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CHAPTER 2

BUSINESS ETHICS

ANSWERS TO LEARNING OBJECTIVES/ FOR REVIEW QUESTIONS AT THE BEGINNING AND THE END OF THE CHAPTER

1A. ***What is business ethics, and why is it important?*** Ethics is the study of what constitutes right or wrong behavior—the fairness, justness, rightness, or wrongness of an action. Business ethics focuses on what constitutes ethical behavior in the world of business. An understanding of business ethics is important to the long-run viability of a business firm and to the well being of the firm's officers, managers, and employees. A business firm also owes duties to a variety of "stakeholders" whom the firm's decisions and activities may affect significantly.

2A. ***How do duty-based ethical standards differ from outcome-based ethical standards?*** Duty-based ethical standards are derived from religious precepts or philosophical principles. Outcome-based ethics focus on the consequences of an action, not on the nature of the action or on a set of pre-established moral values or religious beliefs.

3A. ***What are five steps that a business person can take to evaluate whether his or her actions are ethical?*** The first step is inquiry, the business decision maker must understand the problem, identify the parties involved and collect the relevant facts. Step 2 is to list the possible actions and goals, and discuss and evaluate the ethical principles of each option. The third step is to make a decision or adopt a plan of action. The fourth step is to articulate or document the reasoning (justification) underlying the decision. Once the decision has been made and implemented, step 5 is to evaluate the solution to determine if it was effective. This final step guides the businessperson when making future ethical decisions.

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4A. ***How can business leaders encourage their employees to act ethically?*** Ethical leadership is important to create and maintain an ethical workplace. Managers can set standards, and apply those standards to themselves and their firm's employees.

5A. ***What types of ethical issues might arise in the context of international business transactions?*** The most common types of issues to arise in an international context are those created by the different ethical standards and practices among different cultures and nations. These may include employment policies, the treatment of women and minorities, and (less likely) situations involving bribes.

ANSWERS TO CRITICAL THINKING QUESTIONS AT THE ENDS OF THE FEATURES

ONLINE DEVELOPMENTS—CRITICAL THINKING

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

LINKING BUSINESS LAW TO ACCOUNTING AND FINANCE—CRITICAL THINKING

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

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corporate citizen" certainly cannot hurt when a company is under investigation by regulators.

ANSWERS TO CRITICAL THINKING QUESTIONS AT THE ENDS OF THE CASES

CASE 2.1—QUESTIONS

THE LEGAL ENVIRONMENT DIMENSION

Did Carmela Carpanzano meet the minimum acceptable standard for ethical business behavior? Explain. The minimum acceptable standard for ethical business behavior is compliance with the law. This is sometimes called the moral minimum. If a person only complies with the law, he or she is behaving at the lowest ethical level society accepts. And simply because an action is legal does not mean it is ethical.

In this case, Carmela appears to have met these standards at their lowest level—she did not participate in the fraud against Scott and her lack of participation in the ensuing litigation can be ascribed to her reliance on her father Salvatore to protect her interests. As arguably misplaced as that reliance might have been, she seems to have been truthful and straightforward with the court.

THE ETHICAL DIMENSION

Are the defendants' actions likely to affect their ability to profit from their business in the long run? Discuss. Any successful business has a plan to attain certain goals in the short run and in the long run. In many, if not most situations, the overriding objective is profit maximization. In attempting to maximize profits, however, businesspersons need to distinguish between short- and long-run profit maximization. In the short run, a business may increase its profits by engaging in misconduct. In the long run, however, because of civil suits, criminal charges, settlements, judgments, and bad publicity, such unethical conduct will cause profits to suffer. Overemphasizing short-term profit is the most common cause of ethical problems in business.

In the facts of this case, Salvatore opted for short-run profits by engineering wrongful transfers and expenditures of Scott's money. Due to the judgment of compensatory and punitive damages against Salvatore, and the subsequently likely bad publicity, the profits of his business will be sorely affected going forward.

CASE 2.2—QUESTION

THE ETHICAL DIMENSION

Does an organization have an ethical obligation to secure a safe and

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harassment-free workplace for its employees? Why or why not? Discuss. Yes, employers have a both legal ethical obligations to maintain a workplace free of harassment. As is seen in this case, when an employer discovers harassment through a complaint, the employer has an obligation to take action. The employer must take significant action likely to result in a change in the workplace. In addition, it can be argued that an employer must take action to ensure that there is no harassment occurring – not just wait for a complaint, but actively survey employees and monitor the workplace for harassing behavior. The textbook discussion of acting in good faith and being concerned with doing the right thing dictate that a company be proactive to avoid this harmful behavior.

CASE 2.3—QUESTIONS

WHAT IF THE FACTS WERE DIFFERENT?

Suppose that Shaffer had invoiced Johnson for only $1,500. Would the outcome have been different? Explain your answer. Even if the court had been convinced that Johnson had agreed to spend only $1,000 on the third repair of his truck, the difference between the agreed-on price and the actual invoice price probably would not have seemed large enough to justify Johnson not paying the invoice. Consequently, had all of the other facts remained the same, the court probably would have arrived at a different conclusion.

THE ETHICAL DIMENSION

Would it have been ethical for Shaffer's mechanic to lie to support his employer's case? Discuss. No, it would not have been ethical for the Shaffer mechanic to lie on his employer's behalf. Of course it would have been fraud. This would have been unethical and illegal. And there might have been a question from the legal perspective as to whether his employer directed the misconduct.

ANSWERS TO QUESTIONS IN THE REVIEWING FEATURE AT THE END OF THE CHAPTER

1A. ***Corporate governance***

To ensure that potentially unethical behavior does not escape the attention of those in control of the corporation, Tamik should set up an ethics committee that is separate from the various corporate departments and reports potentially unethical behavior directly to those in control of the corporation.

2A. ***Principle of rights***

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

3A. ***Utilitarian theory***

Utilitarians believe that an action is morally correct when, among the people that it affects, it produces the greatest good to the greatest number. Arnett's decision to continue marketing Kaflux most clearly affected those persons who received the vaccine. Because Kaflux positively affected more persons (preventing fifty deaths), than it allegedly had a negative affect on (twelve children who supposedly committed suicide after experiencing severe hallucinations), Arnett's conduct likely would be considered ethical.

4A. ***Foreign Corrupt Practices Act***

Because Tamik did not attempt to pay off any Japanese government officials and only paid the injured families a cash settlement, the corporation did not violate the Foreign Corrupt Practices Act.

ANSWER TO DEBATE THIS QUESTION IN THE REVIEWING FEATURE AT THE END OF THE CHAPTER

Executives in large corporations are ultimately rewarded if their companies do well, particularly as evidenced by rising stock prices. Consequently, shouldn't we just let those who run corporations decide which level of negative side effects of their goods or services are "acceptable"?

The first problem with this attitude is that executives and managers (and even directors) may be looking at only short-run profits. They therefore might ignore the long-run profitability to their company. If a drug that works well against a potential pandemic causes severe side effects in some people, in the short run, this same drug may save many lives and reduce human suffering. Thus profits could be great initially, with a consequent rise in the stock price. In the longer run, though, when the news gets around that some of those who took the drug suffered severe side effects,

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future sales of the drug might fall, thus reducing profits and causing the stock to price to drop.

One now has to ask the question about who is in the best situation to decide the optimum level of side effects of any drug or good or service sold. (It's impossible to create drugs with zero negative side effects.) Any government regulator will want to make sure that there are few, if any, people who suffer from negative side effects. After all, the government regulator will look bad if the press reports about those who reacted badly to a drug. Therefore, there is a bias within any government regulatory apparatus against any good or service that has bad side effects. More limits on drugs, though, that help millions just because few suffer side effects will cost those who don't obtain the drug—perhaps with their lives.

ANSWERS TO ISSUE SPOTTERS AT THE END OF THE CHAPTER

1A. ***Acme Corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees. Does this raise an ethical conflict between Acme's employees? Between Acme and its employees? Between Acme and its shareholders? Explain your answers.*** When a corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees, an ethical conflict is raised be-tween the firm and its employees and between the firm and its shareholders. This dilemma arises directly out of the effect such a decision has on the firm's profits. If satisfying this obligation increases profitability, then the dilemma is easily resolved in favor of "doing the right thing."

2A. ***Delta Tools, Inc., markets a product that under some circumstances is capable of seriously injuring consumers. Does Delta owe an ethical duty to remove this product from the market, even if the injuries result only from misuse? Why or why not?*** Maybe. On the one hand, it is not the company's "fault" when a product is misused. Also, keeping the product on the market is not a violation of the law, and stopping sales would hurt profits. On the other hand, suspending sales could reduce suffering and could stop potential negative publicity if sales continued.

ANSWERS TO BUSINESS SCENARIOS AND CASE PROBLEMS AT THE END OF THE CHAPTER

2–1A. ***Business ethics***

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Of course it was unethical to sell goods that their maker knew were defective and could cause harm. This is the most reasonable and likely conclusion under any set of standards, even if it were possible to eventually obtain a negative result with respect to a defect from testing that repeatedly yielded a positive result. If Trevor had followed the five-step approach outlined in the text (and discussed below) for making ethical business decisions, the bakery would not have sold these products to the public.

First, the decision maker must identify the parties involved (the bakery, its employees, and the general public) and collect the relevant facts to understand the problem. Ingesting food tainted with salmonella can cause serious illness and death. Because selling food contaminated with salmonella is a public health risk, the general public is a stakeholder in this problem. The owner of the bakery (Trevor) and its employees are also stakeholders, and although they are interested in making a profit, they also will suffer a loss if the bakery's conduct results contamination and customers stop buying the bakery's products. The bakery may not be legally required to report the initial test results to the Food and Drug Administration (FDA), but it is clearly unethical not to do *anything* to address the salmonella contamination found in food that will be sold to the public. Instructing employees to retest the food until the results come out differently does not remedy the problem or avoid potentially fatal consequences. Liability can attach through tort and contract law principles to the sale of goods that the seller knows or should know are defective. Thus, the baker's action in this problem can lead to legal liability if someone is injured by salmonella.

The second step is to list and discuss the possible actions that the bakery could take. The bakery could report the initial results to the FDA, even though it is not required, and ask for the agency's advice on how to handle the salmonella contamination. The bakery should establish procedures for testing (and retesting) food and discover the source of the contamination. This will show employees that the company is concerned with doing the right thing. The bakery might also refuse to sell and voluntarily dispose of the tainted goods.

The third step is for the decision makers to come to a consensus and craft a decision. Clearly, the bakery's decision should not be to simply retest the food until the results are negative and ship it to retailers because this shows a lack of concern for the buyers and indirectly the company's other stakeholders The decision might be to report to the FDA, and follow its instructions for retesting or disposing of the food. Or it might be to voluntarily pull the tainted food off the shelves so as not to put public health at risk. In either situation, the bakery needs to decide how to avoid potential salmonella contamination in the future.

Step four is justification. The decision makers need to document the reasons underlying their decision and course of action. If the decision was to report the results to the FDA and follow its advice on how to handle the contamination, the bakery could justify its actions by articulating that it is concerned with public safety. The same justification applies to a decision to destroy the tainted food. The bakery is justified in

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taking a course of action showing it is better to be safe (and take a monetary loss) than sorry (when a buyer ingests salmonella and dies). Either of these courses of action avoids potentially costly litigation that could result from injured persons suing the company over defective goods, avoids negative publicity and loss of goodwill from a salmonella outbreak. In addition, taking such preventive measures allows the bakery to avoid having the FDA investigate the salmonella problem and possibly issue regulations that would hamper its operation and profits.

The final step is to evaluate the solution after the decision was made and implemented. Whether the bakery decided to report the results to the FDA or just destroy the contaminated food, it should evaluate the effectiveness of its decision and how to avoid potential salmonella contamination in the future. It should establish internal procedures for testing and retesting for salmonella, and should instruct employees on safe handling of food to avoid contamination.

2–2A. ***Ethical conduct***

Minimizing taxes can increase profits. Some people argue that a corporation's only goal should be profit maximization, which will be reflected in a higher market value. From an economist's perspective, when all firms strictly adhere to the goal of profit maximization, resources tend to flow to where they are most highly valued by society. Ultimately, profit maximization, in theory, leads to the most efficient allocation of scarce resources.

But a business's focus on profits in the short run can lead to unethical conduct in the long run. In the short run, a company may increase its profits by taking full advantage of tax laws, even though it knows that the public may perceive this conduct as less than ethical. In the long run, because of bad publicity—exemplified by the executive's statements in this problem—as well as government audits or investigations, and public or private lawsuits, such perception may compound and cause profits to suffer.

Those who run corporations can and should act ethically. Some business leaders and others believe further that corporations should be accountable to society for their actions. One view of corporate social responsibility stresses that corporations have a duty not just to shareholders, but also to other groups affected by corporate decisions. Under this approach, a corporation would consider the impact of its decision on the firm's employees, customers, creditors, suppliers, and the community in which the corporation operates. Another theory of social responsibility argues that corporations should behave as good citizens by promoting goals that society deems worthwhile and taking positive steps toward solving social problems—employment discrimination, human rights, environmental concerns, and similar issues. Under either of these views, in this problem, the corporation would consider the government and the poor in determining and executing fiscal and tax policies.

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Aside from the public's perception and a corporation's social responsibility, an overemphasis on short-term profit maximization is the most common reason that ethical problems occur in business. Thus, the conduct of the corporation in this problem—taking full advantage of the letter of the tax laws and touting that choice publicly—may lead to unintended unethical consequences.

2–3A. SPOTLIGHT ON PFIZER—*Corporate social responsibility*

It could be argued that the defendants have an ethical responsibility to society to voluntarily take steps to reduce the availability of their products to meth makers. This might have become a more certain obligation once the defendants were aware that their products were used in the manufacture of meth. Retailers might have been asked to place the products behind the counter or lock them in display cases and limit sales or require consumers to sign for purchases. Retailers might have been educated about the suspicious behavior of buyers with illegal intent. (These measures were imposed as federal regulations in 2005.) The defendants might have developed alternative medications that did not contain ephedrine or pseudoephedrine.

It could also be argued that the defendants have an ethical responsibility to their shareholders and other stakeholders in their companies to fight regulatory efforts to limit the availability of their products so they could continue making profits. The central purpose of their businesses is to make money, not to affect social change. And the effects on society of the meth epidemic are not the natural and foreseeable consequences of the sales of the defendants' products.

In the actual case, the court compared the counties' claims to other plaintiffs' attempts to recover from gun manufacturers the costs associated with the criminal use of guns. In terms of legal liability, the circumstances connecting the sales of the medications to the provision of government services were too weak for the counties to recoup their costs from the defendants on a theory of implied contract. Also, the sales of the medications were legal, the operations of the STLs were not, the latter were not likely consequences of the former, and thus, in terms of proximate cause for tort liability, the costs to the counties were not reasonably foreseeable. The suit was dismissed.

2–4A. *Ethical leadership*

Ethical leadership is important to create and maintain an ethical workplace. Management can set standards, and apply those standards to themselves and their firm's employees to encourage an ethical business environment. One of the most important factors in creating and maintaining an ethical workplace is the attitude of management. Management's behavior sets the ethical tone of a firm. Employees take their cue from management. If the manager's do not follow ethical norms, employees will be likely to follow that example.

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The circumstances set out in this problem show how a manager's sexist attitudes and actions can affect a workplace. Even if Krasner was not a victim of a violation of a law or a company policy, his complaints reveal that his perspective of his workplace environment was clearly affected by his supervisor's attitudes and actions. Assuming Krasner's complaints were supported by fact, they also indicate that Kiser behaved unethically.

In the actual case on which this problem is based, HSH investigated but did not find a violation of its ethics policies. Krasner filed a suit in a federal district court against the firm, alleging gender-based discrimination, but the court did not find any such discrimination—a female employee in Krasner's position would have experienced the same consequences.

2–5A. ***Business ethics on a global scale***

The Foreign Corrupt Practices Act relates to the payments of foreign officials to make discretionary decisions in favor of the payer. In this circumstance, Kozeny was paying members of a royal family who also held positions of authority in the government to use their influence in order to have decisions made to benefit Kozeny. The payment was structured so that it would happen on an ongoing basis once the decisions were made, but that would still count as bribery of a foreign official under the FCPA. As a general ethical principle, Kozeny is eliminating fair competition with this scheme. That could be considered a violation of fundamental rights under a duty-based analysis.

2–6A. **BUSINESS CASE PROBLEM WITH SAMPLE ANSWER—*Online privacy***

Facebook created a program that makes decisions for users. Many believe that privacy is an extremely important right that should fiercely protected. Thus, using duty-based ethics, any program that has a default of giving out information is unethical. Facebook should create the program as an opt-in program.

In addition, under the Kantian categorical imperative, if every company created opt-out programs that disclosed potentially personal information, the concept of privacy may be reduced to a theoretical concept only. With this reduction or elimination of privacy, one could argue the world is not a better place. From a utilitarian or outcome-based approach, the benefits of an opt-out program might be in ease of creation and starting the program as well as ease of recruiting partner programs. On the negative side, the program would eliminate users' ability to choose whether to to disclose information about themselves. An opt-in program would maintain that user control but might entail higher start-up costs because it would require more marketing to users up front to persuade them to opt-in.

2–7A. ***Business ethics***

Business ethics might have been violated in these circumstances by Mark Ramun, John Ramun, and the employees and managers of Gensis.

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The "tense relationship" between John and Mark at Allied may have been caused or exacerbated by either or both of them. And instead of confronting whatever it was that made their relationship "tense," they may have exacted revenge—John by forcing Mark out of the firm, or Mark by leaving it, after ten years. Of course, this is speculation.

What is not speculation, however, is that Mark took 15,000 pages of Allied's documents on DVDs and CDs (trade secrets) when he left the firm. This act was likely a violation of the law (theft or misappropriation) and clearly a violation of business ethics. Later, Mark joined Allied's competitor, Genesis Equipment & Manufacturing, Inc. Genesis soon developed a piece of equipment that incorporated elements of Allied equipment. This points to a second violation of the law and ethics (use of stolen property) by both Mark and Genesis. Mark appears to have been competing against his family in the marketplace and trying to sell his products through another company. Assuming that Genesis profited from its sale of the equipment, this would have caused losses to Allied and unjustly enriched Genesis. If Mark was paid a bonus or given a promotion, he too would have gained undeservedly.

In the actual case on which this problem is based, Allied filed a suit in a federal district court against Genesis and Mark for misappropriation of trade secrets. A jury awarded Allied more than $3 million in damages, but the court issued a judgment as a matter of law in favor of the defendants. On appeal, the U.S. Court of Appeals for the Sixth Circuit reversed. "It is neither speculative nor conjectural that Genesis unjustly benefitted from its use of Allied's trade secrets."

2–8A. *Business ethics*

Ethics is the study of what constitutes right and wrong behavior. It is a branch of philosophy focusing on morality and the way moral principles are derived and implemented. Ethics has to do with the fairness, justness, rightness, or wrongness of an action. Those who study ethics evaluate what duties and responsibilities exist or should exist for its practitioners. The circumstances set out in this problem underscore the importance of ethics by illustrating the consequences of engaging in ethical misconduct. Those consequences can extend beyond the short run.

Clearly, Glass engaged in ethical misconduct. By fabricating material for more than forty articles for *The New Republic* magazine and other publications whose reputations are founded on truth, Glass betrayed the trust of his editors. He further behaved unethically by fabricating supporting materials to delude *The New Republic's* fact checkers. And once he was suspected, he tried to avoid detection. Later, based on these misdeeds and others, the California Supreme Court refused to admit Glass to the California bar.

Does Glass deserve a "second chance"? Based on the facts in this problem, it can be argued that no, he does not—he had more than one "second chance" and blew them all. This is indicated by the California Supreme Court's citation of

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"numerous instances of dishonesty and disingenuousness" during Glass's "rehabilitation" following "the exposure of his misdeeds." From a more forgiving perspective, it could be argued that he does deserve another chance—because of his misdeeds, his every move will be closely scrutinized and any misconduct would most likely be swiftly spotted and thwarted.

In the actual case on which this problem is based, Glass had earlier applied for, and been denied, admission to the New York bar. Then, as stated in the facts, on Glass's application to the California bar, the California Supreme Court denied him.

2-9A. A QUESTION OF ETHICS—*Consumer rights*

1. In this case, the court found that the company did not violate any laws and that the disclosures were adequate. From an ethical perspective, the question becomes whether the word "may" on the website gave adequate notice to the potential user or borrower that a charge would occur. It is settled legally that it up to a contract signer to read all the components of a contract. In the online environment, it is hard to ever prove that a web page was not edited or changed from one day to the next. A consumer may read the terms and conditions just before a round of edits and then agree and seem bound by changes that did not exist at the time they read them. From a fairness perspective, that would be unethical. At the same time, presumably the reader could print off a copy of the agreement and keep it filed. Underlying societal questions exist as to whether it is fair to assume that a purchaser in an online environment would print off that form contract language in the same way that a signer of a contract keeps a copy of the written contract.

2. The law often is considered the minimum ethical standard that society will allow. If a company follows the law, there will be no formal, societally-imposed consequences. There are many instances, and this is one, where following the law strictly may not be the most ethical action. If the purpose of the Truth-in-Lending Act is to ensure that consumers have full information before making a decision, there may be more ethical ways (warnings, bigger text announcing continuation of terms, more specific language than "may" in the terms) that a company can help consumers be fully informed.

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