ETHICS AND THE CONDUCT OF BUSINESS

EIGHTH EDITION

JOHN R. BOATRIGHT | JEFFREY SMITH

Ethics and the Conduct of Business

Eighth Edition

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Preface

The eighth edition of *Ethics and the Conduct of Business* has reached two significant milestones. The first achievement, which is obvious to anyone reading these words, is the transition to digital media. Through Pearson's online platform REVEL, this text offers not only a new mobile reading experience—on computers, tablets, and even smartphones—but also a new approach to learning, with many interactive features, videos, quizzes, and other educational tools. REVEL creates a new frontier in education for both students and instructors. It is exciting for us, as authors, to be pioneer participants in this promising and innovative endeavor.

Users of previous editions will also note the appearance of a coauthor, Jeffery D. Smith. His collaboration in the eighth edition not only brings a fresh perspective to what is now a joint venture but also prepares for the future of this classic text, which first appeared more than 20 years ago. Under Jeffery's guidance, *Ethics and the Conduct of Business* will hopefully continue to remain current and relevant through many new editions.

The eight editions of *Ethics and the Conduct of Business* have followed the development of the field of business ethics, which has grown in recent decades into an interdisciplinary area of study that has found a secure niche in both liberal arts and business education. Credit for this development belongs to many individuals—both philosophers and business scholars—who have succeeded in relating ethical theory to the various problems of ethics that arise in business. They have shown not only that business is a fruitful subject for philosophical exploration but also that future managers in the world of business can benefit from the results.

Ethics and the Conduct of Business, eighth edition, is a comprehensive and up-to-date discussion of the most prominent issues in the field of business ethics and the major positions and arguments on these issues. It is intended to be used as a text in business ethics courses on either the undergraduate or M.B.A. level. The substantial number of cases included provides ample opportunity for a case-study approach or a combined lecture–discussion format. There has been no attempt to develop a distinctive ethical system or to argue for specific conclusions. The field of business ethics is marked by reasonable disagreement that should be reflected in any good text for a course.

The focus of *Ethics and the Conduct of Business* is primarily on ethical issues that corporate decision makers face in developing policies about employees, customers, investors, and the general public. The positions on these issues and the arguments for them are taken from a wide variety of sources, including economics and the law. The study of ethical issues in business is not confined to a single academic discipline or even to the academic world. The issues selected for discussion are widely debated by legislators, judges, government regulators, business leaders, journalists, and, indeed, virtually everyone with an interest in business.

An underlying assumption of this course is that ethical theory is essential for a full understanding of the positions and arguments offered on the main issues in business ethics. Fortunately, the amount of theory needed is relatively small, and much of the discussion of these issues can be understood apart from the theoretical foundation provided here. The text also contains a substantial amount of legal material, not only because the law addresses many ethical issues but also because management decision making must take account of the relevant law. Many examples are used throughout the text in order to explain points and show the relevance of the discussion to real-life business practice.

New to the Edition

Preparation of the eighth edition of *Ethics and the Conduct of Business* has provided an opportunity to incorporate new developments and to increase its value in the classroom. The major changes from the previous edition are as follows:

- Chapter 5 on business information has been expanded to provide greater coverage on confidential information and the duty of confidentiality.
- Chapter 6 on privacy has been expanded to include more on the protection of both employee and consumer privacy against intrusions, especially from advances in technology.
- The section on product safety has been moved from Chapter 10 on marketing and advertising to the coverage of worker health and safety in Chapter 9. This change has allowed expanded treatment in Chapter 10 of emerging issues in marketing and advertising, especially those related to the use of social media and data analysis, which have been facilitated by the Internet.
- Chapter 12 on corporate social responsibility includes a new section on the recent development of for-profit businesses, known as social enterprises, which operate with a mission to deliver vital social services.

- The Chapter 13 section on corporate governance has been completely rewritten for greater clarity and coherence.
- The eighth edition contains 58 short cases, including 12 new ones on such subjects as a falsified résumé at Yahoo, conflict of interest at Goldman Sachs, a firing at Google for blogging, profiling of Internet visitors by a major bank, variable pricing strategies in grocery stores, Herbalife's unusual multilevel marketing scheme, Coca-Cola's water use in India, and bribery by Walmart executives in Mexico.

Acknowledgments

I, John Boatright, am grateful for the support of Loyola University Chicago and especially the Quinlan School of Business. I have benefited from the resources of the Raymond C. Baumhart, S.J., Chair in Business Ethics, which was created to honor a former president of Loyola University Chicago, who was also a pioneer in the field of business ethics. To Ray Baumhart I owe a special debt of gratitude. I am grateful as well to Jeffery Smith for graciously accepting my offer to become a coauthor of this edition and my ultimate successor in the preparation of future editions. Finally, my deepest expression of appreciation goes to my wife, Claudia, whose affection, patience, and support have been essential for the preparation of the eighth edition, as they were for the ones previous.

It goes without saying that I, Jeffery Smith, am excited to work with John Boatright on this important project and appreciate his generous offer to continue our collaboration on future editions. I hope to maintain the clarity, depth, and even-handedness that have made earlier editions so valuable to students and instructors. For over a decade, I have benefited from the support of the Banta Center for Business, Ethics and Society and my colleagues at the University of Redlands. For everyone there I am grateful. My thanks also go to DePauw University's Prindle Institute for Ethics for hosting me as the Nancy Schaenen Visiting Scholar while portions of the eighth edition were written. And I also owe so much to my lovely wife, Rita, who provides support when I need it most and continues to keep me grounded.

John R. Boatright
Jeffery D. Smith

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About the Authors

John R. Boatright is the Raymond C. Baumhart, S.J., Professor of Business Ethics in the Quinlan School of Business at Loyola University Chicago. He has served as the Executive Director of the Society for Business Ethics, and is a past president of the Society. He was recognized by the Society in 2012 for a "Career of Outstanding Service to the Field of Business Ethics." He is the author of the book *Ethics in Finance*, and has edited *Finance Ethics: Critical Issues in Theory and Practice*. He serves on the editorial boards of *Business Ethics Quarterly, Journal of Business Ethics*, and *Business and Society Review*. He received his Ph.D. in philosophy from the University of Chicago.

Jeffery D. Smith is the Boeing Frank Shrontz Chair of Professional Ethics and Professor of Management in the Albers School of Business and Economics at Seattle University, teaching ethics to management, accounting and finance students. He currently serves on the executive board of the Society for Business Ethics and the editorial board of the international journal of the Society, *Business Ethics Quarterly*. He is the editor of *Normative Theory and Business Ethics* (2008) and has published in a variety of business and philosophy journals. He received his Ph.D. from the University of Minnesota.

Chapter 1
Ethics in the World of Business

Learning Objectives

1.1 Identify ethical issues created by diverse business situations and relationships and the level of decision making required to address them

1.2 Recognize the role of ethics in the conduct of business, with respect to economic principles and the law

1.3 Distinguish between ethical management and the management of ethics, and each of the three main roles of a manager

1.4 Analyze how ethical business conduct is challenged by decision making on individual and organizational levels

Case: Merck and the Marketing of Vioxx

On September 30, 2004, Merck & Co. announced the withdrawal of Vioxx, its highly profitable pain reliever for arthritis sufferers, from the market.[1] This announcement came only seven days after company researchers found in a clinical trial that subjects who used Vioxx more than 18 months had a substantially higher incidence of heart attacks. Merck chairman and CEO Raymond V. Gilmartin described the action as "the responsible thing to do." He explained, "It's built into the principles of the company to think in this fashion. That's why the management team came to such an easy conclusion."[2] In the lawsuits that followed, however, damaging documents emerged casting doubt on Merck's claim that it had acted responsibly by taking appropriate precautions in the development and marketing of the drug.

Development of Vioxx

For decades, Merck's stellar reputation rested on the company's emphasis on science-driven research and development. Merck employed some of the world's most talented and best-paid researchers and led other pharmaceutical firms in the publication of scientific articles and the discovery of new medicines for the treatment of serious conditions that lacked satisfactory therapies. For seven consecutive years in the 1980s, Merck was ranked by *Fortune* magazine as America's most respected company. Merck received widespread accolades in particular for the decision, made in 1978, to proceed with research on a drug for preventing river blindness (onchocerciasis), which is a debilitating parasite infection that afflicts many in Africa, even though the drug was unlikely to pay for itself. Eventually, Merck decided to give away the drug, called Mectizan, for as long as necessary at a cost of tens of millions of dollars per year. This kind of principled decision making was inspired by the words of George W. Merck, the son of the company's founder: "We try never to forget that medicine is for the people. It is not for the profits. The profits follow, and if we have remembered that, they have never failed to appear. The better we have remembered it, the larger they have been."

Vioxx is an example of Merck's innovative research. Developed as a treatment for the pain of arthritis, the drug acts as an anti-inflammant by suppressing an enzyme responsible for arthritis pain. Other drugs in the class of nonsteroidal anti-inflammatory drugs (NSAIDs) inhibit the production of two enzymes COX-1 and COX-2. However, COX-1 is important for protecting the stomach lining, and so ulcers and stomach bleeding are potential side effects of these drugs. The distinctive benefit of Vioxx over other NSAID pain relievers, such as ibuprofen (Advil) and naproxen (Aleve), is that it inhibits the production of only the COX-2 enzyme, and not COX-1. After approval by the Food and Drug Administration (FDA) in May 1999, Vioxx quickly became a popular best seller. More than 20 million people took Vioxx between 1999 and 2004, and at the time of the withdrawal, with 2 million users, Merck was earning $2.5 billion annually or 11 percent of the company's total revenues from the sale of the drug.

Competitive Environment

The success of Vioxx came at a critical time for Merck. Not only were the patents on several profitable drugs due to expire, opening the way for generic competition, but also the competitive environment of the entire pharmaceutical industry was undergoing rapid change. Competition from generic drugs increased dramatically due to federal legislation and also due to the rise of large, powerful managed care organizations, which sought to cut the cost of drug treatments through the use of formularies that restricted the drugs doctors could prescribe. The development of new drugs was increasingly shifting to small entrepreneurial research companies focused on specific technologies, which reduced the competitive advantage of the traditional large pharmaceutical firms. Merck's competitors responded to changes in the competitive environment by acquiring small companies, developing new products that duplicated ones already on the market (so-called "me-too" drugs), entering the generics market, seeking extensions of patents after making only slight improvements, and engaging in aggressive marketing, including the use of controversial direct-to-consumer (DTC) advertising.

The first four strategies—growth by acquisition, the development of "me-too" drugs, the production of generics, and making improvements merely to extend patents—conflicted with Merck's culture and values. However, under the previous CEO, Roy Vagelos (who guided Merck through the development of Mectizan for river blindness), the company greatly increased its emphasis on marketing. This increase in emphasis was considered necessary given the short time available to sell a drug before the patent expired. In particular, evidence was needed not only to prove a product's safety and effectiveness in order to gain FDA approval but also to persuade physicians to prescribe it instead of the competitors' medications. Since much of the information that could persuade doctors was part of a drug's label, marketers needed to be involved in the development of a product from the earliest research stages in order to prepare a persuasive label. The label could be improved further by conducting tests, which were not scientifically necessary but which generated clinically proven results that could be useful in persuading physicians. Under Gilmartin, the company's formally stated strategy became: "Turning cutting-edge science into novel medicines that are true advances in patient care with proven clinical outcomes."

Decision to Withdraw

In announcing the withdrawal of Vioxx, Gilmartin described the evidence of increased risk of heart attacks as "unexpected." In the first lawsuits against Merck that came to trial, evidence was presented to show that company scientists had considered the potential heart problems with Vioxx as early as 1997. The first hint of trouble came in that year as Merck scientists noticed that Vioxx appeared to suppress the production of a substance in the body that acted naturally to reduce the incidence of heart attacks. Although the significance of this discovery was recognized, no follow-up investigations were undertaken.

More significant evidence that Vioxx might contribute to heart attacks was produced by a study concluded in 2000 that was designed to compare the gastrointestinal effects of Vioxx and naproxen in order to improve the label of the Merck product by proving that Vioxx was less harmful to the stomach lining. Although the study, called VIGOR (for Vioxx Gastrointestinal Outcomes Research), showed that Vioxx users had heart attacks at a rate four to five times that of the naproxen group, researchers were uncertain whether the difference was due to an adverse effect of Vioxx in causing heart attacks or a beneficial effect of naproxen in preventing them. The heart attacks in the trial occurred mainly in the Vioxx subjects who were already at greatest risk of heart attacks, and all subjects were prohibited from taking aspirin (which is known to prevent heart attacks) in order to gain reliable results from the study since aspirin affects the stomach. When the results of the VIGOR study were published in the November 2000 issue of the prestigious *New England Journal of Medicine*, the beneficial effects of naproxen were emphasized in a way that implied that Vioxx was safe for people without the risk factors for heart attacks. After initially resisting pressure by the FDA to include a warning on the Vioxx label, Merck finally agreed in April 2002 to add the evidence of an increased incidence of heart attacks. However, the language on the label emphasized, again, the uncertainty of the cause and recommended that people at risk of heart attacks continue to use an anti-inflammant for protection.

In the meantime, Merck continued its aggressive marketing campaign. Between 1999 and 2004, Merck spent more than $500 million on DTC television and print advertising. This expenditure was intended to keep pace with the heavy spending by Pfizer for its competing COX-2 inhibiter Celebrex. Merck also maintained a 3,000-person sales force to meet with doctors for face-to-face conversations about Vioxx. To support this effort, Merck developed materials that provided salespeople with responses to questions from skeptical physicians.[3] One document, called an "obstacle handling guide," advised that questions about the risk of heart attacks be answered with the evasive explanations that Vioxx "would not be expected to demonstrate reductions" in heart attacks and was "not a substitute for aspirin." Another document titled "Dodge Ball Vioxx" concluded with four pages that were blank except for the word "DODGE!" in capital letters on each page. Company documents also describe an effort to "neutralize" skeptical doctors by enlisting their support or at least defusing their opposition by offers of research support or engagements as consultants.[4]

The timeline below outlines key events in the development, approval, and marketing of Vioxx and the outcome for Merck.

The History of Vioxx

The Food and Drug Administration (FDA) has a multi-phase approval process to evaluate the testing, safety, and labeling of all new prescription drugs to be sold in the United States. The FDA also monitors the "post-marketing" safety of approved drugs, to ensure that the public is informed of any new health risks that are revealed by widespread use and additional studies.

Timeline

December 1994	Merck seeks FDA approval to begin Vioxx clinical trials (on human subjects), based on the success of animal testing.
1997	Merck scientists discover the first signs that Vioxx may cause cardiovascular problems.
November 1998	Merck applies for FDA approval to market Vioxx for the treatment of acute pain, dysmenorrhea (menstrual cramps), and osteoarthritis. The application includes the results of about 60 studies, none of which points to potential cardiovascular risks.
January 1999	Merck begins the Vioxx Gastrointestinal Outcomes Research study (VIGOR) to determine whether Vioxx is safer for the digestive system than naproxen, an older painkiller. This later becomes a key selling point for the drug.
May 1999	After a six-month review, the FDA approves Vioxx for the three uses Merck specified in its application.
October 1999 – December 1999	The data and safety monitoring board for Merck's VIGOR study meets several times to discuss its findings. Although Vioxx appears to increase the risk of heart problems in test subjects, the board votes to continue the study and keep marketing Vioxx to the public.
November 2000	Merck's VIGOR study is published in the *New England Journal of Medicine*, but Merck does not include all observed instances of heart attacks and downplays the cardiovascular risks.
2001	The FDA publishes the full VIGOR study results and additional studies conducted by independent parties also indicate that there is a real risk of cardiovascular problems. In September, the FDA warns Merck that the Vioxx marketing campaign and label do not adequately represent its health risks.
April 2002	Merck changes the drug's label to better reflect the dangers and necessary precautions for prescribing doctors and users, based on the VIGOR study. The FDA also approves Vioxx for an additional use: the treatment of rheumatoid arthritis.
September 2004	Merck's APPROVe (Adenomatous Polyp Prevention on Vioxx) study conclusively shows that Vioxx increases the risk of heart attacks and strokes after 18 months of treatment. Merck then voluntarily stops the sale of Vioxx.
January 2005	A British medical journal publishes a study that estimates Vioxx caused heart attacks in 88,000–140,000 Americans and fatal heart attacks in 38,000. Study author David Graham is an FDA scientist who also affirmed the correlation between Vioxx and heart attacks in his earlier testimony to Congress.
November 2007	After facing multiple lawsuits, Merck agrees to pay $4.85 billion to settle about 47,000 personal injury claims from former Vioxx users.
December 2011	Merck pleads guilty to promoting Vioxx as a treatment for rheumatoid arthritis before it received FDA approval for this use in 2002. The company agrees to pay a fine of $628 million in the civil settlement.
April 2012	A U.S. district court orders Merck to pay an additional $322 million as a criminal penalty for its misleading promotion and marketing of Vioxx.

Additional sources: "Sequence of Events with VIOXX, Since Opening of IND," U.S. FDA Advisory Committees Briefing, 9 April 2005; Snigdha Prakash and Vikki Valentine, "Timeline: The Rise and Fall of Vioxx," National Public Radio, 10 November 2007; "U.S. Pharmaceutical Company Merck Sharp & Dohme Sentenced in Connection with Unlawful Promotion of Vioxx," U.S. Department of Justice Press Release, 19 April 2012.

Criticisms and Defenses

The study that conclusively established that Vioxx increased the risk of heart attacks was called APPROVe (Adenomatous Polyp Prevention on Vioxx), which, according to critics, had only a marketing and not a legitimate scientific purpose.[5] Although the company could have delayed the withdrawal until ordered to do so by the FDA, Merck acted voluntarily. Gilmartin said that the company "was really putting patient safety first."[6] However, one critic replied, "If Merck were truly acting in the interest of the public, of course, they should have done more studies on Vioxx's safety when doubts about it first surfaced."[7] Another critic observed that such studies could have been conducted for a fraction of the cost of the $500 million spent on advertising.[8]

An editorial in the *New York Times* declared that "companies must jump at the first hint of risk and warn patients and doctors of any dangers as clearly and quickly as possible. They should not be stonewalling regulators, soft-pedaling risk to doctors or promoting drugs to millions of people who don't need them."[9] A 179-page report commissioned by the Merck board concluded, by contrast, that executives and researchers acted with integrity in addressing incomplete and conflicting evidence and that "their conclusions were reached in good faith and were reasonable under the circumstances."[10] The report closed with the observation that the quick response after the APPROVe study "is not consistent with the view that Merck's corporate culture put profits over patient safety."[11]

Points to Consider…

The Vioxx crisis was an unusually difficult and damaging experience for Merck, which has both a history of responsible conduct and a commitment to the highest standards of ethics. Although Merck's culture is built on strong values, these were not enough to prevent a series of decisions that, right or wrong, seriously damaged the company's carefully built reputation. Merck executives appear to have considered carefully the possible health risk posed by Vioxx, and yet the push for profits may have led them to conclude too easily that Vioxx was not the cause of the heart attacks suffered by test subjects and that further studies were not necessary. The increased role of marketing, including heavy consumer advertising, in a traditionally science-driven culture was probably a factor in whatever mistakes were made, as was the change in strategy to seek evidence of the products' superiority as part of a marketing campaign to influence physicians. However, Merck's strategy could not have avoided some adjustment given the changed competitive environment that was created by forces outside the company's control.

All business organizations face the daunting challenge of adhering to the highest standards of ethics while, at the same time, remaining competitive and providing the products and services that the public demands. The task of managers in these organizations is to make sound business decisions that enable a company to achieve its mission. Some of these decisions involve complex ethical issues that may not be readily apparent, and success in making sound business decisions may depend on understanding these ethical issues and resolving them effectively. Ethical issues are considered by managers in the ordinary course of their work, but they are also matters that are discussed in the pages of the business press, debated in the halls of Congress, and scrutinized by the courts. This public concern arises because ethical issues in business are closely tied to important matters of public policy and to the legislative, administrative, and judicial processes of government. These ethical issues are often only part of a complex set of challenges facing the whole of society.

WRITING PROMPT

Decisions by Multiple Parties

After Vioxx was taken off the market, Congress began investigating the effectiveness and integrity of the FDA's drug approval process along with Merck's own actions. What are the costs and benefits of approving new drugs for sale as quickly as possible? Why might the FDA be reluctant to acknowledge a problem with, or recall, a drug that it had previously approved?

▶ `The response entered here will appear in the performance dashboard and can be viewed by your instructor.`

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1.1: Business Decision Making

1.1 Identify ethical issues created by diverse business situations and relationships and the level of decision making required to address them

Although ethical issues in business are very diverse, the following examples provide a useful starting point.

1. ***The Sales Rep***
   A sales representative for a struggling computer supply firm has a chance to close a multimillion-dollar deal for an office system to be installed over a two-year period. The machines for the first delivery are in the company's warehouse, but the remainder would have to be ordered from the manufacturer. Because the manufacturer is having difficulty meeting the heavy demand for the popular model, the sales representative is not sure that subsequent deliveries can be made on time. Any delay in converting to the new system would be costly to the customer; however, the blame could be placed on the manufacturer.

Ethical Issue: Should the sales representative close the deal without advising the customer of the delivery problem?

2. ***The Research Director***
The director of research in a large aerospace firm recently promoted a woman to head an engineering team charged with designing a critical component for a new plane. She was tapped for the job because of her superior knowledge of the engineering aspects of the project, but the men under her direction have been expressing resentment at working for a woman by subtly sabotaging the work of the team. The director believes that it is unfair to deprive the woman of advancement merely because of the prejudice of her male colleagues, but quick completion of the designs and the building of a prototype are vital to the success of the company.

    Ethical Issue: Should the director remove the woman as head of the engineering team?

3. ***The Marketing Director***
The vice president of marketing for a major brewing company is aware that college students account for a large proportion of beer sales and that people in this age group form lifelong loyalties to particular brands of beer. The executive is personally uncomfortable with the tasteless gimmicks used by her competitors in the industry to encourage drinking on campuses, including beach parties and beer-drinking contests. She worries about the company's contribution to underage drinking and alcohol abuse among college students.

    Ethical Issue: Should the marketing director follow the competition's troubling practices?

4. ***The CEO***
The CEO of a midsize producer of a popular line of kitchen appliances is approached about merging with a larger company. The terms offered by the suitor are very advantageous to the CEO, who would receive a large severance package. The shareholders of the firm would also benefit because the offer for their stock is substantially above the current market price. The CEO learns, however, that plans call for closing a plant that is the major employer in a small town. The firm has always taken its social responsibility seriously, but the CEO is now unsure of how to balance the welfare of the employees who would be thrown out of work and the community where the plant is located against the interests of the shareholders. He is also not sure how much to take his own interests into account.

    Ethical Issue: Should the CEO support a merger that harms the community but benefits the shareholders and himself?

These four examples give some idea of the ethical issues that arise at all levels of business. The individuals in these cases are faced with questions about ethics in their relations with customers, employees, and members of the larger society. Frequently, the ethically correct course of action is clear, and people in business act accordingly. Exceptions occur, however, when there is uncertainty about ethical obligations in particular situations or when considerations of ethics come into conflict with the practical demands of business. The sales representative might not be sure, for example, about the extent to which he is obligated to provide information about possible delays in delivery. And the director of research, although convinced that discrimination is wrong, might still feel that he has no choice but to remove the woman as head of the team in order to get the job done.

WRITING PROMPT

Judgment Calls on the Job

Describe a situation where you needed to make a decision in which the "right" choice had negative consequences for others or yourself personally. Explain your decision and the reasoning for it.

▶ The response entered here will appear in the performance dashboard and can be viewed by your instructor.

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1.1.1: Nature of Business

In deciding on an ethical course of action, we can rely to some extent on the rules of right conduct that we employ in everyday life. Deception is wrong, for example, whether we deceive a friend or a customer. And corporations no less than persons have an obligation not to discriminate or cause harm. However, business activity also has some features that limit the applicability of our ordinary ethical views. In business settings, we encounter situations that are significantly different from those of everyday life, and business roles place their own obligations on us. For example, CEOs, by virtue of their position, have responsibilities to several different constituencies, and they face ethical challenges in finding the proper balance among these possibly conflicting responsibilities.

One distinguishing feature of business is its *economic* character. In the world of business, we interact with each other not as family members, friends, or neighbors, but as buyers and sellers, employers and employees, and the like. Trading, for example, is often accompanied by hard bargaining, in which both sides conceal their full hand and perhaps engage in some bluffing. And a skilled salesperson is well versed in the art of arousing a customer's attention (sometimes by a bit of puffery) to clinch the sale. Still, there is an "ethics of trading" that prohibits the use of false or deceptive claims and tricks such as "bait-and-switch" advertising.

Employment is also recognized as a special relationship, with its own standards of right and wrong. Employers are generally entitled to hire and promote whomever they wish and to lay off or terminate workers without regard for the impact on the people affected. (This right is being increasingly challenged, however, by those who hold that employers ought to fire only for cause and to follow rules of due process in termination decisions.) Employees also have some protections, such as a right not to be discriminated against or to be exposed to workplace hazards. There are many controversies about the employment relationship, such as the rights of employers and employees with regard to privacy and freedom of speech, for example.

The ethics of business, then, is at least in part the ethics of economic or market activity, such as the conduct of buyers and sellers in a market and of employers and employees in the workplace. So we need to ask, what are the ethical rules or standards that ought to govern these kinds of activities? And how do these rules and standards differ from those that apply in other spheres of life?

A second distinguishing feature of business is that it typically takes place in *organizations*. An organization, according to organizational theory, is a hierarchical system of functionally defined positions designed to achieve some goal or a set of goals. Consequently, the members of a business organization, in assuming a particular position, take on new obligations to pursue the goals of a firm. Because business involves economic transactions and relationships that take place in markets and also in organizations, it raises ethical issues for which the ethics of everyday life has not prepared us. Although the familiar ethical rules about honesty, fairness, promise keeping, and the like are applicable to business, it is necessary in many cases to rethink how they apply in business situations. This is not to say that the ethics of business is different from ethics in everyday life, but only that business is a different context, and it presents us with new situations that require us to think through the ethical issues.

WRITING PROMPT

A Business Mindset

What do people usually mean when they defend a business decision by saying, "Business is business"? By what standards should business decisions be evaluated, and how do these compare to the standards in your personal life?

▶ **The response entered here will appear in the performance dashboard and can be viewed by your instructor.**

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1.1.2: Levels of Decision Making

Decision making in business occurs on three distinct levels:

- the level of the *individual*
- the level of the *organization*
- the level of the *business system*

Situations that confront individuals in the workplace and require them to make a decision about their own response are on the level of individual decision making. An employee with an unreasonably demanding boss, for example, or with a boss who is discovered padding his expense account faces the question: **"What do *I* do?"** Whether to live with the difficult boss or to blow the whistle on the padding is a question to be answered by the individual and acted on accordingly.

Many ethical problems occur at the level of the organization in the sense that the individual decision maker is acting on behalf of the organization in bringing about some organizational change. Sexual harassment, for example, is an individual matter for the person suffering the abuse, but a manager in an office where sexual harassment is happening must take steps not only to rectify the situation but also to ensure that it does not occur again. The decision in this case may be a disciplinary action, which involves a manager acting within his or her organizational role. The manager may also institute training to prevent sexual harassment and possibly develop a sexual harassment policy, which not only prohibits certain behavior but also creates procedures for handling complaints. Responding to harassment as a manager, as opposed to dealing with harassment as a victim, involves decisions on the organizational level rather than the individual level. The question here is, **"What do *we as an organization* do?"**

Problems that result from accepted business practices or from features of the economic system cannot be effectively addressed by any single organization, much less a lone individual. Sales practices within an industry, for example, are difficult for one company to change single-handedly because the company is constrained by competition with possibly less-ethical competitors. The most effective solution is likely to be an industry-wide code of ethics, agreed to by all. Similarly, the lower pay for women work results from structural features of the labor market, which no one company or even industry can alter. A single employer cannot adopt a policy of comparable worth, for example, because the problem of lower pay for women is systemic, and consequently any substantial change must be on the level of the system. Systemic problems are best solved by some form of regulation or economic reform. On the systemic level, the relevant question is, **"What do *we as a society* do?"**

Use Table 1.1 to review these concepts.

Table 1.1 Levels of Decision Making in Business

Review the type of problem that should be resolved at each level of decision making and the relevant question for each. Then hide the cells in the table to quiz your understanding of these situations.

Level	Type of Problem	Relevant Question
The Individual	The problem confronts an individual and requires that person to make a decision about his or her own response.	What do I do?
The Organization	The problem requires that the individual decision maker act on behalf of the organization to resolve the situation and possibly bring about some organizational change.	What do we as an organization do?
The Business System	The problem results from accepted business practices or from features of the economic system which cannot be effectively addressed by any single individual or organization.	What do we as a society do?

Identification of the appropriate level for a decision is important because an ethical problem may have no solution on the level at which it is approached. The beer marketer described earlier may have little choice but to follow the competition in using tasteless gimmicks because the problem has no real solution on the individual or organizational level. An effective response requires that she place the problem on the systemic level and seek a solution appropriate to that level. Richard T. DeGeorge has described such a move as "ethical displacement," which consists of addressing a problem on a level other than the one on which the problem appears.[12] The fact that some problems can be solved only by displacing them to a higher level is a source of great distress for individuals in difficult situations because they still must find some less-than-perfect response on a lower level.

WRITING PROMPT

The Authority to Decide

An angry customer is speaking on the phone with a customer service representative. The customer demands a full refund for the defective item she purchased online, although it is past the 30-day period allowed for returns. Describe a possible solution that could be offered at each level of decision making, and explain which level is required to resolve the problem to the customer's satisfaction.

▶ **The response entered here will appear in the performance dashboard and can be viewed by your instructor.**

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1.2: Ethics, Economics, and Law

1.2 Recognize the role of ethics in the conduct of business, with respect to economic principles and the law

Businesses are economic organizations that operate within a framework of law and regulation. They are organized primarily to provide goods and services, as well as jobs, and their success depends on operating efficiently and competitively. In a capitalist system, firms operate in an open market by providing goods and services that customers want and by doing so at a low price. This is possible only when the desired goods and services are produced by multiple firms competing to attract customers. Thus, profit is not the end or purpose of business, as is commonly asserted, but is merely the return on the investment in a business that is possible only when the business is competitive. Business has often been described as a game, in which the aim is to make as much profit as possible while staying within the rules of the game, which are set mainly by government through laws and regulations.[13] On the view of business as a game, profit is a measure and the reward of success, but it cannot be gained without also aiming to be competitive. Moreover, it is necessary, in pursuing profits, to observe certain ethical standards, as well as laws and regulation, as a means to the end of profit making.

Both economics and law are critical to business decision making, but the view that they are the only relevant considerations and that ethics does not apply is plainly false. Even hard-fought games like football have a code of sportsmanship in addition to a rule book, and business, too, is governed by more than the legal rules. In addition, a competitive business system, in which everyone pursues his or her self-interest, depends for its existence on ethical behavior and is itself justified on ethical grounds. However, the relationships of business ethics to economics and the law are very complicated and not easily summarized. The following discussion is intended to clarify these relationships.

1.2.1: Ethics and Economics

According to economic theory, firms in a free market utilize scarce resources or factors of production (labor, raw materials, and capital) in order to produce an output (goods and services). The demand for this output is determined by the preferences of individual consumers who select from among the available goods and services so as to maximize the satisfaction of their preferences, which is called "utility." Firms also seek to maximize their preferences or utility by increasing their output up to the point where the amount received from the sale of goods and services equals the amount spent for labor, raw materials, and capital—that is, where marginal revenues equal marginal costs. Under fully competitive conditions, the result is economic efficiency, which means the production of the maximum output for the least amount of input.

Economics thus provides an explanatory account of the choices of economic actors, whether they be individuals or firms. By this account, the sole reason for any choice is to maximize utility. However, ethics considers many other kinds of reasons, including rights and justice and other noneconomic values. To make a choice on the basis of ethics—that is, to use ethical reasons in making a decision—appears at first glance to be incompatible with economic choice. To make decisions on economic grounds and on ethical grounds is to employ two different kinds of reasoning. This apparent incompatibility dissolves on closer inspection. If the economists' account of economic reasoning is intended to be merely an explanation, then it tells us how we *do* reason in making economic choices but not how we *ought* to reason. Economics as a science need do no more than offer explanations, but economists generally hold that economic reasoning is also justified. That is, economic actors *ought* to make utility-maximizing choices, which is an ethical, and not merely an economic, judgment.

JUSTIFICATION OF MARKET SYSTEM The argument for this position, that economic actors ought to make utility-maximizing choices, is the classical defense of the market system. In *The Wealth of Nations*, Adam Smith, the "father" of modern economics, justified the pursuit of self-interest in exchange on the grounds that by making trades for our own advantage, we promote the interests of others. The justification for a free-market capitalist system is, in part, that by pursuing profit, business firms promote the welfare of the whole society. Commentators on Adam Smith have observed that this argument assumes a well-ordered civil society with a high level of honesty and trust and an abundance of other moral virtues. Smith's argument would not apply well to a chaotic society marked by pervasive corruption and mistrust. Furthermore, in his defense of the free market in *The Wealth of Nations*, Smith was speaking about *exchange*, whereas economics also includes *production* and *distribution*.[14] The distribution of goods, for example, is heavily influenced by different initial endowments, access to natural resources, and the vagaries of fortune, among other factors. Whether the vast disparities in wealth in the world are justified is a question of distribution, not exchange, and is not addressed by Smith's argument.

Moreover, certain conditions must be satisfied in order for business activity to benefit the society. These include the observance of minimal moral restraints to prevent theft, fraud, and the like. Markets must be fully competitive, with easy entry and exit, and everyone must possess all relevant information. In addition, all costs of production should be reflected in the prices that firms and consumers pay. For example, unintended consequences of business activity, such as job-related accidents, injuries from defective products, and pollution, are costs of production that are often not covered or internalized by the manufacturer but passed to others as spillover effects or *externalities*. Many business ethics problems arise when these conditions for the operation of a free market are not satisfied.

CONDITIONS FOR FREE MARKETS A common view is that ensuring the conditions for free markets and correcting for their absence are jobs for government. It is government's role, in other words, to create the rules of the game that allow managers to make decisions solely on economic grounds. However, the task of maintaining the marketplace cannot be handled by government alone, and the failure of government to do its job may create an obligation for business to help. Although government does enact and enforce laws against theft and fraud, including such specialized forms as the theft of trade secrets and fraud in securities transactions, there are many gray areas in which self-regulation and restraint should be exercised in order to preserve a well-functioning marketplace.

An example of a gray area in law is the "hardball" tactics employed by Toys "R" Us.[15]

Case: Toys "R" Us

Toys "R" Us employees allegedly bought inventory off the shelves of a competitor, Child World, during a promotion in which customers received $25 gift certificates for buying merchandise worth $100. The employees of Toys "R" Us were accused of selecting products that Child World sold close to cost, such as diapers, baby food, and infant formula. These items could be resold by Toys "R" Us at a profit because the purchase price at Child World was barely above what a wholesaler would charge, and then Toys "R" Us could redeem the certificates for additional free merchandise, which could be resold at an even higher profit. Child World claimed that its competitor bought up to $1.5 million worth of merchandise in this undercover manner and received as much as $375,000 worth of gift certificates.

Hardball tactics like those allegedly employed by Toys "R" Us are apparently legal, although Child World stated that the promotion excluded dealers, wholesalers, and retailers. Executives at Toys "R" Us did not deny the accusation and contended that the practice is common in the industry. Child World may have left itself open to such a hardball tactic by slashing prices and offering the certificates in an effort to increase market share against its larger rival. Still, many companies would consider such deliberate sabotage of a competitor to be an unacceptable business practice that is incompatible with the market system—especially when it is their competitors who play hard ball.

FAIRNESS IN FREE MARKETS Recent work in economics has revealed the influence of ethics on people's economic behavior. Economists have shown how a reputation for honesty and trustworthiness, for example, attracts customers and potential business partners, thus creating economic opportunities that would not be available otherwise. Similarly, people and firms with an unsavory reputation are punished in the market. People are also motivated in their market behavior by considerations of fairness. This is illustrated by the "ultimatum bargaining game," in which two people are given a certain amount of money (say $10) on the condition that one person proposes how the money is to be divided (e.g., $5 to each) and the second person accepts or rejects the proposed division. The first person can make only one proposal, and if the proposal is rejected by the second person, the money is taken away and each person receives nothing. Economic theory suggests that the second person would accept any proposal, no matter how small the share, if the alternative is no money at all. Hence, the first person could offer to share as little as $1 or less. But many people who play the game will refuse a proposal in which they receive a share that is considered too small and hence unfair.[16] They would rather have nothing than be treated unfairly.

Another example of the importance of fairness in business is the action taken by Home Depot in response to a devastating hurricane.

Case: Home Depot

When weather forecasters predicted that Hurricane Andrew would strike the Miami area with full force, customers rushed to stock up on plywood and other building materials.[17] That weekend the 19 Home Depot stores in southern Florida sold more 4-foot-by-8-foot sheets of exterior plywood than they usually sell in two weeks. On August 24, 1992, the hurricane struck, destroying or damaging more than 75,000 homes, and in the wake of the devastation, individual price gougers were able to sell basics like water and food as well as building materials at wildly inflated prices. But not Home Depot. The chain's stores initially kept prices on plywood at pre-hurricane levels, and when wholesale prices rose on average 28 percent, the company announced that it would sell plywood, roofing materials, and plastic sheeting at cost and take no profit on the sales. It did limit quantities, however, to prevent price gougers from reselling the goods at higher prices. In addition, Home Depot successfully negotiated with its suppliers of plywood to roll back prices to pre-hurricane levels. Although prices increased early in anticipation of Hurricane Andrew, Home Depot was still able, with the cooperation of suppliers, to sell half-inch plywood sheets for $10.15 after the hurricane, compared with a price of $8.65 before, thereby limiting the increase to less than 18 percent.

Home Depot executives explained their decision as an act of good ethics by not profiting from human misery. However, economists explain the behavior of companies like Home Depot and its suppliers by the fact that considerations of fairness force firms to limit profit-seeking behavior. Consumers remember price gouging and other practices that they consider unfair and will punish the wrongdoers by ceasing to do business with them or even by engaging in boycotts. One study found that people do not believe that scarcity is an acceptable reason for raising prices (despite what economists teach about supply and demand),[18] and so Home Depot and its suppliers, which are there for the long haul, have more to lose than gain by taking advantage of a natural disaster. Evidence also indicates that people in a natural disaster feel that everyone ought to make some sacrifice, so that profit seeking by a few is perceived as shirking a fair share of the burden.[19] Although Home Depot's actions can be lauded as a display of good ethics, the company also made a shrewd business decision.

Finally, when economics is used in practice to support matters of public policy, it must be guided by noneconomic values. Economic analysis can be applied to the market for cocaine as easily as to the soybean market, but it cannot tell us whether we should allow both markets. That is a decision for public policy makers on the basis of other considerations. A tax system, for example, depends on sound economic analysis, but the U.S. tax code attempts to achieve many aims simultaneously and to be accepted as fair. In drafting a new tax code, a demonstration that a particular system is the most efficient from a purely economic perspective would not necessarily be persuasive to a legislator who may also be concerned about considerations of fairness.

WRITING PROMPT

Toys "R" Us and Home Depot

Consider the actions of Toys "R" Us and Home Depot and contrast their demonstrated views of what is "fair" in business. How might the considerations of fairness in either case contribute to a well-functioning marketplace?

▶ The response entered here will appear in the performance dashboard and can be viewed by your instructor.

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1.2.2: Ethics and Law

Business activity takes place within an extensive framework of law, and some people hold that law is the only set of rules that applies to business activity. Law, not ethics, these people believe, is the only relevant guide. The reasons that lead people to hold this view are varied, but two predominate.[20]

TWO SCHOOLS OF THOUGHT **One school of thought is that law and ethics govern two different realms**. Law prevails in public life, whereas ethics is a private matter. The law is a clearly defined set of enforceable rules that applies to everyone, whereas ethics is a matter of personal opinion that reflects how we choose to lead our own lives. Consequently, it would be a mistake to apply ethical rules in business, just as it would be a mistake to apply the rules of poker to tennis. A variant of this position is that the law represents a minimal level of expected conduct that everyone should observe. Ethics, on the other hand, is a higher, optional level. It is "nice" to be ethical, but our conduct has to be legal.

Both versions of this school of thought are mistaken. Although ethics does guide us in our private lives, it is also applicable to matters in the public realm. We can identify business practices as ethical or unethical, as, for example, when we say that discrimination or consumer fraud is wrong. Moral judgments are also made about economic systems. Thus, most people believe that capitalism is morally justified, although it has many critics who raise moral objections.

The other school of thought is that the law embodies the ethics of business. There are ethical rules that apply to business, according to this position, and they have been enacted by legislators into laws, which are enforceable by judges in a court. As a form of social control, law has many advantages over ethics. Law provides more precise and detailed rules than ethics, and the courts not only enforce these rules with state power but also are available to interpret them when the wording is unclear. A common set of rules known to all also provides a level playing field. Imagine the chaos if competing teams each decided for themselves what the rules of a game ought to be. For these reasons, some people hold that it is morally sufficient in business merely to observe the law. Their motto is, "If it's legal, then it's morally okay."[21]

In countries with well-developed legal systems, the law is a relatively complete guide for business conduct. In the United States, much of what is unethical is also illegal. However, many other countries of the world have undeveloped legal systems so that ethics, not law, provides the main source of guidance. The relative lack of international law leaves ethics as an important guide for global business. Moreover, no legal system can embrace the whole of morality. Ethics is needed not only to address situations not covered by law but also to guide the creation of new law. The 1964 Civil Rights Act, for example, was passed by Congress in response to the recognition that discrimination, which was legally practiced at the time, is morally wrong.

WHY LAW IS NOT ENOUGH Despite their differences, these two schools of thought have the same practical implication: Managers need to consider only the law in making decisions. This implication is not only false but also highly dangerous. Regardless of the view that a practicing manager takes on the relationship of law and ethics, reliance on the law alone is a prescription for disaster, as many individuals and firms have discovered. Approval from a company's legal department does not always assure a successful legal resolution, and companies have prevailed in court only to suffer adverse consequences in the marketplace. As a practical matter, then, managers need to consider both the ethical and legal aspects of a situation in making a decision for many reasons, including the following.

First, the law is inappropriate for regulating certain aspects of business activity. Not everything that is immoral is illegal. Some ethical issues in business concern interpersonal relations at work or relations between competitors, which would be difficult to regulate by law. Taking credit for someone else's work, making unreasonable demands on subordinates, and unjustly reprimanding an employee are all ethically objectionable practices, but they are best left outside the law. Some hardball tactics against competitors may also be legal but ethically objectionable. Whether the effort of Toys "R" Us to sabotage a promotion by its competitor is acceptable behavior (as discussed in the "Conditions for Free Markets" section) is open to dispute, but not every legal competitive maneuver is ethical. Generally, legislatures and the courts are reluctant to intervene in ordinary business decisions unless significant rights or interests are at stake. They rightly feel that outsiders should not second-guess the business judgment of people closer to a problem and impose broad rules for problems that require a more flexible approach. Companies also prefer to handle many problems without outside interference. Still, just because it is not illegal to do certain things does not mean that they are morally okay.

Second, the law is often slow to develop in new areas of concern. Christopher D. Stone points out that the law is primarily reactive, responding to problems that people in the business world can anticipate and deal with long before they come to public attention.[22] The legislative and judicial processes themselves take a long time, and meanwhile much damage can be done. This is true not only for newly emergent problems but also for long-recognized problems where the law has lagged behind public awareness. For example, sexual harassment was not recognized as a legal wrong by the courts until 1977, and it took successive court decisions over two more decades for the legal prohibition on sexual harassment to fully develop. At the present time, legal protections for employees who blow the whistle and those who are unjustly dismissed are just beginning to develop. Employers should not wait until they are forced by law to act on such matters of growing concern.

Third, the law itself often employs moral concepts that are not precisely defined. As a result, it is impossible in some instances to understand the law without considering matters of morality. The requirement of *good faith*, for example, is ubiquitous in law. The National Labor Relations Act requires employers and the representatives of employees to bargain "in good faith." One defense against a charge of price discrimination is that a lower price was offered in a good-faith attempt to meet the price of a competitor. Yet the notion of good faith is not precisely defined in either instance. Abiding by the law, therefore, requires decision makers to have an understanding of this key moral concept. Other imprecisely defined legal concepts are "fair dealing," "best effort," and "due care."

A fourth argument, closely related to the preceding one, is that the law itself is often unsettled, so that whether some course of action is legal must be decided by the courts. And in making a decision, the courts are often guided by moral considerations. Many people have thought that their actions, although perhaps immoral, were still legal, only to discover otherwise. The courts often refuse to interpret the law literally when doing so gives legal sanction to blatant immorality. Judges have some leeway or discretion in making decisions. In exercising this discretion, judges are not necessarily substituting morality for law but rather expressing a morality that is embodied in the law. Where there is doubt about what the law is, morality is a good predictor of how the courts will decide.

Fifth, a pragmatic argument is that the law is a rather inefficient instrument, and an exclusive reliance on law alone invites legislation and litigation where they are not necessary. Many landmark enactments, such as the Civil Rights Act of 1964, the National Environment Policy Act of 1969, the Occupational Safety and Health Act of 1970, and the Consumer Protection Act of 1972, were passed by Congress in response to public outrage over the well-documented failure of American businesses to act responsibly. Although business leaders lament the explosion of product liability suits by consumers injured by defective products, for example, consumers are left with little choice but to use the legal system when manufacturers themselves hide behind "If it's legal, it's morally okay." Adopting this motto, then, is often shortsighted, and businesses may often advance their self-interest more effectively by engaging in greater self-regulation that observes ethical standards.

Use Table 1.2 to review these points and consider their implications for business decisions.

Table 1.2 Acting Ethically and Legally

Why should managers consider the ethical—and not merely the legal—aspects of a situation when making decisions? Review the arguments in favor of considering both ethics and law in business and the corresponding implication of each argument. Then hide the cells to quiz yourself.

Argument	Implication
1. The law cannot regulate all aspects of business activity.	Not everything that is legal is moral. Not everything that is immoral is illegal.
2. The law is often slow to develop in new areas of concern.	Businesses should not wait to "do the right thing" until forced to act by law.
3. The law often employs moral concepts that are not precisely defined.	To abide by the law, business leaders need to understand key moral concepts well enough to use their own judgment when making decisions.
4. The law itself is unsettled on whether some course of action is legal.	The courts are often guided by moral considerations in making a decision. Where there is doubt about what the law is, morality is a good predictor.
5. An exclusive reliance on law alone and failure to act responsibly can result in legislation and litigation.	Self-regulation and observing ethical standards can prevent unnecessary lawsuits and new laws that may interfere with business.

1.3: Ethics and Management

1.3 Distinguish between ethical management and the management of ethics, and each of the three main roles of a manager

Most managers think of themselves as ethical persons, but some still question whether ethics is relevant to their role as a manager. It is important for people in business to be ethical, they might say, but being ethical in business is no different than being ethical in private life. The implication is that a manager need only be an ethical person. There is no need, in other words, to have specialized knowledge or skills in ethics.

Nothing could be further from the truth. Although there is no separate ethics of business, situations arise in business that are not easily addressed by ordinary ethical rules. We have already observed that the obligation to tell the truth is difficult to apply to the dilemma faced by the sales rep. In addition, the manager of a sales force might face the task of determining the rules of acceptable sales practices for the whole organization and ensuring that the rules are followed. More broadly, high-level managers have a responsibility for creating and maintaining an ethical corporate climate that protects the organization against unethical and illegal conduct by its members. Furthermore, a well-defined value system serves to guide organizations in uncertain situations and to gain acceptance of painful but necessary change.

1.3.1: Ethical Management and Management of Ethics

A useful distinction can be made between *ethical management* and the *management of ethics.* Business ethics is often conceived as acting ethically as a manager by doing the right thing. This is ethical management. Acting ethically is important for both individual success and organizational effectiveness. Ethical misconduct has ended more than a few promising careers, and some business firms have been severely harmed and even destroyed by the actions of a few individuals. Major scandals in the news attract our attention, but people in business face less momentous ethical dilemmas in the ordinary course of their work. These dilemmas sometimes result from misconduct by others, as when a subordinate is ordered to commit an unethical or illegal act, but they are also inherent in typical business situations.

The management of ethics is acting effectively in situations that have an ethical aspect. These situations occur in both the internal and external environments of a business firm. Internally, organizations bind members together through myriad rules, procedures, policies, and values that must be carefully managed. Some of these, such as a policy on conflict of interest or the values expressed by a company's mission statement, explicitly involve ethics. Effective organizational functioning also depends on gaining the acceptance of the rules, policies, and other guides, and this acceptance requires a perception of fairness and commitment. For example, an organization that does not "walk the talk" when it professes to value diversity is unlikely to gain the full cooperation of its employees. With respect to the external environment, corporations must successfully manage the demands for ethical conduct from groups concerned with racial justice, human rights, the environment, and other matters.

In order to practice both ethical management and the management of ethics, it is necessary for managers to possess some specialized *knowledge.* Many ethical issues have a factual background that must be understood. In dealing with a whistle-blower or developing a whistle-blowing policy, for example, the managers of a company should be aware of the motivation of whistle-blowers, the measures that other companies have found effective, and, not least, the relevant law. In addition, many ethical issues involve competing theoretical perspectives that need to be understood by a manager. Whether it is ethical to use confidential information about a competitor or personal information about an employee depends on theories about intellectual property rights and the right to privacy that are debated by philosophers and legal theorists. Although a manager need not be equipped to participate in these debates, some familiarity with the theoretical considerations is helpful in dealing with practical situations.

To make sound ethical decisions and to implement them in a corporate environment are *skills* that come with experience and training. Some managers make mistakes because they fail to see the ethical dimensions of a situation. Other managers are unable to give proper weight to competing ethical factors or to see other people's perspectives. Thus, a manager may settle a controversial question to his or her satisfaction, only to discover that others still disagree. Moral imagination is often needed to arrive at creative solutions to problems. Finally, the resolution of a problem usually involves persuading others of the rightness of a position, and so the ability to explain one's reasoning is a valuable skill.

The need for specialized knowledge and skills is especially acute when business is conducted abroad.[23] In global business, there is a lack of consensus on acceptable standards of conduct, and practices that work well at home may fare badly elsewhere. This is especially true in less-developed countries with lower standards and weak institutions. How should a manager proceed, for example, in a country with exploitive labor conditions, lax environmental regulations, and pervasive corruption? Even the most ethical manager must rethink his or her beliefs about how business ought to be conducted in other parts of the world.

1.3.2: Ethics and the Manager's Role

Every person in business occupies a role. A role is a structured set of relationships with accompanying rights and obligations. Thus, to be a purchasing agent or a personnel director or an internal auditor is to occupy a role. In occupying a role, a person assumes certain rights that are not held by everyone as well as certain role-specific obligations. Thus, a purchasing agent is empowered to make purchases on behalf of an organization and has a responsibility to make purchasing decisions that are best for the organization. To be a "good" purchasing agent is to do the job of a purchasing agent well.

The obligations of a particular role are sometimes added to those of ordinary morality. That is, a person who occupies a role generally assumes obligations over and above those of everyday life. Sometimes, however, role obligations come into conflict with our other obligations. In selecting people for promotion, a personnel director, for example, is obligated to set aside any considerations of friendship and to be wholly impartial. A person in this position may also be forced to terminate an employee for the good of the organization, without regard for the impact on the employee's life. A personnel director may even be required to implement a decision that he or she believes to be morally wrong, such as terminating an employee for inadequate cause. In such situations, the obligations of a role appear to be in conflict with the obligations of ordinary morality.

Various justifications have been offered for role obligations. One justification is simply that people in certain positions have responsibilities to many different groups and hence must consider a wide range of interests. The decisions of a personnel director have an impact on everyone connected with a business organization, and so denying a promotion to a friend or terminating an employee may be the right thing to do, all things considered. A more sophisticated justification is that roles are created in order to serve society better as a whole. A well-designed system of roles, with accompanying rights and obligations, enables a society to achieve more and thereby benefits everyone. A system of roles thus constitutes a kind of division of labor. As in Adam Smith's pin factory, in which workers who perform specific operations can be more productive than individuals working alone, so, too, a business organization with a multiplicity of roles can be more productive and better serve society.

We cannot understand the role obligations of managers without knowing more about their specific role. Managers serve at all levels of an organization—top, middle, and lower—and fulfill a variety of roles. Usually, these are defined by a job description, such as the role of a purchasing agent or a personnel director. Uncertainty arises mainly when we ask about the role of top managers, that is, high-level corporate executives who make key decisions about policy and strategy. The higher one goes in a business organization, the more roles one occupies. Many of the ethical dilemmas for top managers are due to conflicts between three main roles.

1. *Managers as Economic Actors.*

One inescapable requirement of the manager's role is to make sound economic or business decisions that enable a firm to succeed in a competitive market. As economic actors, managers are expected to consider primarily economic factors in making decisions, and the main measure of success is profitability. This is the goal of managers who serve as economic actors even if they operate a sole proprietorship, a partnership, or any other kind of business enterprise. However, as previously noted, ethical issues are intertwined with business considerations in decision making, and the soundness of business decisions often depends on the recognition of these ethical issues and their appropriate resolution.

2. *Managers as Company Leaders.*

As leaders of business organizations, managers are entrusted with enormous assets and given a charge to manage these assets prudently. Employees, suppliers, customers, investors, and other so-called stakeholders have a stake in the success of a firm, and managers are expected to meet all of their legitimate expectations and to balance any conflicting interests. Corporations are also human communities in which individuals find not only the means to support themselves but also personal satisfaction and meaning. Top managers, in particular, serve these roles by building and maintaining a company's culture, developing a shared purpose and strategic vision, and, most importantly, meeting challenges and creating a strong, enduring organization.

3. *Managers as Community Leaders.*

Top managers of companies exert enormous power both inside and outside their organizations. Although they are not elected in a democratic process, they nevertheless have many attributes of government officials, such as the power to make decisions that profoundly impact society. The CEO or chairman of a large corporation also serves as an ambassador, representing the company in its relations with its myriad constituencies. In any political system, such great power must be legitimized by showing how it serves some generally accepted societal goals, and managerial power is no exception. So, top managers are expected to demonstrate corporate leadership that serves the interests of society as a whole.

Use Figure 1.1 to review the multiple roles a manager may hold in an organization.

Figure 1.1 Roles of a Manager

Economic Actors	Company Leaders	Community Leaders
Every manager is expected to base decisions primarily on economic factors so the organization can be competitive and profitable. This requires the ability to solve ethical problems that arise in the course of everyday business.	Top managers are entrusted with managing enormous assets to meet the expectations of multiple parties. They also must • build and maintain a company's culture, • develop a shared purpose and strategic vision, and • meet challenges to create a strong, enduring organization.	Some top managers wield enormous power both inside and outside their organizations. Like elected officials, they are expected to demonstrate corporate leadership that serves the interests of society as a whole.

Many of the ethical dilemmas facing managers involve not merely a conflict between one's personal morality and the morality of a role but also a conflict between the moral demands of different roles. For example, a manager may have to balance fairness to employees or a benefit to the community against an obligation to act in the best interest of the company. Or a CEO may find that he or she cannot easily serve both as a company leader and as a community leader when a decision must be made about a merger that would close a local plant. Some of the hardest dilemmas in business ethics result from such role conflicts.

WRITING PROMPT

Ethical Standards for Different Managers

Explain the ethical responsibility of a CEO of a large multinational corporation and that of a proprietor of a small business. What differences, if any, in ethical standards do these leaders face?

▶ `The response entered here will appear in the performance dashboard and can be viewed by your instructor.`

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1.4: Ethics in Organizations

1.4 Analyze how ethical business conduct is challenged by decision making on individual and organizational levels

The manager who seeks to act ethically and to ensure the ethical conduct of others—to achieve "ethical management" and "the management of ethics," respectively—must have the ability not only to understand ethical issues and resolve them effectively, but also to appreciate the challenges of ethical decision making and ethical conduct in an organizational setting. The fact that much business activity takes place in organizations has profound consequences for the manager's role responsibilities for several reasons.

- First, much decision making in business is a collaborative endeavor in which each individual may play only a small role. Many organizational decisions get made without any one person coming to a decision or being responsible for it.
- Second, this collaborative decision-making process is subject to dynamic forces that may not be recognized or understood by any of the participants. As a result, decisions get made that have consequences no one intended or expected.
- Third, many organizational acts are not the result of any one person's actions but are collective actions that result from a multiplicity of individual actions. Many corporate acts are thus "deeds without doers."[24]
- Fourth, organizations themselves create an environment that may lead otherwise ethical people to engage in unethical conduct. Organizational life, according to sociologist Robert Jackall, poses a series of "moral mazes" that people must navigate at their own peril.[25] Consequently, the typical case of wrongdoing in organizations involves missteps that are due more to inadequate thought than to deliberate malice, where people get "lost" in a moral maze.

The following two sections discuss the findings, mainly of psychologists and sociologists, about how ethical mistakes result from flaws in individual decision making and from organizational forces.

1.4.1: Individual Decision Making

Wrongdoing is often attributed to the proverbial "bad apple," the individual who knows that an action is wrong but deliberately does it anyway. Such persons can be condemned for having a bad character, and the lesson for others is to develop a good character. This common misunderstanding is misleading both as an analysis of the causes of bad conduct and as a prescription for ensuring good conduct. Of course, there are bad apples, and they should not be hired or, if hired, should be let go once their rottenness is known. This "bad apples" explanation is not very convincing, however, when wrongdoing is committed by people we would identify as good employees or managers. Moreover, when misconduct is widespread in an organization, as is often the case in major scandals, it is not plausible to believe that dozens if not hundreds of people are all "bad apples." Some other explanations are needed, and fortunately psychologists and sociologists have offered many.

First, many individuals work in environments in which they lack strong guidance and receive conflicting signals.[26] Often there is strong pressure to follow orders and get the job done. Barbara Toffler, who wrote a book about the last days of Arthur Andersen, relates the tale of an undergraduate who interned at a major accounting firm where he was ordered to make an accounting entry that appeared to be irregular. When he told his superior, "This doesn't look right to me. Why am I doing it?" the reply was, "You're doing it because I told you to do it."[27] Employees who are told "Just do it!" without more explicit instructions and without adequate resources may perceive these words as an implicit order to do whatever it takes to get a job done. Employees are also urged to be "team players" and go along with whatever is being done. Senior managers, in giving orders, often prefer not to give detailed guidance, in part to avoid operational responsibility ("Just do it, and don't tell me how you got it done"). They also sometimes lack an appreciation of the operational difficulties of a job and thus leave to subordinates the task of solving problems their own ways.

Second, individuals are prone to rationalization and can often effectively persuade themselves that a course of action is morally right or, at least, is not wrong under the circumstances. Saul Gellerman, in the article "Why 'Good' Managers Make Bad Ethical Choices," identifies four dangerous rationalizations.[28]

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

What are some other rationalizations?

Examples

A particularly common rationalization in business is "everybody's doing it." This retort may even justify some actions when refraining would put a company at a competitive disadvantage (when competitors engage in deceptive advertising, for example) or when business cannot be conducted without so acting (e.g., engaging in foreign bribery).[29] Other rationalizations include:

- "No real harm is done" or "No harm no foul"
- "I deserve this" or "They owe this to me" (sometimes used to justify pilfering)
- "It's for a good cause" (the ends justify the means)
- "If I don't do this, someone else will" (restraint is futile; the consequences will happen anyway)

Sociologists who have studied crime, including the kind of white-collar crime that occurs in business, have described a process of rationalization they call "neutralization" that enables lawbreakers to deny the criminality of their behavior.[30] Among the techniques of neutralization are the following claims:

- one is not really responsible ("I was out of my mind")
- no real harm was done ("No one will miss that amount of money")
- the victim deserved the harm ("I was only paying him back")
- one's accusers are being unfair ("I'm being singled out for blame")
- one was following some higher duty or loyalty ("I had to protect my friends")

All the rationalizations detailed here show the immense capacity of people to engage in self-deception.

Third, psychologists have identified a number of features of human decision making that produce errors of judgment.[31] Two of these researchers contend that "unethical business practices may stem not from the traditionally assumed trade-off between ethics and profits or from a callous disregard of other people's interest or welfare, but from psychological tendencies that foster poor decision making, both from an ethical and a rational perspective."[32] Some of these "psychological tendencies" are *biases* that shift our decisions in one direction or another, while others are *heuristics* or rule-of-thumb methods that we employ in reasoning.

What are some examples?

Examples

Among the biases and heuristics discovered by psychologists are the following:

- People weigh losses more heavily than gains and thus take greater risks to avoid losing something they have than to gain something that they do not have (loss aversion bias).
- People pay more attention to information that confirms existing attitudes and beliefs instead of focusing on information that poses challenges to their attitudes and beliefs (confirmation bias).
- People tend to persist in a course of action already underway, even in the face of information that should lead them to reconsider their initial decision (commitment or sunk cost bias).
- People are often overconfident about their own prospects for success and about the predictability and the controllability of outcomes, and they make poor judgments about risk, overestimating some risks and discounting others, often ignoring low-probability events and favoring certain over uncertain outcomes.
- In the anchoring and adjustment heuristic, people tend to form an initial choice ("anchor") early in the decision-making process and then adjust the choice in response to additional information ("adjustment"). Thus, the final decision is heavily influenced by the initial choice, especially given that people often fail to make adequate adjustments.

Psychologists have also noted that biases and heuristics prevent us from foreseeing disasters that we should have seen coming[33] and lead us to overlook the unethical conduct of others.[34] Instances of defective products, accounting fraud, and industrial accidents have been closely studied to reveal the psychological factors that explain how such bad decisions could have been made by decent, diligent, and competent individuals.

These biases and heuristics were developed long ago in the process of evolution to enable human beings to decide and act quickly, especially in dangerous situations with too much information to process fully. Generally, they have served the human race well in pre-historic times but can lead to mistakes in the modern world. Some of the blame for faulty decision making belongs to evolution.

1.4.2: Organizational Decision Making

When a company produces a defective product (for example, Merck's Vioxx or Toyota's accelerator mechanism) or collapses from massive accounting fraud (as did Enron and WorldCom) or experiences a major industrial accident (such as the Bhopal disaster), the fault generally lies with a series of decisions that can be understood only by examining organizational factors. With the benefit of hindsight, some mistaken decisions can often be found, but sometimes all of the decisions involved seemed reasonable at the time. In such cases, the causes of major scandals and disasters must be sought in the decision-making processes.

Decision making in organizations is marked by four features that contribute to mistakes, big and small.

- First, major decisions are not made all at once with all their consequences and ramifications understood; rather, they are made over time in a series of small steps, no one of which may raise any particular concerns.
- Second, as they are made over time, these multiple decisions develop a commitment to a course of action that is usually difficult to stop.

Once a project is underway, there may be considerable sunk costs that cannot be recovered, and anyone who proposes a halt to a project bears a burden of proof to justify it, whereas little justification is needed to proceed with a project underway. Stopping a project also means that mistakes were made, which it may be difficult for managers to admit since someone must bear the blame. With commitment to a course of action also comes a psychological tendency to interpret evidence in ways that support one's beliefs and interests. This factor probably goes far toward explaining why, in the development of Vioxx, Merck executives misinterpreted the results of the VIGOR study and concluded that they were due to the heart-protection benefit of naproxen and not to any harmful effect from Vioxx.

The third and fourth factors are the most important: namely,

- the diffusion of information and
- the fragmentation of responsibility that occurs in organizational decision making.[35]

The information that would show that a product has a defect, for example, may exist within an organization in an unassembled form in which different facts are known to different individuals. However, unless this information is assembled and made known to at least one person, there may be no reason for anyone in the organization to conclude that a product is defective. Furthermore, when information is distributed in organizations on a need-to-know basis, each decision maker may have sufficient information for the decisions that that person makes but lack the necessary information for recognizing a defect.

With diffusion of information comes fragmentation of responsibility. Each decision in a series may be made by different individuals or groups, all of whom are discharging their specific responsibility and doing so well, based on the information available to them. Thus, a researcher testing a drug for its efficacy in treating a certain condition may assume that other researchers have already proven its safety, so safety is not *that* researcher's responsibility. And the salespeople who pitch the drug to doctors assume that the researchers have done their job to test its safety and efficacy; that is not *their* responsibility. In the end, when a drug is recalled, it may be that no one is responsible since no one has failed in discharging his or her responsibility. It is often said that "the buck stops at the top," that the CEO or some other senior executive has a responsibility to ensure, in this example, that a drug is safe, but that person is hostage to a host of decisions made by others that he or she cannot fully assess. In such cases, only the organization as a whole can be blamed or held responsible, and the only remedy to prevent a recurrence is to improve the decision-making process within the organization.

WRITING PROMPT

Organizational Decisions

Describe an instance when a group of which you were a member made a mistake or poor decision. List which factor(s) of organizational decision making contributed to this mistake.

▶ `The response entered here will appear in the performance dashboard and can be viewed by your instructor.`

Submit

Conclusion: Ethics in the World of Business

Business ethics, as presented in this course, is concerned with identifying and understanding the ethical issues that arise in business and with developing the knowledge and skills needed by a practicing manager to address these issues and to make sound business decisions—that is, decisions that are sound from both an ethical and a business perspective. Ethical issues are an inevitable element of business decision making and are deeply intertwined with managerial practice and economic activity generally. In fact, the success of individual managers, business organizations, and, indeed, the whole economic system depends upon ethical decisions and practices.

Both economics and law are important guides for business decision making, but, as this chapter has shown, they are not complete. Nor can business ethics be understood merely as the treatment of ethical issues from a philosophical perspective. As the work of psychologists and sociologists on organizational misconduct shows, it is not enough merely to determine a right course of action. Misconduct in organizations is also the result of flaws in individual and organizational decision making that can be corrected only by changes in decision-making processes. Although this course deals mainly with the treatment of ethical issues in business, practicing managers must also address the larger challenge of preventing misconduct within organizations.

End-of-Chapter Case Studies

This chapter concludes with four case studies.

Unethical decisions can end promising business careers with alarming speed and finality. Each of the following four case studies involves a seemingly "good" person who makes a bad business decision without giving the situation adequate ethical consideration. In "A Sticky Situation," a young sales representative makes a series of seemingly inconsequential half-true statements that lead him, in the end, to seriously mislead an important client. In the other three cases, top executives (a president and two CEOs) lose their jobs for serious lapses of ethical judgment in covering up the adulteration and misbranding of a product (Beech-Nut Apple Juice), violating government bidding requirements (Bath Iron Works), and falsifying a résumé (Yahoo).

Case: A Sticky Situation

Kent Graham is still on the telephone, receiving the good news that he has just secured his largest order as an account manager for Dura-Stick Label Products.[36] His joy is tinged with uncertainty, however.

Dura-Stick is a leader in label converting for the durable-products marketplace. Label converting consists of converting log rolls of various substrates (paper, polyester, vinyl) into die-cut, printed labels. The company specializes in high-performance labels for the automotive, lawn and garden, and appliance industries. Dura-Stick has a well-deserved reputation for quality, technical knowledge, and service that enables the company to command a premium price for its products in a very competitive market.

Kent Graham has been with Dura-Stick for two years. Because he came to the company with 10 years of experience in the label industry, he was able to negotiate a very good salary and compensation plan, but his accomplishments since joining Dura-Stick have been mediocre at best. Kent fears that his time with Dura-Stick might be limited unless he starts closing some big accounts. Furthermore, with a wife and two children to support, losing his job would be disastrous. Kent was on a mission to land a big account.

Kent called on Jack Olson at Spray-On Inc., a manufacturer of industrial spraying systems for the automotive painting industry. Dura-Stick has been providing Spray-On with various warning and instructional labels for about 20 years. Jack has been very pleased with Dura-Stick's performance, especially the quality of its manufacturing department under the direction of Tim Davis. After giving Kent another excellent vendor evaluation report, Jack began to describe a new project at Spray-On, a paint sprayer for household consumer use that needs a seven-color label with very precise graphics. This label is different from the industrial two-color labels that Dura-Stick currently supplies to Spray-On.

Jack explained that this was the biggest project that Spray-On has undertaken in recent years and that it would generate a very large order for some label company. Jack then asked Kent, "Does Dura-Stick produce these multi-color, consumer-type labels?" Kent thought for a moment. He knew that a "yes" would give him a better shot at the business, and Dura-Stick might be able to handle the job, even though the company's experience to date was only with two-color labels. Almost without thinking, he replied, "Sure we can handle it, Jack, that's right up our alley!"

"That's great news," Jack shot back. "Now take this sample and give me your proposal by Monday. Oh, and by the way, I hope your proposal looks good, because I would really feel confident if this important project were in the hands of your production people!"

Kent gave the sample to Marty Klein, who is responsible for coordinating the costs and price quotes for new opportunities. Marty took one look at the sample and said emphatically, "We'll have to farm this one out." Kent's heart sank down to his shoes. He knew that Jack would want to work with Dura-Stick only if the labels were produced at Dura-Stick's facility. Yet, he still allowed Marty to put the numbers together for the proposal. Kent presented the proposal to Jack at Spray-On. "Gee, Kent, these prices are pretty high, about 20 percent higher than your competition. That's pretty hard to swallow."

Kent knew that the price would be high because it included the cost of another company producing the labels plus Dura-Stick's usual profit margin, but he countered cheerily, "You know the quality that we provide and how important this project is to your company. Isn't it worth the extra 20 percent for the peace of mind that you will have?"

"Let me think about it," Jack replied.

The next day, Kent got a phone call from Jack.

"Congratulations, Kent, Dura-Stick has been awarded the business. It was a tough sell to my people, but I convinced them that the extra money would be well spent because of the excellent production department that you have. If it wasn't for the fact that Tim Davis will personally oversee production, you guys probably would not have gotten this business."

Kent had to bite his tongue. He knew that Tim would not be involved because the labels would be produced in Kansas City by Labeltec, which would then send the finished labels to Dura-Stick for shipment to Spray-On's facility. Kent also knew that Jack would be completely satisfied with the quality of the labels. Besides, this order was crucial to his job security, not to mention the well-being of his company.

While Jack continued to explain Spray-On's decision, Kent pondered how he should close this conversation.

SHARED WRITING: A STICKY SITUATION

Decide if Kent's statements were within accepted business practice. Was Kent telling the truth or lying to his client?

Review and comment on at least two classmates' responses, including one that opposes your own.

▶ **A minimum number of characters is required to post and earn points. After posting, your response can be viewed by your class and instructor, and you can participate in the class discussion.**

Post **0 characters | 140 minimum**