of certain chemical substances to protect human health and the environment
Resource Conservation and Recovery Act, 1976	Gives the EPA authority to control hazardous waste from the "cradle to grave"; includes the generation, transportation, treatment, storage, and disposal of hazardous waste, as well as a framework for the management of nonhazardous waste
Comprehensive Environmental Response, Compensation, and Liability Act, 1980	Created a tax on chemical and petroleum industries and provides broad federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment
Emergency Planning and Community Right-to-Know Act, 1986	The national legislation on community safety, designed to help local communities protect public health, safety, and the environment from chemical hazards
Oil Pollution Act, 1990	Streamlined and strengthened the EPA's ability to prevent and respond to catastrophic oil spills; a trust fund financed by a tax on oil is available to clean up spills when the responsible party is incapable of doing so or unwilling to do so
Pollution Prevention Act, 1990	Focuses industry, government, and public attention on reducing the amount of pollution through cost-effective changes in production, operation, and raw materials use

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(continued)

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TABLE 4.5 Laws Protecting the Environment *(continued)*

Food Quality Protection Act, 1996	Amended the Federal Insecticide, Fungicide and Rodenticide Act and the Federal Food Drug and Cosmetic Act; the requirements include a new safety standard—reasonable certainty of no harm—that must be applied to all pesticides used on foods
Energy Policy Act, 2005	Addresses the way energy is produced in the United States in terms of energy efficiency, renewable energy, oil and gas, coal, Tribal energy, nuclear matters and security, vehicles and motor fuels, hydrogen, electricity, energy tax incentives, hydropower and geothermal energy, and climate change technology
Energy Independence and Security Act, 2007	Established a plan for moving the United States toward a more sustainable future, with steps that include the phasing out of the incandescent light bulb

the penalty.[25] Congress regularly evaluates legislation to increase the penalties for disposing of toxic wastes. Disposal issues remain controversial because, although everyone acknowledges that the wastes must go somewhere, no community wants them dumped in its own backyard.

One solid-waste problem is the result of rapid innovations in computer hardware, which render machines obsolete after just 18 months. Today, hundreds of millions of computers have reached obsolescence and tens of millions of these are expected to end up in landfills. Cell phones are another problem, with billions destined for landfills. Computers and cell phones both contain such toxic substances as lead, mercury, and polyvinyl chloride, which can leach into the soil and contaminate groundwater when disposed of improperly. Websites like electronicsrecycling.org help consumers find locations to recycle their phones and computers. The Environmental Protection Agency hosts its own electronics recycling program, which collects around 67 million pounds of electronics a year. Stores like Staples and Best Buy offer limited recycling programs, and companies like Dell and Samsung are all seeking to extend the availability of recycling for their products.[26]

GATEKEEPERS AND STAKEHOLDERS

Trust is the glue that holds businesses and their stakeholders together. Trust creates confidence and helps to forge relationships of reliance between businesses and stakeholders. Trust also allows businesses to depend upon one another as they make transactions or exchange value. Ethics helps create the foundational trust between two parties in a transaction. There are many people who must trust and be trusted to make business work properly. Sometimes these parties are referred to as *gatekeepers.* Gatekeepers include accountants, who are essential to certifying the accuracy of financial information, as well as lawyers, financial rating agencies, and even financial reporting services. All of these groups are critical in providing information that allows stakeholders to gain an understanding of the financial position of an organization. Most of these gatekeepers operate with professional codes of ethics and face legal consequences, or even disbarment, if they fail to operate within agreed-upon principles of conduct. Therefore, there is a strong need for gatekeepers to uphold ethical standards and remain independent through using standard methods and procedures that can be audited by other gatekeepers, the regulatory system, and investors.

Accountants

> "Gatekeepers such as lawyers, financial rating agencies, and even financial reporting services must have high ethical standards."

Accountants measure and disclose financial information, with an assurance of accuracy, to the public. Managers, investors, tax authorities, and other stakeholders who make resource allocation decisions are all groups who use the information provided by accountants. Accountants make certain basic assumptions about their clients. One assumption is that the corporation is an entity that is separate and distinct from its owners, and that it will continue to operate as such in the future. Another assumption is that a stable monetary system (such as the dollar) is in place and that all necessary information concerning the business is available and presented in an understandable manner. Accountants have their own set of rules, one of which is that, if there is a choice between equally acceptable accounting methods, they should use the one that is least likely to overstate or misdirect. During the 2008–2009 financial meltdown, many people lost trust in accountants and auditors because a few made unscrupulous decisions.

Some accountants have not been adhering to their responsibilities to stakeholders. For example, Arthur Andersen was once a standard bearer for integrity. But at Andersen, growth became the priority, and its emphasis on recruiting and retaining big clients came at the expense of quality and independent audits. The company linked its consulting business in a joint cooperative relationship with its audit arm, which compromised its auditors' independence, a quality crucial to the execution of a credible audit. The firm's focus on growth generated a fundamental change in its corporate culture, one in which its high-profit consulting business was regarded as more important than providing objective auditing services. This situation presented a conflict of interest and posed a problem when partners had to decide how to treat questionable accounting practices discovered at some of Andersen's largest clients. Ultimately, Arthur Andersen was dissolved because of its ties to the Enron scandal. Gatekeepers such as lawyers, financial rating agencies, and even financial reporting services must have high ethical standards. These groups must be trusted by all stakeholders, and most operate with professional codes of ethics.

Risk Assessment

Another critical gatekeeper group in the financial meltdown was risk assessors of financial products. The top three companies in the world that independently assess financial risks are Standard & Poor's, Moody's, and Fitch. They assess risk and express it through letters ranging from "AAA," which is the highest grade, to "C," which is junk. Different rating services use the same letter grades, but use various combinations of upper- and lowercase letters to differentiate themselves.

As early as 2003, financial analysts and the three global rating firms suspected that there were some major problems with the way their models were assessing risk. In 2005 Standard & Poor's realized that its algorithm for estimating the risks associated with debt packages was flawed. As a result, it asked for comments on improving its equations. In

2006–2007 many governmental regulators and others started to realize what the rating agencies had known for years: their ratings were not very accurate. One report stated that the high ratings given to debt were based on inadequate historical data, and that businesses were "ratings shopping" to obtain the best rating possible. Investment banks were among some of the worst offenders, paying for ratings and therefore causing conflicts of interest. The amount of revenue these three companies annually receive is approximately $5 billion.

Further investigations uncovered many disturbing problems. Moody's, Standard & Poor's, and Fitch had all violated a code of conduct "that required analysts to consider only credit factors, not the potential impact on Moody's, or an issuer, an investor or other market participant."[27] These companies had also become overwhelmed by an increase in the volume and sophistication of the securities they were asked to review. Finally, faced with less time to perform the due diligence expected of them, analysts began to cut corners.

SEC Chairman Mary Schapiro believes that the SEC must take more drastic measures to implement oversight for credit-rating firms—a group that was largely blamed for not catching risky activity in the financial sector sooner. Part of the problem, as Schapiro sees it, is that credit rating firms are paid by the securities that they rank. This creates a conflict of interest problem and can affect the reliability of the ratings.[28] No organization is exempt from criticism over its level of transparency. While large financial firms have been the target of most of the public's anger over risk taking and executive pay, even nonprofits are now being scrutinized more carefully.[29]

THE SARBANES–OXLEY (SOX) ACT

In 2002, largely in response to widespread corporate accounting scandals, Congress passed the Sarbanes–Oxley Act to establish a system of federal oversight of corporate accounting practices. In addition to making fraudulent financial reporting a criminal offense and strengthening penalties for corporate fraud, the law requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reporting to their investors and other stakeholders.

Supported by both Republicans and Democrats, the Sarbanes–Oxley Act was enacted to restore stakeholder confidence after accounting fraud at Enron, WorldCom, and hundreds of other companies resulted in investors and employees losing much of their savings. During the resulting investigations, the public learned that hundreds of corporations had not reported their financial results accurately. Many stakeholders came to believe that accounting firms, lawyers, top executives, and boards of directors had developed a culture of deception to ensure investor approval and gain a competitive advantage. As a result of public outrage over the accounting scandals, the Sarbanes–Oxley Act garnered nearly unanimous support not only in Congress but also from government regulatory agencies, the president, and the general public. When President George W. Bush signed the Sarbanes–Oxley Act into law, he emphasized the need for new standards of ethical behavior in business, particularly among the top managers and boards of directors responsible for overseeing business decisions and activities.

At the heart of the Sarbanes–Oxley Act is the **Public Company Accounting Oversight Board,** which monitors accounting firms that audit public corporations and establishes standards and rules for auditors in accounting firms. The law gave the board investigatory and disciplinary power over auditors and securities analysts who issue reports about corporate performance and health. The law attempts to eliminate conflicts of interest by prohibiting accounting firms from providing both auditing and consulting services to the

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same client companies without special permission from the client firm's audit committee; it also places limits on the length of time lead auditors can serve a particular client. The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles. Additionally, the law modifies the attorney-client relationship to require lawyers to report wrongdoing to top managers and/or the board of directors. It also provides protection for "whistle-blowing" employees who might report illegal activity to authorities. This "whistle-blower" protection was strengthened with the passage of the Dodd–Frank Act several years later.

> "The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles."

On the other hand, SOX has raised a number of concerns. The complex law imposed additional requirements and costs on executives. Additionally, the new act has caused many firms to restate their financial reports to avoid penalties. Big public companies spent thousands of hours and millions of dollars annually to make sure that someone was looking over the shoulder of key accounting personnel at every step of every business process, according to Financial Executives International. Perhaps the biggest complaint is that in spite of Sarbanes–Oxley, financial executives were able to discover new loopholes that allowed them to engage in the misconduct that contributed to the global financial crisis.

Public Company Accounting Oversight Board

SOX aims to promote transparency, reduce conflict of interest, and increase accountability. For instance, one of its provisions called for the establishment of a board to oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies. The Public Company Accounting Oversight Board has faced several challenges throughout the years, including a lawsuit claiming that the board was unconstitutional. The lawsuit made it all the way to the Supreme Court. The court ruled in favor of the board. The board must also overcome obstacles with foreign auditing firms. Although Sarbanes–Oxley requires registration from all auditors listed on the U.S. public market including foreign auditors, several countries, such as the European Union and China, do not allow inspections of their auditing firms.[30]

Auditor and Analyst Independence

The Sarbanes–Oxley Act also seeks to eliminate conflicts of interest among auditors, security analysts, brokers, dealers, and the public companies they serve in order to ensure enhanced financial disclosures of public companies' true conditions. To accomplish auditor independence, Section 201 prohibits registered public accounting firms from providing both non-audit and audit services to a public company. National securities exchanges and registered securities associations have already adopted similar conflict-of-interest rules for security analysts, brokers, and dealers who recommend equities in research reports. Such independence enables the Sarbanes–Oxley Act to better ensure compliance with the requirement for more detailed financial disclosures representing public companies' true condition. For example, registered public accounting firms are now required to identify all material correcting adjustments to reflect accurate financial statements. Also, all material off-balance-sheet transactions and other relationships with unconsolidated entities that affect current or future financial conditions of a public company must be disclosed in each annual and quarterly financial report. In addition, public companies must also report "on a rapid and current basis" material changes in the financial condition or operations.

Whistle-Blower Protection

Employees of public companies and accounting firms are also accountable to report unethical behavior. The Sarbanes–Oxley Act intends to motivate employees through whistle-blower protection that prohibits the employer from taking certain actions against employees who lawfully disclose private employer information to parties in a judicial proceeding involving a fraud claim, among others. Whistle-blowers are also granted a remedy of special damages and attorneys' fees. Unfortunately, this law did not protect certain whistle-blowers from being penalized prior to the financial crisis. Whistle-blowers at Lehman Brothers, Madoff Securities, and Stanford Financial Group (which also operated a Ponzi scheme) warned auditors and government officials of misconduct at the company. Some whistle-blowers were fired or, after losing lawsuits filed against the offending company, were forced to pay large sums in back pay and attorney's fees.[31] These cases prompted a provision for stronger whistle-blower protection in the Dodd–Frank Act, discussed in the next section.

Cost of Compliance

The national cost of compliance of the Sarbanes–Oxley Act can be extensive and can include internal costs, external costs, and auditor fees. For example, Section 404 requires companies to document both the results of financial transactions and the processes they have used to generate them. A company may have thousands of processes that have never been written down. Writing down the processes is time consuming and costly.[32] Also, because the cost of compliance is so high for many small companies, some publicly traded companies have even considered delisting themselves from the U.S. Stock Exchange.

However, studies have shown that although compliance costs were high shortly after Sarbanes–Oxley was passed, they have declined over the years. Companies have reported that their compliance costs have decreased 50 percent from their level when the laws were put into effect. One reason why the costs may be decreasing is that companies have more experience with Sarbanes–Oxley, and therefore require less time to complete the process. While 61 percent of respondent companies believed that the costs of Sarbanes–Oxley exceeded its benefits during the first year, today approximately 70 percent believe the benefits outweigh the costs.[33]

DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

In 2010 President Obama signed into law the Dodd–Frank Wall Street Reform and Consumer Protection Act. It was heralded as "a sweeping overhaul of the financial regulatory system . . . on a scale not seen since the reforms that followed the Great Depression."[34] The new law seeks to improve financial regulation, increase oversight of the industry, and prevent the types of risk-taking, deceptive practices, and lack of oversight that led to the 2008–2009 financial crisis.[35] It contains sixteen provisions that include increasing

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the accountability and transparency of financial institutions, creating a bureau to educate consumers in financial literacy and protect them from deceptive financial practices, implementing additional incentives for whistle-blowers, increasing oversight of the financial industry, and regulating the use of complex derivatives.

Response to the law was split along party lines, with vocal opponents as well as proponents. Critics have several concerns, including claims that the rules on derivatives are too burdensome, the belief that such wide-scale changes will create chaos in the regulatory system, and the fear that the government will gain too much power.[36] Other companies, such as JPMorgan, claim that they support the law in general but oppose certain provisions.[37] The following sections will describe some of the most notable provisions of the Dodd–Frank Act.

New Financial Agencies

One of the provisions of the Dodd–Frank Act instituted the creation of two new financial agencies, the Office of Financial Research and the Financial Stability Oversight Council. The Office of Financial Research is charged with improving the quality of financial data available to government officials and creating a better system of analysis for the financial industry.[38] The Financial Stability Oversight Council (FSOC) is responsible for maintaining the stability of the financial system in the United States through monitoring the market, identifying threats, promoting market discipline among the public, and responding to major risks that threaten stability.[39] FSOC has the authority to limit or closely supervise financial risks, create stricter standards for banking and nonbanking financial institutions, and disband financial institutions that present a serious risk to market stability.[40] The addition of these two new agencies is intended not only to improve information collecting and oversight, but also to close the types of loopholes that allowed financial industries to engage in risky and deceptive conduct prior to the financial crisis.

Consumer Financial Protection Bureau

Another agency that the Dodd–Frank Act created was the **Consumer Financial Protection Bureau (CFPB),** an independent agency within the Federal Reserve System that "regulate[s] the offering and provision of consumer financial products or services under the Federal consumer financial

DEBATE ISSUE TAKE A STAND

Will the Consumer Financial Protection Bureau Benefit Consumers?

Many consumers struggle when it comes to understanding financial issues. They often make decisions on credit cards, home mortgages, insurance, and loans without understanding important concepts such as interest rates, repayment, and default. The Dodd–Frank Act created the Consumer Financial Protection Bureau to help consumers and investors better understand the complex financial products they are purchasing. However, many financial institutions and legislators are concerned that this new Consumer Financial Protection Bureau may have too much power. Therefore, there will be attempts to curb the power of the bureau through budget cuts and possibly getting those connected with the financial industry into the bureau to provide oversight of the agency's operations. There is also concern that the agency could even increase the costs of borrowing and credit cards by putting a burden on banks through increased regulation. It is difficult to know exactly how the agency will implement its new powers and how much benefit consumers will receive from the regulation.

1. The Consumer Financial Protection Bureau will help consumers understand financial products.
2. The Consumer Financial Protection Bureau will be a burden on financial institutions and could increase the cost of financial services for consumers.

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laws."[41] One of the problems leading up to the 2008–2009 financial crisis was the fact that average investors often did not understand the complex financial products they were purchasing. The CFPB aims to protect consumers from this problem in the future. The government has granted the agency supervisory power over credit markets as well as the authority to monitor lenders and ensure that they are in compliance with the law.[42] The CFPB also has the responsibility to curtail unfair lending and credit card practices, enforce consumer financial laws, and check the safety of financial products before their launch into the market.[43]

The CFPB is not without its critics. Several financial firms and legislators believe that the bureau has too much power. Criticism has been levied against President Obama for bypassing Senate approval in appointing White House advisor Elizabeth Warren to oversee the creation of the bureau, and lawmakers in opposition to the CFPB are attempting to curb the bureau's powers, possibly through budget cuts. Additionally, financial institutions are concerned that the bureau's powers could lead to strict sanctions.[44] On the other hand, two-thirds of Americans agree that some type of financial reform is needed.[45] To protect against misconduct at all levels, the CFPB has oversight powers over institutions often accused of questionable dealings, such as payday lenders and debt collectors.[46] The goal of the CFPB is to create a more equitable and transparent financial environment for consumers.

Whistle-blower Bounty Program

It is clear that the whistle-blower provisions implemented in Sarbanes–Oxley were not enough to prevent the massive misconduct occurring at business institutions before the financial crisis. To encourage more employees to come forward when they witness misconduct, the Dodd–Frank law instituted a whistle-blower bounty program. Whistle-blowers who report financial fraud to the Securities and Exchange Commission and Commodities Exchange Commission are eligible to receive 10 percent to 30 percent of fines and settlements if their reports result in convictions of more than $1 million in penalties.[47]

While this will likely encourage more people to step forward, there are some challenges that will need to be considered for the program to be a success. For instance, the SEC will almost certainly be flooded with tips, some of which will come from people who just want the money. Still, the SEC is optimistic that half the tips it receives will result in payouts, suggesting that the number of credible whistle-blower complaints will increase dramatically.[48]

LAWS THAT ENCOURAGE ETHICAL CONDUCT

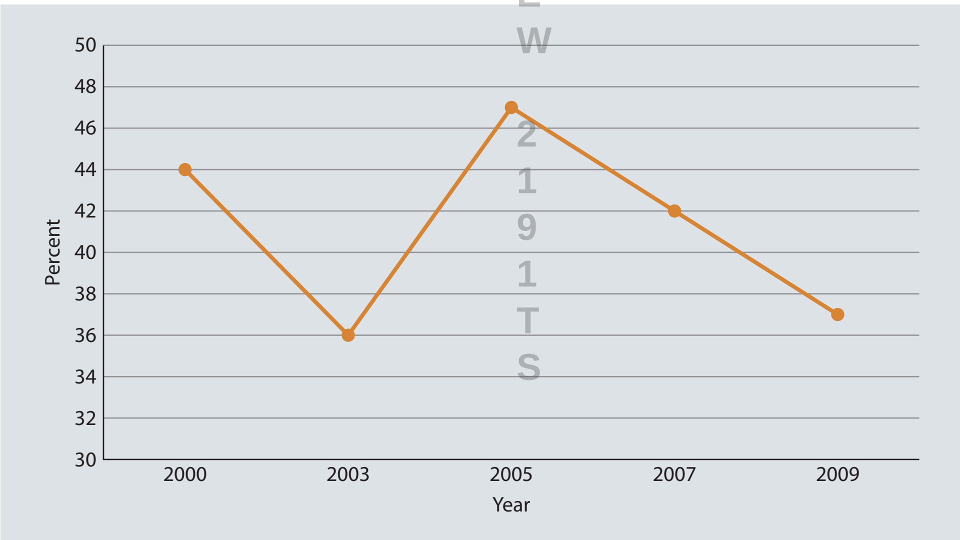
Violations of the law usually begin when businesspeople stretch the limits of ethical standards, as defined by company or industry codes of conduct, and then choose to engage in schemes that either knowingly or unwittingly violate the law. In recent years, new laws and regulations have been passed to discourage such decisions—and to foster programs designed to improve business ethics and social responsibility (Table 4.6). The most important of these are the Federal Sentencing Guidelines for Organizations (FSGO), the Sarbanes–Oxley Act, and the Dodd–Frank Act. One of the goals of these acts is to require employees to report observed misconduct. The development of reporting systems has advanced, with most companies having some method for employees to report observed misconduct. However, while reported misconduct is up, a sizable percentage of employees still do not report misconduct, as Figure 4.4 shows.

TABLE 4.6 Institutionalization of Ethics through the U.S. Sentencing Guidelines for Organizations

1991	*Law:* U.S. Sentencing Guidelines for Organizations created for federal prosecutions of organizations. These guidelines provide for just punishment, adequate deterrence, and incentives for organizations to prevent, detect, and report misconduct. Organizations need to have an effective ethics and compliance program to receive incentives in the case of misconduct.
2004	*Amendments:* The definition of an effective ethics program now includes the development of an ethical organizational culture. Executives and board members must assume the responsibility of identifying areas of risk, providing ethics training, creating reporting mechanisms, and designating an individual to oversee ethics programs.
2007–2008	*Additional definition of a compliance and ethics program:* Firms should focus on due diligence to detect and prevent misconduct and to promote an organizational culture that encourages ethical conduct. More details are provided, encouraging the assessment of risk and outlining appropriate steps in designing, implementing, and modifying ethics programs and training that will include all employees, top management, and the board or governing authority. These modifications continue to reinforce the importance of an ethical culture in preventing misconduct.
2010	*Amendments:* Chief compliance officers are directed to make their reports to their firm's board rather than to the general counsel. Companies are encouraged to create hotlines, perform self-audit programs, and adopt controls to detect misconduct internally. More specific language has been added to the word *prompt* in regards to what it means to promptly report misconduct. The amendment also extends operational responsibility to all personnel within a company's ethics and compliance program.

Source: "U.S. Sentencing Guidelines Changes Become Effective November 1," FCPA Compliance and Ethics Blog, November 2, 2010, http://tfoxlaw.wordpress.com/2010/11/02/us-sentencing-guidelines-changes-become-effective-november-1/ (accessed March 15, 2011).

FIGURE 4.4 Percentage of Employees Who Do Not Report Observed Misconduct



Source: 2007 National Business Ethics Survey, p. 17.

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FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS

As mentioned in Chapter 1, Congress passed the FSGO in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance. These guidelines, which were developed by the U.S. Sentencing Commission, apply to all felonies and class A misdemeanors committed by employees in association with their work. As an incentive, organizations that have demonstrated due diligence in developing effective compliance programs to discourage unethical and illegal conduct may be subject to reduced organizational penalties if an employee commits a crime.[49] Overall, the government philosophy is that legal violations can be prevented through organizational values and a commitment to ethical conduct.

The commission delineated seven steps that companies must implement to demonstrate due diligence:

1. A firm must develop and disseminate a code of conduct that communicates required standards and identifies key risk areas for the organization.
2. High-ranking personnel in the organization who are known to abide by the legal and ethical standards of the industry (such as an ethics officer, vice president of human resources, general counsel, and so forth) must have oversight over the program.
3. No one with a known propensity to engage in misconduct should be put in a position of authority.
4. A communications system for disseminating standards and procedures (ethics training) must also be put into place.
5. Organizational communications should include a way for employees to report misconduct without fearing retaliation, such as an anonymous toll-free hotline or an ombudsman. Monitoring and auditing systems designed to detect misconduct are also required.
6. If misconduct is detected, then the firm must take appropriate and fair disciplinary action. Individuals both directly and indirectly responsible for the offense should be disciplined. In addition, the sanctions should be appropriate for the offense.
7. After misconduct has been discovered, the organization must take steps to prevent similar offenses in the future. This usually involves making modifications to the ethical compliance program, conducting additional employee training, and issuing communications about specific types of conduct.

The government expects these seven steps for compliance programs to undergo continuous improvement and refinement.[50]

These steps are based on the commission's determination to emphasize compliance programs and to provide guidance for both organizations and courts regarding program effectiveness. Organizations have flexibility about the type of program they develop; the seven steps are not a checklist requiring that legal procedures be followed to gain certification of an effective program. Organizations implement the guidelines through effective core practices that are appropriate for their firms. The programs they put into effect must be capable of reducing the opportunity that employees have to engage in misconduct.

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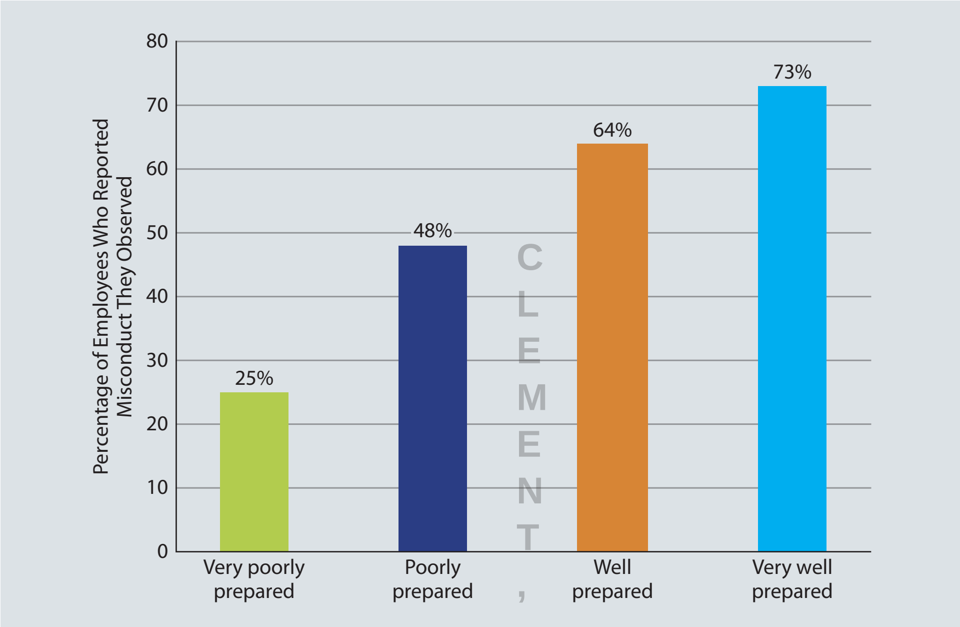
FIGURE 4.5 Employees Who Feel Better Prepared Are More Likely to Report



Source: *Research Brief from the 2009 NBES* (Arlington, VA: Ethics Resource Center, 2010), 19.

A 2004 amendment to the FSGO requires that a business's governing authority be well informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm's leadership, usually the board of directors. The board must ensure that there is a high-ranking manager accountable for the day-to-day operational oversight of the ethics program; provide for adequate authority, resources, and access to the board or an appropriate subcommittee of the board; and ensure that there are confidential mechanisms available so that the organization's employees and agents may report or seek guidance about potential or actual misconduct without fear of retaliation. Finally, the board is required to oversee the discovery of risks and to design, implement, and modify approaches to deal with those risks. Figure 4.5 demonstrates that prepared employees are more likely to respond to various ethical and legal risks. If board members do not understand the nature, purpose, and methods available to implement an ethics program, the firm is at risk of inadequate oversight and ethical misconduct that may escalate into a scandal.[51]

A 2005 Supreme Court decision held that the federal sentencing guidelines were not mandatory but should serve only as recommendations for judges to use in their decisions. Some legal and business experts believe that this decision might weaken the implementation of the FSGO, but most federal sentences have remained in the same range as before the Supreme Court decision. The guidelines remain an important consideration in developing an effective ethics and compliance program.[52]

The 2007–2008 amendments to the FSGO extend the required ethics training to members of the board or governing authority, high-level personnel, employees, and the organizations' agents. This change applies not only oversight but mandatory training to all levels of the organization. Merely distributing a code of ethics does not meet the training requirements. The 2007 and 2008 amendments now require most governmental contractors to provide ethics and compliance training.

As new FSGO amendments are implemented, more explicit responsibility is being placed on organizations to improve and expand ethics and compliance provisions to include all employees and board members, as was demonstrated in four amendments to the guidelines implemented in 2010. The first amendment concerned chief compliance officers who report misconduct to the general counsel. The guidelines recommend simplifying the complexity of reporting relationships by having the chief compliance officer make reports directly to the board or to a board committee. Companies are also encouraged to extend their internal ethical controls through hotlines, self-auditing programs, and other mechanisms so that misconduct can be detected internally rather than externally. In the third amendment, the FSGO added more specific language of the word *prompt* to help employees recognize what it means to report an ethical violation promptly. Finally, the FSGO amended the extent of operational responsibility to apply to all personnel within a company's ethics and compliance program.[53] The Department of Justice, through the Thompson Memo (Deputy Attorney General Larry Thompson's 2003 memo to U.S. Attorneys), advanced general principles to consider in cases involving corporate wrongdoing. This memo makes it clear that ethics and compliance programs are important to detecting the types of misconduct most likely to occur in a particular corporation's line of business. If it does not have an effective ethics and compliance program in place to detect ethical and legal lapses, a firm found in violation should not be treated leniently. Additionally, the prosecutor generally has wide latitude in determining when, whom, and whether to prosecute violations of federal law. U.S. attorneys are directed that charging for even minor misconduct may be appropriate when the wrongdoing was perpetuated by a large number of employees in a particular role—for example, sales staff or procurement officers—or was condoned by upper management. Without an effective program to identify an isolated rogue employee involved in misconduct, a firm may suffer serious consequences in terms of regulatory issues, enforcement, and sentencing.[54] Therefore, there is general agreement both in law and administrative policy that an effective ethics and compliance program is necessary to prevent misconduct and reduce the legal consequences if it does occur.

HIGHLY APPROPRIATE CORE PRACTICES

The focus of core practices is on developing structurally sound organizational practices and structural integrity for financial and nonfinancial performance measures, rather than on an individual's morals. Although the Sarbanes–Oxley Act and the Dodd–Frank Act provide standards for financial performance, most ethical issues relate to nonfinancials such as marketing, human resource management, and customer relations. Abusive behavior, lying, and conflict of interest are still three significant issues.

A group called the Integrity Institute has developed an integrated model that attempts to standardize the measurement of nonfinancial performance. Methodologies have been developed to assess communications, compensation, social responsibility, corporate culture, leadership, risk, and stakeholder perceptions, as well as the more subjective aspects of earnings, corporate governance, technology, and other important nonfinancial areas. The model exists to establish a standard that can predict the sustainability and success of an organization. The Integrity Institute uses measurement to an established standard as the basis for certification of integrity.[55] The Institute is one of the first to attempt such a model.

The majority of executives and board members want to measure nonfinancial performance, but no standards currently exist. The Open Compliance Ethics Group (oceg.org) has developed benchmarking studies that are available to organizations wanting to conduct self-assessments to determine the elements of their ethics programs. Developing organizational systems and processes is a requirement of the regulatory environment, but organizations are given considerable freedom in developing ethics and compliance programs. Core practices do exist and can be identified in every industry. Trade associations' self-regulatory groups and research studies often provide insights into the expected best core practices. An important priority is for each firm to assess its legal and ethical risk areas, and then to develop structures to prevent, detect, and quickly correct any misconduct.

Consider McDonald's approach to answering critics about nutritional guidance. The company began an initiative to provide nutritional information on its product packaging worldwide, becoming the first in its industry to do so. McDonald's has been seeking to build trust and loyalty among consumers, something that the company proclaims is highly important to it. McDonald's also offers new healthier products, such as oatmeal and apple slices in children's meals. The company withdrew its supersize meals after a damaging portrayal of the company in the film *Super Size Me.* The product sizes available at McDonald's are small, medium, and large, but upgrading to a bigger-portion size remains inexpensive.[56]

Voluntary Responsibilities

Voluntary responsibilities fall into the category of a business's contributions to its stakeholders. Businesses that address their voluntary responsibilities provide four major benefits to society. They:

1. Improve quality of life and help make communities places where people want to do business, raise families, and enjoy life. Thus, improving the quality of life in a community makes it easier to attract and retain employees and customers.
2. Reduce government involvement by providing assistance to stakeholders.
3. Develop employee leadership skills. Many firms, for example, use campaigns by the United Way and other community service organizations as leadership- and skill-building exercises for their employees.
4. Help create an ethical culture and values that can act as a buffer to organizational misconduct.[57]

The most common way that businesses demonstrate their voluntary responsibilities is through donations to local and national charitable organizations. In 2010 the Giving USA Foundation reported charitable contributions of $291 billion. Individual donations were $212 billion, and corporations gave $15.3 billion.[58] For example, Wells Fargo & Co. contributes around $100 million annually in community grants to nonprofits and schools, and $45 million and 100,000 volunteers to Habitat for Humanity and other housing nonprofits. The company also purchases green energy, and it has a website devoted to financial education. Its employees have donated hundreds of

> "The most common way that businesses demonstrate their voluntary responsibilities is through donations to local and national charitable organizations."

thousands of hours to charities around the nation.[59] Indeed, many companies have become concerned about the quality of education in the United States after realizing that the current pool of prospective employees lacks many basic work skills. Recognizing that today's students are tomorrow's employees and customers, firms such as Kroger, Campbell Soup Co., American Express, Apple, Xerox, and Coca-Cola have donated money, equipment, and employee time to help improve schools in their communities and throughout the nation.

The Walmart Foundation, the charitable giving branch of Walmart Inc., donated $624 million in 2010 to charities and communities across the globe, and it is the largest corporate cash contributor in the nation.[60] The money supported a variety of causes such as child development, education, the environment, and disaster relief. Walmart officials believe that the company can make the greatest impact on communities by supporting issues and causes that are important to its customers and associates in their own neighborhoods. By supporting communities at the local level, Walmart encourages customer loyalty and goodwill.[61]

Cause-Related Marketing

The first attempts by organizations to coordinate organizational goals with philanthropic giving emerged with cause-related marketing in the early 1980s. **Cause-related marketing** ties an organization's product(s) directly to a social concern through a marketing program.

With cause-related marketing, a percentage of a product's sales is usually donated to a cause that appeals to the target market. Yoplait, for example, generates proceeds for the Susan G. Komen for the Cure cause with its Save Lids to Save Lives program. Susan G. Komen for the Cure is a nonprofit organization that raises funds to fight breast cancer. Yoplait has created an annual philanthropic program that encourages consumers to send in pink Yoplait yogurt lids. For every lid sent in, Yoplait donates 10 cents to Susan G. Komen for the Cure, with a guaranteed donation of $500,000. Within 12 years, the program has resulted in more than $25 million in contributions.[62]

Cause-related marketing can also affect buying patterns. For such a campaign to be successful, consumers must sympathize with the cause, the brand and cause must be perceived as a good fit, and consumers should be able to transfer their feelings about the cause to their brand perceptions and purchase intentions. Surveys reveal that 85 percent of consumers view a brand more favorably if it contributes to a cause they care about, and 80 percent indicate their willingness to switch to a brand that supports a worthwhile cause if its price and quality are equal to its competitors'.[63] This finding lends support to the idea that cause-related marketing can help to bolster a firm's reputation.

Cause-related marketing has its weaknesses too, however. For instance, consumers may perceive a company's cause-related campaign as merely a publicity stunt, especially if they cannot understand the link between the campaign and the company's business practices. Also, cause-related campaigns are often of short duration, so consumers may not adequately associate the business with a particular cause. Strategic philanthropy is more holistic, as it ties the company's philanthropic giving to its overall strategy and objectives.

Strategic Philanthropy

Strategic philanthropy is the synergistic and mutually beneficial use of an organization's core competencies and resources to deal with key stakeholders so as to bring about organizational and societal benefits. It uses the profit motive, but argues that philanthropy must have at least a long-term positive impact. For example, Gentle Giant Moving Company, a

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U.S. moving company with offices in eight states, has made it a priority to incorporate philanthropy and social responsibility into its business strategy. In addition to its goal to become the best movers in the industry, Gentle Giants values customer satisfaction so much that it provides a 100 percent money-back guarantee if customers are not happy with its service. The company has established a charitable foundation that supports youth leadership development, housing assistance and homeless prevention, and green initiatives to make its practices more eco-friendly. Founder Peter O'Toole also cares for his employees and works to instill in them the type of values that Gentle Giant embodies. The company's successful integration of strategic philanthropy into its organizational practices has won it numerous awards, including a spot on *The Wall Street Journal*'s "Top Small Workplaces," a Better Business Bureau International Torch Award for Marketplace Ethics, and the Better Business Bureau Local Torch Award for Excellence (which it won four times).[64]

Home Depot directs much of the money it spends on philanthropy toward affordable housing, at-risk youth, the environment, and disaster recovery. Since 2008, Home Depot has been working with Habitat for Humanity on a five-year, $30 million initiative to provide funding for at least 5,000 energy-efficient homes. After the 2010 earthquake in Haiti, Home Depot and the Home Depot Foundation donated thousands of dollars, including a $100,000 contribution to the Red Cross, for earthquake relief and recovery.[65] These organizations demonstrate how companies can successfully incorporate voluntary responsibilities into their business strategies.

THE IMPORTANCE OF INSTITUTIONALIZATION IN BUSINESS ETHICS

Institutionalization involves embedding values, norms, and artifacts in organizations, industries, and society. In the United States and many other countries, institutionalization involves legislation that is often finalized through Supreme Court decisions. Therefore, this chapter provides an overview of legal as well as cultural institutions that work both outside and inside the organizational environment to support and control ethical decision making in organizations.

As discussed in Chapter 2, those in charge of corporate governance should be especially mindful of the institutions, including mandated requirements for legal compliance as well as core practices and voluntary actions, that support ethics and social responsibility. While voluntary conduct, including philanthropic activities, is not required to run a business, the failure to understand highly appropriate and common practices, referred to as core practices, provides the opportunity for unethical conduct.

It is important to recognize that the institutionalization of business ethics has advanced rapidly over the last 20 years as stakeholders have recognized the need to improve business ethics. The government has stepped in when scandals and misconduct have damaged consumers, investors, and other key constituents important for businesses. More recently, gatekeepers such as lawyers, financial rating agencies, and even financial reporting services have been questioned as some of their decisions seem to have contributed to major scandals involving companies like AIG, Countrywide Financial, and Lehman Brothers. Legislation and amendments related to the Federal Sentencing Guidelines for Organizations, the Sarbanes–Oxley Act, and the Dodd–Frank Act, have attempted to develop and enforce ethical practices that will support trust in business.

SUMMARY

To understand the institutionalization of business ethics, it is important to understand the voluntary and legally mandated dimensions of organizational practices. Core practices are documented best practices, often encouraged by legal and regulatory forces as well as by industry trade associations. The effective organizational practice of business ethics requires all three dimensions to be integrated into an ethics and compliance program. This integration creates an ethical culture that can effectively manage the risks of misconduct. Institutionalization in business ethics relates to established laws, customs, and the expectations of organizational ethics programs that are considered a requirement in establishing reputation. Institutions reward and sanction ethical decision making by providing structure and reinforcing societal expectations. In this way, society as a whole institutionalizes core practices and provides organizations with the opportunity to take their own approach, only taking action if there are violations.

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Civil and criminal laws regulating business conduct are passed because society—including consumers, interest groups, competitors, and legislators—believes that business must comply with society's standards. Such laws regulate competition, protect consumers, promote safety and equity in the workplace, protect the environment, and provide incentives for preventing misconduct.

In 2002, largely in response to widespread corporate accounting scandals, Congress passed the Sarbanes–Oxley Act to establish a system of federal oversight of corporate accounting practices. In addition to making fraudulent financial reporting a criminal offense and strengthening penalties for corporate fraud, the law requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reporting to investors and other stakeholders. The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles. For instance, the law requires top managers to certify that their firms' financial reports are complete and accurate, making CEOs and CFOs personally accountable for the credibility and accuracy of their companies' financial statements. The act establishes an oversight board to oversee the audit of public companies. The oversight board aims to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies.

In 2010, largely in response to the widespread misconduct leading to the global recession, the Dodd–Frank Wall Street Reform and Consumer Protection Act was passed. The purpose of the Dodd–Frank Act is to prevent future misconduct in the financial sector, protect consumers from complex financial instruments, oversee market stability, and create transparency in the financial sector. The Act created two financial agencies, the Financial Stability Oversight Council and the Office of Financial Research. It also created the Consumer Financial Protection Bureau to regulate the industry and ensure that consumers are protected against overly complex and/or deceptive financial practices. Whistle-blower protection was extended to include a whistle-blower bounty program whereby whistle-blowers who report corporate misconduct to the SEC may receive 10 percent to 30 percent of settlement money if their reports result in a conviction of more than $1 million in penalties.

Congress passed the Federal Sentencing Guidelines for Organizations (FSGO) in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance. These guidelines, which were developed by the U.S. Sentencing Commission, apply to all felonies and class A misdemeanors committed by

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employees in association with their work. As an incentive, organizations that have demonstrated due diligence in developing effective compliance programs that discourage unethical and illegal conduct may be subject to reduced organizational penalties if an employee commits a crime. Overall, the government philosophy is that legal violations can be prevented through organizational values and a commitment to ethical conduct. A 2004 amendment to the FSGO requires that a business's governing authority be well-informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm's leadership, usually the board of directors. The board must ensure that there is a high-ranking manager accountable for the day-to-day operational oversight of the ethics program. The board must provide for adequate authority, resources, and access to the board or an appropriate subcommittee of the board. The board must also ensure that there are confidential mechanisms available so that the organization's employees and agents may report or seek guidance about potential or actual misconduct without fear of retaliation. A 2010 amendment to the FSGO directs chief compliance officers to make their reports to the board rather than to the general counsel.

The FSGO and the Sarbanes–Oxley Act provide incentives for developing core practices that help ensure ethical and legal compliance. Core practices move the emphasis from a focus on the individual's moral capability to a focus on developing structurally sound organizational core practices and structural integrity for both financial performance and nonfinancial performance. The Integrity Institute has developed an integrated model to standardize the measurement of nonfinancial performance. It has developed methodologies to assess communications, compensation, social responsibility, corporate culture, leadership, risk, and stakeholder perceptions, as well as the more subjective aspects of earnings, corporate governance, technology, and other important nonfinancial areas.

Voluntary responsibilities touch on businesses' social responsibility insofar as businesses contribute to the local community and to society as a whole. Voluntary responsibilities provide four major benefits to society: improving the quality of life, reducing government involvement by providing assistance to stakeholders, developing staff leadership skills, and building staff morale. Companies contribute significant amounts of money to education, the arts, environmental causes, and the disadvantaged by supporting local and national charitable organizations. Cause-related marketing ties an organization's product(s) directly to a social concern through a marketing program. Strategic philanthropy involves linking core business competencies to societal and community needs.

IMPORTANT TERMS FOR REVIEW

voluntary practices

philanthropy

core practices

Better Business Bureau

mandated boundaries

civil law

criminal law

procompetitive legislation

consumer protection law

Occupational Safety and Health Administration

sustainability

Environmental Protection Agency

Public Company Accounting Oversight Board

Consumer Financial Protection Bureau

cause-related marketing

strategic philanthropy

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RESOLVING ETHICAL BUSINESS CHALLENGES*

Albert Chen was sweating profusely in his Jaguar on the expressway as he thought about his options and the fact that Christmas and the Chinese New Year were at hand. He and his wife, Mary, who were on their way to meet Albert's parents at New York's John F. Kennedy International Airport, seemed to be looking up from an abyss, with no daylight to be seen. Several visits and phone calls from various people had overwhelmed them.

Albert had graduated with honors in finance after marrying Mary in his senior year. They had both obtained prestigious brokerage jobs in the New York area, and both had been working killer hours to develop their accounts. Listening to other brokers, both had learned that there were some added expenses to their professions. For example, they were told that brokers need to "look" and "act" successful. So Albert and Mary bought the appropriate clothes and cars, joined the right clubs, and ate at the right restaurants with the right people. They also took the advice of others, which was to identify the "players" of large corporations at parties and take mental notes. "You'd be surprised at what information you hear with a little alcohol in these people," said one broker. Both started using this strategy, and five months later their clients began to see significant profits in their portfolios.

Their good luck even came from strange places. For example, Albert had an uncle whose work as a janitor gave him access to many law offices that had information on a number of companies, especially those about to file for bankruptcy. Mary and Albert were able to use information provided by this uncle to benefit their clients' portfolios. The uncle even had some of his friends use Albert. To Albert's surprise, his uncle's friends often had nest eggs in excess of $200,000. Because some of these friends were quite elderly, Albert was given permission to buy and sell nonrisky stocks at will.

Because both of them were earning good salaries, the Chens soon managed to invest in the market themselves, and their investments included stock in the company for which Mary's father worked. After 18 months, Albert started working for Jarvis, Sunni, Lamar & Morten (JSL&M). JSL&M's reputation was that of a fast mover in the business. "We go up to the line and then measure how wide the line is so that we know how far we can go into it," was a common remark at the brokerage firm.

About six months ago, Mary's father, who was with a major health care company, commented that the management team was running the company into the ground. "If only someone could buy the company and put in a good management team," he mused. After that conversation, Mary investigated the company and discovered that the stock was grossly undervalued. She made a few phone calls and found a company that was interested in doing a hostile takeover. Mary also learned from her father that if a new management were acceptable to the union, the union would do everything in its power to oust the old management—by striking, if necessary—and welcome the new one. As things started to materialize, Mary told several of her best clients, who in turn did very well on the stock. This increased her status in the firm, which kept drawing bigger clients.

Albert soon became a player in initial public stock offerings (IPOs) of new companies. Occasionally when Albert saw a very hot IPO he would talk to some of his best venture-capital friends, who then bought the IPOs and gained some very good returns. This strategy helped attract some larger players in the market. By this point in his young career, Albert had made a great many friends.

One of those friends was Barry, who worked on the stock floor. As they were talking one day, Barry mentioned that if Albert wanted, when placing orders to buy shares, he would occasionally put Albert's or Mary's trade before the client order, as a favor.

The first sign of trouble in their lives came when Mary told Albert about what was happening at her office. "I'm getting e-mail from some of the brokers with off-color jokes and even some nude photos of women and men. I just don't care for it."

"So what are you doing about it?" Albert asked.

"Well, I've just started not even opening my messages if they come from these people," Mary replied.

"What about messages that request that you send them on? What do you do with those?" queried Albert.

"I just e-mail them along without looking at them," was her response.

"This isn't good, Mary. A couple of analysts were just fired for doing that at a big firm last week," said Albert.

Several weeks later the people who were sending Mary the obnoxious messages were fired. Mary was also asked to see the head of her division. When she came to his office, he said, "Please shut the door, Mary. I have some bad news. I know that you weren't involved with what was happening with the e-mail scandal; however, you did forward messages that contained such material. As a result, I have no alternative but to give you your two weeks' notice. I know this is unfair, but I have my orders. Because of this mess, the SEC wants to check all your trades for the last eight months. It seems to be a formality, but it will take time, and as you well know, the chances of going to another firm with that hanging over your head are slim. I'm sorry that it's only two months until the holidays." That night Mary fell into a depression.

To exacerbate the situation, Albert's parents were flying in from the People's Republic of China. They were not happy with Albert's marriage to a non-Chinese woman, but they had consoled themselves that Mary had a good job. They had also said that if things should go badly for Albert and Mary in New York, they could always come to the parents' retirement home in Taiwan. However, the idea of leaving the United States, attempting to learn Mandarin, and raising children in an unfamiliar culture did not appeal to Mary.

Albert was also having some problems. Because their income was cut in half, Albert tried to make up for the loss by trading in some high-risk markets, such as commodities and precious metals. However, many of these investments turned sour, and he found himself buying and selling more and more to pull his own portfolio, as well as those of his clients, into the black. He was getting worried because some of his uncle's friends' portfolios were losing significant value. Other matters, however, were causing him even more anxiety. The previous week Barry had called him, asking for some inside information on several companies that he was working with for an IPO. Albert knew that this could be construed as insider information and had said no.

Today, Barry called again and said, "Look, Al, I've been doing you favors for a while. I need to score big because of the holidays. You probably don't know, but what I've been doing for you could be construed as spinning, which is not looked upon favorably. I'm not asking for the IPO information—I'm demanding it. Is that clear enough for you, Al? E-mail it over by tomorrow morning." Then Barry hung up.

An hour later Albert's supervisor came in and said, "Al, I need a favor from you. I want you to buy some stock for a few friends and me. When it goes to $112, I want you to sell it. We'll pay the taxes and give you a little bonus for Christmas as well. I want you to buy tomorrow as soon as the market opens. Here are the account numbers for the transaction. I must run. See you tomorrow."

QUESTIONS | EXERCISES

1. Identify the ethical and legal issues of which Albert needs to be aware.
2. Discuss the advantages and disadvantages of each decision that Albert could make and has made.
3. Identify the pressures that have brought about these issues.

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

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Voluntary practices include documented best practices. **Yes** **No**
2. The primary method for resolving business ethics disputes is through the criminal court system. **Yes** **No**
3. The FSGO provides an incentive for organizations to conscientiously develop and implement ethics programs. **Yes** **No**
4. The Sarbanes–Oxley Act encourages CEOs and CFOs to report their financial statements accurately. **Yes** **No**
5. Strategic philanthropy represents a new direction in corporate giving that maximizes the benefit to societal or community needs and relates to business objectives. **Yes** **No**

ANSWERS **1. No.** Core practices are documented best practices. **2. No.** Civil litigation is the primary way in which business ethics disputes are resolved. **3. Yes.** Well-designed ethics and compliance programs can minimize legal liability when organizational misconduct is detected. **4. No.** The Sarbanes–Oxley Act *requires* CEOs and CFOs to accurately report their financial statements to a federal oversight committee; they must sign the document and are held personally liable for any inaccuracies. **5. Yes.** Strategic philanthropy helps both society and the organization.

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