CHAPTER OUTLINE

Introduction

Business Ethics and Social Responsibility

The Role of Ethics in Business

Recognizing Ethical Issues in Business
Making Decisions about Ethical Issues
Improving Ethical Behavior in Business

The Nature of Social Responsibility

Social Responsibility Issues

OBJECTIVES

After reading this chapter, you will be able to:

- Define business ethics and social responsibility and examine their importance.
- Detect some of the ethical issues that may arise in business.
- Specify how businesses can promote ethical behavior.
- Explain the four dimensions of social responsibility.
- Debate an organization’s social responsibilities to owners, employees, consumers, the environment, and the community.
- Evaluate the ethics of a business’s decision.
Ethisphere magazine (www.ethisphere.com) is published by the Ethisphere Institute to illuminate the correlation between ethics and profits. Their mission is to “help corporate executives guide their enterprises toward gaining market share and creating sustainable competitive advantage through better business practices and corporate citizenship.” Business has found that good ethics doesn’t happen automatically. Employees need a shared vision that results in all employees abiding by the company’s code of ethics and policies on business conduct. The editors and writers for the magazine attempt to determine absolute behaviors that can be utilized to differentiate one organization from another. For example, Ethisphere has developed a methodology to examine companies’ codes of ethics and provide a grade for how the business compares with others. Issues relate to how the code itself is written, what it contains, what it omits, and how it is communicated. All play instrumental underlying roles in whether the code has the power to influence not only perceptions, but actions as well. For example, Centex Corp. received an A because of a terrific layout and thoughtful learning guide that speaks directly to employee conduct. An employee reporting mechanism called the “Speak Up” line was made very visible so that employees could easily discuss issues of concern. Other companies highly ranked in the study included Alcoa, Eaton Corporation, Kiplinger’s, GE, Kellogg’s, and John Deere.

A recent ranking of government contractors found that Verizon Wireless had the best code of business ethics and the best overall ethics program. Other companies that were found to have high-ranking codes of ethics included General Electric, Procter & Gamble, Lockheed Martin, and
Honeywell. Companies use benchmarking, that is, comparing themselves with others in their industry, to gain insights about how to improve their code of ethics programs. Providing the criteria for evaluating codes of ethics also assists companies in developing and revising their codes. Organizations are expected to establish ethical standards and provide compliance systems to maintain appropriate conduct within all levels of the organization. Many companies are starting to recognize that providing jobs and profits are not sufficient criteria to be a responsible member of society. It is important to be socially responsible—that is, to work with stakeholders such as employees, customers, communities, and governments to make sure that the company does its part to minimize negative impacts on society and maximize contributions to important issues that are being addressed worldwide. Global warming, recycling, and sustainability are social responsibility issues; employee misconduct in performing business activities is a significant concern of business ethics. Both business ethics and social responsibility are essential parts of being a good corporate citizen.¹

Introduction

As the opening vignette illustrates, the Ethisphere Institute has taken on the challenge of contributing to society by linking ethics and profits. At the other extreme, wrongdoing by some businesses has focused public attention and government involvement on encouraging more acceptable business conduct. Any business decision may be judged as right or wrong, ethical or unethical, legal or illegal.

In this chapter, we take a look at the role of ethics and social responsibility in business decision making. First we define business ethics and examine why it is important to understand ethics’ role in business. Next we explore a number of business ethics issues to help you learn to recognize such issues when they arise. Finally, we consider steps businesses can take to improve ethical behavior in their organizations. The second half of the chapter focuses on social responsibility. We survey some important responsibility issues and detail how companies have responded to them.
and a great deal of complacency on the part of employees who saw wrongdoing and ignored it. Enron is not alone. Most unethical activities within organizations are supported by an organizational culture that encourages employees to bend the rules.  

Many consumers and social advocates believe that businesses should not only make a profit but also consider the social implications of their activities. We define social responsibility as a business’s obligation to maximize its positive impact and minimize its negative impact on society. Although many people use the terms social responsibility and ethics interchangeably, they do not mean the same thing. Business ethics relates to an individual’s or a work group’s decisions that society evaluates as right or wrong, whereas social responsibility is a broader concept that concerns the impact of the entire business’s activities on society. From an ethical perspective, for example, we may be concerned about a health care organization overcharging the government for Medicare services. From a social responsibility perspective, we might be concerned about the impact that this overcharging will have on the ability of the health care system to provide adequate services for all citizens. A more specific issue is the concern that mobile phone companies are acting irresponsibly by targeting children as young as 6 with brightly colored kiddie phones. Some worry that such phones addict the very young, and proper research has not yet been conducted on the health risks to young brains and tissue.  

The most basic ethical and social responsibility concerns have been codified by laws and regulations that encourage businesses to conform to society’s standards, values, and attitudes. For example, after accounting scandals at a number of well-known firms in the early 2000s shook public confidence in the integrity of Corporate America, the reputations of every U.S. company suffered regardless of their association with the scandals. To help restore confidence in corporations and markets, Congress passed the Sarbanes-Oxley Act, which criminalized securities fraud and stiffened penalties for corporate fraud. At a minimum, managers are expected to obey all laws and regulations. Most legal issues arise as choices that society deems unethical, irresponsible, or otherwise unacceptable. However, all actions deemed unethical by society are not necessarily illegal, and both legal and ethical concerns change over time (see Table 2.1). Business law refers to the laws and regulations that
govern the conduct of business. Many problems and conflicts in business can be avoided if owners, managers, and employees know more about business law and the legal system. Business ethics, social responsibility, and laws together act as a compliance system, requiring that businesses and employees act responsibly in society. In this chapter, we explore ethics and social responsibility; Appendix A addresses business law, including the Sarbanes-Oxley Act.

The Role of Ethics in Business

You have only to pick up The Wall Street Journal or USA Today to see examples of the growing concern about legal and ethical issues in business. HealthSouth, for example, has joined the growing list of companies tarnished by accounting improprieties and securities fraud. Former CEO Richard Scrushy was indicted for allegedly conspiring to inflate the health care firm’s reported revenues by $2.7 billion to meet shareholder expectations. Although Scrushy pleaded “not guilty” to the 85 criminal charges, 15 former HealthSouth executives have admitted to participating in the deception. Scrushy was ultimately acquitted by a jury trial in the first attempt to hold a chief executive accountable under the Sarbanes-Oxley Act. The defense called the star witness, former HealthSouth finance chief William T. Owens, a big rat. Scrushy was found guilty on six counts of bribery and mail fraud by an Alabama court for paying an Alabama governor to be on the state hospital regulatory board. He plans to appeal the conviction. Regardless of what an individual believes about a particular action, if society judges it to be unethical or wrong, whether correctly or not, that judgment directly affects the organization’s ability to achieve its business goals.

Well-publicized incidents of unethical and illegal activity—ranging from accounting fraud to using the Internet to steal another person’s credit-card number, from deceptive advertising of food and diet products to unfair competitive practices in the computer software industry—strengthen the public’s perceptions that ethical standards and the level of trust in business need to be raised. Author David Callahan has commented, “Americans who wouldn’t so much as shoplift a pack of chewing gum are committing felonies at tax time, betraying the trust of their patients, misleading investors, ripping off their insurance companies, lying to their clients, and much more.”

Often, such charges start as ethical conflicts but evolve into legal disputes when cooperative conflict resolution cannot be accomplished. Headline-grabbing scandals like Enron are not limited to the United States. For example, in Germany the president of Deutsche Post AG, parent of DHL, had to resign after being accused of tax evasion. In the United States, Charles O. Prince III, former CEO of Citigroup; Stanley O’Neal, former CEO of Merrill Lynch; and Angela Mozilo, founder and CEO of Countrywide Financial, rejected suggestions that they reaped lavish compensation packages while engaging in highly risky subprime lending associated with an international financial crisis. While O’Neal was fired for Merrill Lynch’s poor performance, he was given a $161 million severance package on top of the $70 million he earned during four years as CEO.

However, it is important to understand that business ethics goes beyond legal issues. Ethical conduct builds trust among individuals and in business relationships, which validates and promotes confidence in business relationships. Establishing trust and confidence is much more difficult in organizations that have reputations for acting unethically. If you were to discover, for example, that a manager had misled you about company benefits when you were hired, your trust and confidence
in that company would probably diminish. And if you learned that a colleague had lied to you about something, you probably would not trust or rely on that person in the future.

Ethical issues are not limited to for-profit organizations either. In government, several politicians and some high-ranking officials have been forced to resign in disgrace over ethical indiscretions. Irv Lewis “Scooter” Libby, a White House advisor, was indicted on five counts of criminal charges: one count of obstruction of justice, two counts of perjury, and two counts of making false statements. Libby was convicted on four of those counts in 2007. Although President Bush commuted the sentence, Libby was still ordered to pay a $250,000 fine. While serving as attorney general of New York, Eliot Spitzer had a reputation for fighting crime. He too has stumbled into an ethical mess of his own making. The New York governor appeared in a federal complaint charging others with managing an international prostitution ring. Spitzer was named as a client of the crime ring, having hired a prostitute in Washington, D.C., for $4,300. During his race for governor of New York, Spitzer spoke of his duties as attorney general, saying: “I had a simple rule. I never asked if a case was popular or unpopular. I never asked if it was big or small, hard or easy. I simply asked if it was right or wrong.” Spitzer resigned as governor of New York, his career destroyed by his misconduct. Even sports can be subject to ethical lapses. At many universities, for example, coaches and athletic administrators have been put on administrative leave after allegations of improper recruiting practices came to light. Jimmy Johnson’s crew chief, Chad Knaus, was thrown out of the Daytona 500 for illegal modifications made to Johnson’s car during NASCAR pole qualifying. Although Johnson finished fifth in qualifying, he was required to start from the rear of the field. He then went on to win the Daytona 500. Thus, whether made in science, politics, sports, or business, most decisions are judged as right or wrong, ethical or unethical. Negative judgments can affect an organization’s ability to build relationships with customers and suppliers, attract investors, and retain employees.

Although we will not tell you in this chapter what you ought to do, others—your superiors, co-workers, and family—will make judgments about the ethics of your actions and decisions. Learning how to recognize and resolve ethical issues is an important step in evaluating ethical decisions in business.

Recognizing Ethical Issues in Business

Learning to recognize ethical issues is the most important step in understanding business ethics. An ethical issue is an identifiable problem, situation, or opportunity that requires a person to choose from among several actions that may be evaluated as right or wrong, ethical or unethical. In business, such a choice often involves weighing monetary profit against what a person considers appropriate conduct. The best way to judge the ethics of a decision is to look at a situation from a customer’s or competitor’s viewpoint: Should liquid-diet manufacturers make unsubstantiated claims about their products? Should an engineer agree to divulge her former employer’s trade secrets to ensure that she gets a better job with a competitor? Should a salesperson omit facts about a product’s poor safety record in his presentation to a customer? Such questions require the decision maker to evaluate the ethics of his or her choice.

Many business issues may seem straightforward and easy to resolve or the surface, but are in reality very complex. A person often needs several years of experience in business to understand what is acceptable or ethical. For example, if you
are a salesperson, when does offering a gift—such as season basketball tickets—to a customer become a bribe rather than just a sales practice? Clearly, there are no easy answers to such a question. But the size of the transaction, the history of personal relationships within the particular company, as well as many other factors may determine whether an action will be judged as right or wrong by others. Companies across the United States are starting to prevent access to Internet-video services at work. At issue is the theft of time by employees, who use YouTube and MySpace for an hour on average each workday. Another issue is the use of company resources to provide personal internet access.

Ethics is also related to the culture in which a business operates. In the United States, for example, it would be inappropriate for a businessperson to bring an elaborately wrapped gift to a prospective client on their first meeting—the gift could be viewed as a bribe. In Japan, however, it is considered impolite not to bring a gift. Experience with the culture in which a business operates is critical to understanding what is ethical or unethical.

To help you understand ethical issues that perplex businesspeople today, we will take a brief look at some of them in this section. Ethical issues can be more complex now than in the past. The vast number of news-format investigative programs has increased consumer and employee awareness of organizational misconduct. In addition, the multitude of cable channels and Internet resources has improved the awareness of ethical problems among the general public. The National Business Ethics Survey of more than 3,400 U.S. employees found that workers witness many instances of ethical misconduct in their organizations (see Table 2.2). The most common types of observed misconduct in the private sector were putting one’s own interests ahead of the organization, abusive behavior, and lying to employees.

One of the principal causes of unethical behavior in organizations is overly aggressive financial or business objectives. Many of these issues relate to decisions and concerns that managers have to deal with daily. It is not possible to discuss every issue, of course. However, a discussion of a few issues can help you begin to recognize the ethical problems with which businesspersons must deal. Many ethical issues in business can be categorized in the context of their relation with abusive and intimidating behavior, conflicts of interest, fairness and honesty, communications, and business associations.

### Table 2.2 Types and Incidences of Observed Misconduct

<table>
<thead>
<tr>
<th>Type of Conduct Observed</th>
<th>Employees Observing It</th>
</tr>
</thead>
<tbody>
<tr>
<td>Putting own interests ahead of organization</td>
<td>22%</td>
</tr>
<tr>
<td>Abusive behavior</td>
<td>21</td>
</tr>
<tr>
<td>Lying to employees</td>
<td>20</td>
</tr>
<tr>
<td>Misreporting hours worked</td>
<td>17</td>
</tr>
<tr>
<td>Internet abuse</td>
<td>16</td>
</tr>
<tr>
<td>Safety violations</td>
<td>15</td>
</tr>
<tr>
<td>Lying to stakeholders</td>
<td>14</td>
</tr>
<tr>
<td>Discrimination</td>
<td>13</td>
</tr>
<tr>
<td>Stealing</td>
<td>11</td>
</tr>
</tbody>
</table>

Abusive and Intimidating Behavior. Abusive or intimidating behavior is the second most common ethical problem for employees. These concepts can mean anything from physical threats, false accusations, being annoying, profanity, insults, yelling, harshness, ignoring someone, to unreasonable behavior; and the meaning of these words can differ by person—you probably have some ideas of your own. Abusive behavior can be placed on a continuum from a minor distraction to a disruption of the workplace. For example, what one person may define as yelling might be another’s definition of normal speech. Civility in our society is a concern, and the workplace is no exception. The productivity level of many organizations has been diminished by the time spent unraveling abusive relationships.

Abusive behavior is difficult to assess and manage because of diversity in culture and lifestyle. What does it mean to speak profanely? Is profanity only related to specific words or other such terms that are common in today’s business world? If you are using words that are normal in your language but others consider profanity, have you just insulted, abused, or disrespected them?

Within the concept of abusive behavior, intent should be a consideration. If the employee was trying to convey a compliment but the comment was considered abusive, then it was probably a mistake. The way a word is said (voice inflection) can be important. Add to this the fact that we now live in a multicultural environment—doing business and working with many different cultural groups—and the businessperson soon realizes the depth of the ethical and legal issues that may arise. There are problems of word meanings by age and within cultures. For example an expression such as “Did you guys hook up last night?” can have various meanings, including some that could be considered offensive in a work environment.

Bullying is associated with a hostile workplace when a person or group is targeted and is threatened, harasseled, belittled, verbally abused, or overly criticized. Bullying may create what some consider a hostile environment, a term generally associated with sexual harassment. Although sexual harassment has legal recourse, bullying has little legal recourse at this time. Bullying is a widespread problem in the United States, and can cause psychological damage that can result in health endangering consequences to the target. The Workplace Bullying Institute’s latest survey found that “37% of U.S. workers have been bullied, that is 54 million Americans.” Another 12 percent of workers have witnessed bullying. As Table 2.3 indicates, bullying can use a mix of verbal, nonverbal, and manipulative threatening expressions to damage workplace productivity. One may wonder why workers tolerate such activities, if

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

PART 1 Business in a Changing World

The problem is that 81 percent of workplace bullies are supervisors. A top officer at Boeing cited an employee survey indicating 26 percent had observed abusive or intimidating behavior by management.18

**Conflict of Interest.** A conflict of interest, the most common ethical issue identified by employees, exists when a person must choose whether to advance his or her own personal interests or those of others. For example, a manager in a corporation is supposed to ensure that the company is profitable so that its stockholder-owners receive a return on their investment. In other words, the manager has a responsibility to investors. If she instead makes decisions that give her more power or money but do not help the company, then she has a conflict of interest—she is acting to benefit herself at the expense of her company and is not fulfilling her responsibilities as an employee. To avoid conflicts of interest, employees must be able to separate their personal financial interests from their business dealings. For example, a $1 million donation by Citigroup to the 92nd Street, Y nursery school represents a possible conflict of interest. Jack Grubman, an analyst for Salomon Smith Barney, upgraded his rating for AT&T stock after Sanford Weill, the CEO of Citigroup (the parent company of Salomon Smith Barney), agreed to use his influence to help Grubman’s twins gain admission to the elite Manhattan nursery school. During the late 1990s, Weill, an AT&T board member, had been upset that Citigroup wasn’t getting any of AT&T’s business. Grubman changed AT&T’s rating to buy, and a year later bragged in an e-mail that he had made the switch to placate Weill in exchange for Weill’s help in getting Grubman’s children into the 92nd Street Y nursery school. Grubman has denied elevating his rating for AT&T’s stock to gain his children admission to the school, but they were enrolled. Industry leaders still avoid him, publicly anyway, but on the fringes of telecom, Grubman has had no trouble finding people who are willing to overlook his past or are simply unaware of it. According to a *Fortune* article, although Grubman was “banned from Wall Street, the former Telecom King wants to prove that he wasn’t a huckster”.19

As mentioned earlier, it is considered improper to give or accept bribes—payments, gifts, or special favors intended to influence the outcome of a decision. A bribe is a conflict of interest because it benefits an individual at the expense of an organization or society. Companies that do business overseas should be aware that bribes are a significant ethical issue and are, in fact, illegal in many countries. For example, three former executives of IBM Korea went to jail in Seoul after being convicted of using bribes to win orders for computer parts.20 While bribery is an increasing issue in many countries, it is more prevalent in some countries than in others. Transparency International has developed a Corruption Perceptions Index (Table 2.4). Note there are 19 countries perceived as less corrupt than the United States.21

**Fairness and Honesty.** Fairness and honesty are at the heart of business ethics and relate to the general values of decision makers. At a minimum, business persons are expected to follow all applicable laws and regulations. But beyond obeying the law, they are expected not to harm customers, employees, clients, or competitors knowingly through deception, misrepresentation, coercion, or discrimination. Honesty and fairness can relate to how the employees uses the resources of the organization. More than two-thirds of employees have taken office supplies from work to use for matters unrelated to their job. Most employees do not view taking office supplies as stealing or dishonest, with 97 percent saying they have never gotten caught and it would not matter if they were. In addition, only 3.7 percent say they...
have taken items like keyboards, software, and memory sticks. Still, an employee should be aware of policies on taking items and recognize how these decisions relate to ethical behavior. Figure 2.1 on page 000 provides an overview of the most pilfered office supplies.

One aspect of fairness relates to competition. Although numerous laws have been passed to foster competition and make monopolistic practices illegal, companies sometimes gain control over markets by using questionable practices that harm competition. Bullying can also occur between companies that are intense competitors. Even respected companies such as Intel have been accused of monopolistic bullying. A competitor, Advanced Micro Devices (AMD), claimed in a lawsuit that 38 companies, including Dell and Sony, were strong-arming customers (such as Apple) into buying Intel chips rather than those marketed by AMD. The AMD lawsuit seeks billions of dollars and will take years to litigate. In many cases, the alleged misconduct can have not only monetary and legal implications but can threaten reputation, investor confidence, and customer loyalty. A front-cover Forbes headline stated “Intel to ADM: Drop Dead.” The intensely competitive atmosphere and Intel’s ability to use its large size won it the high-profile Apple account, displacing IBM and Freescale. ADM claims it had no opportunity to bid because Intel had offered to deploy 600 Indian engineers to help Apple software run more smoothly on Intel chips.

Another aspect of fairness and honesty relates to disclosure of potential harm caused by product use. Mitsubishi Motors, Japan’s number-four automaker, faced criminal charges and negative publicity after executives admitted that the company had systematically covered up customer complaints about tens of thousands of defective automobiles over a 20-year period. They allegedly made the cover-up in order to avoid expensive and embarrassing product recalls.

Dishonesty has become a significant problem in the United States. As reported earlier in this chapter, lying was the second most observed form of misconduct.

## Table 2.4

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>CPI Score*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Finland/Denmark/New Zealand</td>
<td>9.4</td>
</tr>
<tr>
<td>4</td>
<td>Singapore/Sweden</td>
<td>9.3</td>
</tr>
<tr>
<td>6</td>
<td>Iceland</td>
<td>9.2</td>
</tr>
<tr>
<td>7</td>
<td>Netherlands/Switzerland</td>
<td>9.0</td>
</tr>
<tr>
<td>9</td>
<td>Canada/Norway</td>
<td>8.7</td>
</tr>
<tr>
<td>11</td>
<td>Australia</td>
<td>8.6</td>
</tr>
<tr>
<td>12</td>
<td>Luxembourg/United Kingdom</td>
<td>8.4</td>
</tr>
<tr>
<td>14</td>
<td>Hong Kong</td>
<td>8.3</td>
</tr>
<tr>
<td>15</td>
<td>Austria</td>
<td>8.1</td>
</tr>
<tr>
<td>16</td>
<td>Germany</td>
<td>7.8</td>
</tr>
<tr>
<td>17</td>
<td>Ireland/Japan</td>
<td>7.5</td>
</tr>
<tr>
<td>19</td>
<td>France</td>
<td>7.3</td>
</tr>
<tr>
<td>20</td>
<td>United States</td>
<td>7.2</td>
</tr>
</tbody>
</table>

*CPI score relates to perceptions of the degree of corruption as seen by businesspeople and country analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

in the National Business Ethics Survey. Dishonesty is not found only in business, however.

A survey of nearly 25,000 high school students revealed that 62 percent of the students admitted to cheating on an exam at least once, 35 percent confessed to copying documents from the Internet, 27 percent admitted to shoplifting, and 23 percent owned up to cheating in order to win in sports.\(^\text{25}\) If today's students are tomorrow's leaders, there is likely to be a correlation between acceptable behavior today and tomorrow. This adds to the argument that the leaders of today must be prepared for the ethical risks associated with this downward trend. According to a poll by Deloitte and Touche of teenagers aged 13 to 18, when asked if people who practice good business ethics are more successful than those who don't, 69 percent of teens agreed.\(^\text{26}\) The same poll found only 12 percent of teens think business leaders today are ethical. On the other hand, another survey indicated that many students do not define copying answers from another student's paper or downloading music or content for classroom work as cheating.\(^\text{27}\)

**Communications.** Communications is another area in which ethical concerns may arise. False and misleading advertising, as well as deceptive personal-selling tactics, anger consumers and can lead to the failure of a business. Truthfulness about product safety and quality are also important to consumers. Claims about dietary supplements and weight-loss products can be particularly problematic. For example, the Fountain of Youth Group LLC and its founder, Edita Kaye, settled charges brought by the Federal Trade Commission that the company made unsubstantiated claims about its weight-loss products. Under the settlement, the firm agreed to stop making specific weight-loss and health claims without competent scientific proof. It was also fined $6 million, but that fine was suspended because the firm lacked the resources to pay it.\(^\text{28}\)

Some companies fail to provide enough information for consumers about differences or similarities between products. For example, driven by high prices for medicines, many consumers are turning to Canadian, Mexican, and overseas Internet sources for drugs to treat a variety of illnesses and conditions. However, research suggests that a significant percentage of these imported pharmaceuticals may not actually contain the labeled drug, and the counterfeit drugs could even be harmful to those who take them.\(^\text{30}\)

Another important aspect of communications that may raise ethical concerns relates to product labeling. The U.S. Surgeon General currently requires cigarette...
Consider Ethics and Social Responsibility
Repainting Mattel’s Image

What comes to mind when you think “Mattel”? Do you remember the Mattel toys that you loved as a kid; that you’ve purchased for your children, nieces, or nephews? Or do you think of recalls and danger? During 2007 alone, Mattel was required to recall millions of toys, creating negative press and horrified parents. As Christmas 2007 loomed, Mattel was struggling to revive its image, as the company seemed in danger of consumer abandonment. Parents interviewed throughout the United States were vowing to steer clear of toys sold by Mattel. So what caused the recalls and the uproar? Although responsibility ultimately rests with Mattel, the issue brought to light was Mattel’s relationship with and reliance on Chinese toy manufacturers—companies that proved not to adhere to U.S. safety standards.

A recent estimate indicates that China produces 70 to 80 percent of all toys sold in the United States. It is a challenge for any shopper to avoid purchasing toys made in China. So what about China’s manufacturing process caused Mattel to recall so many children’s products? The answer might shock us in the United States—lead paint! You might ask hasn’t this been outlawed? Yes, paint containing more than 0.06 percent lead has been banned for residential use since 1978. So, how could this toxic substance possibly end up on children’s toys? It turns out that the rules set for residential paint do not translate to paint used on toys. It is no secret that companies such as Mattel produce their toys in China in order to cut costs, even though China has different health and safety standards than the United States. Does this create a problem? It certainly looks like it does.

As Mattel struggles to convince consumers that these mistakes will never be repeated, many are wondering how well the company will survive this scandal. As much as the company might like to place the blame on China, it is Mattel’s ultimate responsibility to ensure the production of safe toys. The U.S. Consumer Report Product Safety Commission is now working with China to eliminate the use of lead paint in production, but what is Mattel doing? According the company, production processes and testing procedures have been strengthened. It claims to have implemented a “3-stage safety check” designed to make sure that all paint is tested prior to use, testing and unannounced inspections are also being increased, and every production run will be tested before toys are released. The company, which has also been saddled with issues resulting from recalls of toys containing small magnets that were found to be choking hazards, continues to scramble to put a fresh veneer on its tainted image. However, some analysts suggest that the best move would be to break off relations with China all together. Others suggest that Mattel ought to become more actively involved in helping China work toward stricter rules and the use of safer products. Therefore, as Mattel works to correct its mistakes and China starts to strengthen its regulations, consumers will be watching and thinking twice before purchasing toys labeled “Mattel” and “Made in China.”

Discussion Questions
1. Lead paint in toys may not technically be illegal, so what did Mattel do wrong in this situation? Could the company have prevented this crisis? How?
2. Now that the damage has been done, what can Mattel do to restore its image?
3. Lead paint on toys is not the only health hazard scare coming out of China (there have also been problems with tainted medicines, fish with high levels of mercury, and other products containing high levels of lead). Should U.S. companies stop sourcing goods from China? Why or why not?
protection legislation. Because of the debate surrounding the acceptability of these business activities, they remain major ethical issues.

**Business Relationships.** The behavior of businesspersons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behavior within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically.

Managers, in particular, because of the authority of their position, have the opportunity to influence employees’ actions. For example, a manager might influence employees to use pirated computer software to save costs. The use of illegal software puts the employee and the company at legal risk, but employees may feel pressured to do so by their superior’s authority. The National Business Ethics Survey found that employees who feel pressure to compromise ethical standards view top and middle managers as the greatest source of such pressure.

It is the responsibility of managers to create a work environment that helps the organization achieve its objectives and fulfill its responsibilities. However, the methods that managers use to enforce these responsibilities should not compromise employee rights. Organizational pressures may encourage a person to engage in activities that he or she might otherwise view as unethical, such as invading others’ privacy or stealing a competitor’s secrets. For example, Betty Vinson, an accounting executive at WorldCom, protested when her superiors asked her to make improper accounting entries in order to cover up the company’s deteriorating financial condition. She acquiesced only after being told that it was the only way to save the troubled company. She, along with several other WorldCom accountants, pleaded guilty to conspiracy and fraud charges related to WorldCom’s bankruptcy after the accounting improprieties came to light. The firm may provide only vague or lax supervision on ethical issues, creating the opportunity for misconduct. Managers who offer no ethical direction to employees create many opportunities for manipulation, dishonesty, and conflicts of interest.

**Plagiarism**—taking someone else’s work and presenting it as your own without mentioning the source—is another ethical issue. As a student, you may be familiar with plagiarism in school; for example, copying someone else’s term paper or quoting from a published work or Internet source without acknowledging it. In business, an ethical issue arises when an employee copies reports or takes the work or ideas of others and presents it as his or her own. At *USA Today*, for example, an internal investigation into the work of veteran reporter Jack Kelley identified dozens of stories in which Kelley appeared to have plagiarized material from competing newspapers. The investigation also uncovered evidence Kelley fabricated significant portions of at least eight major stories and conspired to cover up his lapses in judgment. The newspaper later apologized to its readers, and Kelley resigned. A manager attempting to take credit for a subordinate’s ideas is engaging in another type of plagiarism.

**Making Decisions about Ethical Issues**

Although we’ve presented a variety of ethical issues that may arise in business, it can be difficult to recognize specific ethical issues in practice. Whether a decision maker recognizes an issue as an ethical one often depends on the issue itself. Managers, for example, tend to be more concerned about issues that affect those close to them, as well as issues that have immediate rather than long-term consequences. Thus, the
perceived importance of an ethical issue substantially affects choices. However, only a few issues receive scrutiny, and most receive no attention at all.35

Table 2.5 lists some questions you may want to ask yourself and others when trying to determine whether an action is ethical. Open discussion of ethical issues does not eliminate ethical problems, but it does promote both trust and learning in an organization.36 When people feel that they cannot discuss what they are doing with their co-workers or superiors, there is a good chance that an ethical issue exists. Once a person has recognized an ethical issue and can openly discuss it with others, he or she has begun the process of resolving that issue.

**Improving Ethical Behavior in Business**

Understanding how people make ethical choices and what prompts a person to act unethically may reverse the current trend toward unethical behavior in business. Ethical decisions in an organization are influenced by three key factors: individual moral standards, the influence of managers and co-workers, and the opportunity to engage in misconduct (Figure 2.2). While you have great control over your personal ethics outside the workplace, your co-workers and superiors exert significant control over your choices at work through authority and example. In fact, the activities and examples set by co-workers, along with rules and policies established by the firm, are critical in gaining consistent ethical compliance in an organization. If the company fails to provide good examples and direction for appropriate conduct, confusion and conflict will develop and result in the opportunity for misconduct.

If your boss or co-workers leave work early, you may be tempted to do so as well. If you see co-workers engaged in personal activities such as shopping online or watching YouTube, then you may be more likely to do so also. In addition, having sound personal values contributes to an ethical workplace.

Because ethical issues often emerge from conflict, it is useful to examine the causes of ethical conflict. Business managers and employees often experience some tension between their own ethical beliefs and their obligations to the organizations in which they work. Many employees utilize different ethical standards at work than...
they do at home. This conflict increases when employees feel that their company is encouraging unethical conduct or exerting pressure on them to engage in it.

It is difficult for employees to determine what conduct is acceptable within a company if the firm does not have established ethics policies and standards. And without such policies and standards, employees may base decisions on how their peers and superiors behave. Professional codes of ethics are formalized rules and standards that describe what the company expects of its employees. Codes of ethics do not have to be so detailed that they take into account every situation, but they should provide guidelines and principles that can help employees achieve organizational objectives and address risks in an acceptable and ethical way. The development of a code of ethics should include not only a firm’s executives and board of directors, but also legal staff and employees from all areas of a firm. Table 2.6 lists some key things to consider when developing a code of ethics.

Codes of ethics, policies on ethics, and ethics training programs advance ethical behavior because they prescribe which activities are acceptable and which are not, and they limit the opportunity for misconduct by providing punishments for violations of the rules and standards. According to the National Business Ethics Survey (NBES), employees in organizations that have written standards of conduct, ethics training, ethics offices or hotlines, and systems for anonymous reporting of misconduct are more likely to report misconduct when they observe it. The survey also found that such programs are associated with higher employee perceptions that they will be held accountable for ethical infractions. The enforcement of such codes and policies through rewards and punishments increases the acceptance of ethical standards by employees.

One of the most important components of an ethics program is a means through which employees can report observed misconduct anonymously. The NBES found that although employees are increasingly reporting illegal and unethical activities they observe in the workplace, 54 percent of surveyed employees indicated they are unwilling to report misconduct because they fear that no corrective action will be taken, or that their report will not remain confidential. The lack of anonymous reporting mechanisms may encourage whistleblowing, which occurs when an employee exposes an employer’s wrongdoing to outsiders, such as the media or government regulatory agencies. However, more companies are establishing programs

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**TABLE 2.6**

Key Things to Consider in Developing a Code of Ethics

- Create a team to assist with the process of developing the code (include management and nonmanagement employees from across departments and functions).
- Solicit input from employees from different departments, functions, and regions to compile a list of common questions and answers to include in the code document.
- Make certain that the headings of the code sections can be easily understood by all employees.
- Avoid referencing specific U.S. laws and regulations or those of specific countries, particularly for codes that will be distributed to employees in multiple regions.
- Hold employee group meetings on a complete draft version (including graphics and pictures) of the text using language that everyone can understand.
- Inform employees that they will receive a copy of the code during an introduction session.
- Let all employees know that they will receive future ethics training which will, in part, cover the important information contained in the code document.

to encourage employees to report illegal or unethical practices internally so that they can take steps to remedy problems before they result in legal action or generate negative publicity. In recent years, whistleblowers have provided crucial evidence documenting illegal actions at a number of companies. At Enron, for example, Sherron Watkins, a vice president, warned the firm’s CEO, Ken Lay, that the energy company was using improper accounting procedures. Lay forwarded Watkins’s concerns to Vinson and Elkins, Enron’s outside lawyers, and they provided opinion letters approving the questionable transactions. Watkins also took her concerns to senior accountants at Arthur Andersen, and it is unclear if any action was taken. Watkins sold some of her Enron stock based on her knowledge, but was not indicted for insider trading. Soon after, Watkins testified before Congress that Enron had concealed billions of dollars in debt through a complex scheme of off-balance sheet partnerships. Enron ultimately went bankrupt when its improprieties and high levels of debt were exposed. Unfortunately, whistleblowers are often treated negatively in organizations. The government seeks to discourage this practice by rewarding firms that encourage employees to report misconduct—with reduced fines and penalties when violations occur.

The current trend is to move away from legally based ethical initiatives in organizations to cultural- or integrity-based initiatives that make ethics a part of core organizational values. Organizations recognize that effective business ethics programs are good for business performance. Firms that develop higher levels of trust function more efficiently and effectively and avoid damaged company reputations and product images. Organizational ethics initiatives have been supportive of many positive and diverse organizational objectives, such as profitability, hiring, employee satisfaction, and customer loyalty. Conversely, lack of organizational ethics initiatives and the absence of workplace values such as honesty, trust, and integrity can have a negative impact on organizational objectives and employee retention. According to one report on employee loyalty and work practices, 79 percent of employees who questioned their bosses’ integrity indicated that they felt uncommitted or were likely to quit soon.

The Nature of Social Responsibility

There are four dimensions of social responsibility: economic, legal, ethical, and voluntary (including philanthropic) (Figure 2.3). Earning profits is the economic foundation of the pyramid in Figure 2.3, and complying with the law is the next step. However a business whose sole objective is to maximize profits is not likely to consider its social responsibility, although its activities will probably be legal. (We looked at ethical responsibilities in the first half of this chapter.) Finally, voluntary responsibilities are additional activities that may not be required but which promote
Corporate citizenship is the extent to which businesses meet the legal, ethical, economic, and voluntary responsibilities placed on them by their various stakeholders. It involves the activities and organizational processes adopted by businesses to meet their social responsibilities. A commitment to corporate citizenship by a firm indicates a strategic focus on fulfilling the social responsibilities expected of it by its stakeholders. Corporate citizenship involves action and measurement of the extent to which a firm embraces the corporate citizenship philosophy and then follows through by implementing citizenship and social responsibility initiatives. One of the major corporate citizenship issues is the focus on preserving the environment. Consumers, governments, and special interest groups such as The Nature Conservancy are concerned about greenhouse gases and CO₂ carbon emissions that are contributing to global warming. The United States was the number-one CO₂ producer, at nearly a quarter of the world’s greenhouse gas emissions, until China’s emissions surpassed the country sometime in 2006 or 2007. The majority of people agree that climate change in a global emergency, but there is not agreement on how to solve the problem. One study done at Princeton University calls for a reduction of 25 billion tons of carbon emissions over the next 50 years—the equivalent of erasing nearly four years of global emissions at today’s rates.

Part of the answer to this crisis is alternative energy such as solar, wind, biofuels, and hydro applications. The American Solar Energy Society estimates that the...
The number of “green” jobs could rise to 40 million by 2030. The drive for alternative fuels such as ethanol from corn has added new issues such as food price increases and food shortages. More than 2 billion consumers earn less than $2 a day in wages. Sharply increased food costs has led to riots and government policies to restrict trade in basic commodities such as rice, corn, and soybeans.

To respond to these developments, most companies are introducing eco-friendly products and marketing efforts. Americans as consumers are generally concerned about the environment, but only 47 percent trust companies to tell them the truth in environmental marketing. This is because most businesses are promoting themselves as green-conscious and concerned about the environment without actually making the necessary commitments to environmental health. Even employees feel their employers aren’t doing enough to protect the environment, with nearly 60 percent feeling that more needs to be done to reduce, recycle, and support green policies.

Corporate Responsibility Officer (CRO) magazine publishes an annual list of the 100 best American corporate citizens based on service to seven stakeholder groups: stockholders, local communities, minorities, employees, global stakeholders, customers, and the environment. Table 2.7 shows the top 20 from that list.

Although the concept of social responsibility is receiving more and more attention, it is still not universally accepted. Table 2.8 lists some of the arguments for and against social responsibility.
PART 1  Business in a Changing World

Social Responsibility Issues

As with ethics, managers consider social responsibility on a daily basis. Among the many social issues that managers must consider are their firms’ relations with owners and stockholders, employees, consumers, the environment, and the community. For example, Indra Nooyi, CEO of PepsiCo, believes that companies must embrace “purpose,” not just for financial results, but also for the imprint they leave on society. She goes on to say that stakeholders, including employees, consumers, and regulators, “will leave no doubt that performance without purpose is not a long-term sustainable formula.”

Social responsibility is a dynamic area with issues changing constantly in response to society’s demands. There is much evidence that social responsibility is associated with improved business performance. Consumers are refusing to buy from businesses that receive publicity about misconduct. A number of studies have found a direct relationship between social responsibility and profitability, as well as a link that exists between employee commitment and customer loyalty—two major concerns of any firm trying to increase profits.

This section highlights a few of the many social responsibility issues that managers face; as managers become aware of and work toward the solution of current social problems, new ones will certainly emerge.

Relations with Owners and Stockholders. Businesses must first be responsible to their owners, who are primarily concerned with earning a profit or a return on their investment in a company. In a small business, this responsibility is fairly easy to fulfill because the owner(s) personally manages the business or knows the managers well. In larger businesses, particularly corporations owned by thousands of stockholders, ensuring responsibility becomes a more difficult task.

TABLE 2.8
The Arguments For and Against Social Responsibility

<table>
<thead>
<tr>
<th>For:</th>
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<tr>
<td>1. Business helped to create many of the social problems that exist today, so it should play a significant role in solving them, especially in the areas of pollution reduction and cleanup.</td>
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<tr>
<td>2. Businesses should be more responsible because they have the financial and technical resources to help solve social problems.</td>
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<tr>
<td>3. As members of society, businesses should do their fair share to help others.</td>
</tr>
<tr>
<td>4. Socially responsible decision making by businesses can prevent increased government regulation.</td>
</tr>
<tr>
<td>5. Social responsibility is necessary to ensure economic survival: If businesses want educated and healthy employees, customers with money to spend, and suppliers with quality goods and services in years to come, they must take steps to help solve the social and environmental problems that exist today.</td>
</tr>
</tbody>
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<table>
<thead>
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<th>Against:</th>
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<tr>
<td>1. It sidetracks managers from the primary goal of business—earning profits. Every dollar donated to social causes or otherwise spent on society's problems is a dollar less for owners and investors.</td>
</tr>
<tr>
<td>2. Participation in social programs gives businesses greater power, perhaps at the expense of particular segments of society.</td>
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<tr>
<td>3. Some people question whether business has the expertise needed to assess and make decisions about social problems.</td>
</tr>
<tr>
<td>4. Many people believe that social problems are the responsibility of government agencies and officials, who can be held accountable by voters.</td>
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A business’s obligations to its owners and investors, as well as to the financial community at large, include maintaining proper accounting procedures, providing all relevant information to investors about the current and projected performance of the firm, and protecting the owners’ rights and investments. In short, the business must maximize the owners’ investment in the firm.

Employee Relations. Another issue of importance to a business is its responsibilities to employees. Without employees, a business cannot carry out its goals. Employees expect businesses to provide a safe workplace, pay them adequately for their work, and keep them informed of what is happening in their company. They want employers to listen to their grievances and treat them fairly. When employees at Ramtech Building Systems Inc. approached management with their concerns about cursing used in the company’s manufacturing facilities, a Language Code of Ethics was instituted. Many employees indicate that obscene language is common in the workplace, particularly in high-stress jobs. For example, 43 percent of the 12,000 U.S. Postal Service employees surveyed recently reported being cursed at in the workplace. Companies are adjusting their policies and offering training to clean up employee language.

Destination CEO
Bakery with a Conscience

The Dancing Deer Baking Company, located in Boston, Massachusetts, is one of a growing number of small companies that takes social responsibility seriously. They bake all of their products from all-natural ingredients and mix them all with a liberal helping of social conscientiousness. Social responsibility is clearly a core value for Dancing Deer. Social responsibility is practiced both internally with its employees, and externally, with the community. All employees have a direct stake in the company with ownership interests, a practice introduced when the company was only two years old and hadn’t yet posted a profit. Employee ownership is only one of a number of progressive employee benefits provided by the company. In addition to strong employee relations, Trish Karter, the company’s CEO, is committed to the social cause of ensuring that people are educated and can play productive roles in society. To support this core value, she has emphasized social programs sponsored by the company.

The company was founded in 1994, its core values of social responsibility driving its mission. That remains true today. The company contributes 35 percent of proceeds from one of its product lines to the Sweet Home Project that provides education and a fresh start for those who have had unfortunate lives: drug addictions, poverty, single parents, and other challenges. While Dancing Deer may be a small business, it bakes up a large number of cookies and brownies each day: 43,000 cookies and 12,000 brownies, daily! The company has experienced growth each year, with $10.5 million in sales—up 30 percent from 2006. CEO Trish Karter is not satisfied, however. The company has a goal of $50 million in sales within the next few years.

Discussion Questions
1. Do you think that Dancing Deer Bakery’s social responsibility can positively affect sales? Why or why not?
2. What is the difference between business ethics and social responsibility? In which does Dancing Deer Bakery’s programs fit best?
3. Dancing Deer Bakery prides itself on its employee relations. Why are employee relations important?
Congress has passed several laws regulating safety in the workplace, many of which are enforced by OSHA. Labor unions have also made significant contributions to achieving safety in the workplace and improving wages and benefits. Most organizations now recognize that the safety and satisfaction of their employees are critical ingredients in their success, and many strive to go beyond what is legally expected of them. Healthy, satisfied employees also supply more than just labor to their employers. Employers are beginning to realize the importance of obtaining input from even the lowest-level employees to help the company reach its objectives.

A major social responsibility for business is providing equal opportunities for all employees regardless of their sex, age, race, religion, or nationality. Women and minorities have been slighted in the past in terms of education, employment, and advancement opportunities; additionally, many of their needs have not been addressed by business. For example, as many as 1.6 million current and former female Wal-Mart employees filed a class-action discrimination lawsuit accusing the giant retailer of paying them lower wages and salaries than it does men in comparable positions. Pretrial proceedings not only uncovered discrepancies between the pay of men and women but also the fact that men dominate higher-paying store manager positions while women occupy more than 90 percent of cashier jobs, most of which pay about $14,000 a year. Wal-Mart faces fines and penalties in the millions of dollars if found guilty of sexual discrimination. Women, who continue to bear most child-rearing responsibilities, often experience conflict between those responsibilities and their duties as employees. Consequently, day care has become a major employment issue for women, and more companies are providing day care facilities as part of their effort to recruit and advance women in the workforce. In addition, companies are considering alternative scheduling such as flex-time and

### Going Green

**Southwest Windpower**

Companies globally and nationally are jumping on the renewable energy bandwagon, as consumers demand more environmentally friendly alternatives to traditional coal-fired electricity. Consumers are seeking to minimize their carbon footprint and their global greenhouse gas emissions, while at the same time circumnavigating higher energy costs. This being the case, the idea that consumers might generate their own electricity via wind turbines has never been more viable. Southwest Windpower, based in Flagstaff, Arizona, has recognized this tremendous market niche. The Skystream 3.7 is the newest creation from Southwest to hit the markets. At between 34 and 70 feet tall, with 12-foot rotors, the Skystream 3.7 is capable of producing power with breezes of 8 mph and achieves full output in 23 mph winds. The Skystream can be installed in lots as small as one acre, and is exceptionally quiet. (Its range of 40 to 50 decibels is quieter than the average background noise level in an office.) The target market is not yet the average consumer, as costs per turbine range from $12,000 to $15,000. However, depending on installation costs, wind-speed average, rebates, and local electricity costs, the Skystream 3.7 can pay for itself in as little as five years. With energy use at an all-time high and increasing, consumers are demanding more environmentally friendly alternatives. The wind turbines produced by Southwest Windpower hold a lot of potential and may soon be a viable energy alternative for a much broader range of consumers.

**Discussion Questions**

1. What are some of the advantages and disadvantages of purchasing a wind power system? Is this practical for the average consumer?
2. What are some of the problems that could arise with wind power? What are the advantages?
3. What are some other ways consumers can reduce their carbon footprint?
job sharing to accommodate employee concerns. Telecommuting has grown significantly over the past 5 to 10 years as well. Many Americans today believe business has a social obligation to provide special opportunities for women and minorities to improve their standing in society.

**Consumer Relations.** A critical issue in business today is business’s responsibility to customers, who look to business to provide them with satisfying, safe products and to respect their rights as consumers. The activities that independent individuals, groups, and organizations undertake to protect their rights as consumers are known as **consumerism.** To achieve their objectives, consumers and their advocates write letters to companies, lobby government agencies, make public service announcements, and boycott companies whose activities they deem irresponsible.

Many of the desires of those involved in the consumer movement have a foundation in John F. Kennedy’s 1962 consumer bill of rights, which highlighted four rights. The **right to safety** means that a business must not knowingly sell anything that could result in personal injury or harm to consumers. Defective or dangerous products erode public confidence in the ability of business to serve society. They also result in expensive litigation that ultimately increases the cost of products for all consumers. The right to safety also means businesses must provide a safe place for consumers to shop. In recent years, many large retailers have been under increasing pressure to improve safety in their large warehouse-type stores. At Home Depot, for example, three consumer deaths and numerous serious injuries have been caused by falling merchandise. One lawsuit brought against the company over injuries received in one of its stores resulted in a $1.5 million judgment. To help prevent further deaths, injuries, and litigation, Home Depot now has a corporate safety officer and has hired 130 safety managers to monitor store compliance with new safety measures.55

The **right to be informed** gives consumers the freedom to review complete information about a product before they buy it. This means that detailed information about ingredients, risks, and instructions for use are to be printed on labels and packages. The **right to choose** ensures that consumers have access to a variety of products and services at competitive prices. The assurance of both satisfactory quality and service at a fair price is also a part of the consumer’s right to choose. Some consumers are not being given this right. Many are being billed for products and services they never ordered. According to the Federal Trade Commission, complaints about unordered merchandise and services recently jumped 169 percent over a two-year period. The **right to be heard** assures consumers that their interests will receive full and sympathetic consideration when the government formulates policy. It also assures the fair treatment of consumers who voice complaints about a purchased product.

The role of the Federal Trade Commission’s Bureau of Consumer Protection exists to protect consumers against unfair, deceptive, or fraudulent practices. The bureau, which enforces a variety of consumer protection laws, is divided into five divisions. The Division of Enforcement monitors legal compliance and investigates violations of laws, including unfulfilled holiday delivery promises by online shopping sites, employment opportunities fraud, scholarship scams, misleading advertising for health care products, and more.
Home Depot acknowledges the importance of all stakeholders in operating its business.

Environmental Issues. Environmental responsibility has become a leading issue as both business and the public acknowledge the damage done to the environment in the past. Today’s consumers are increasingly demanding that businesses take a greater responsibility for their actions and how they impact the environment.

Animal Rights. One area of environmental concern in society today is animal rights. Probably the most controversial business practice in this area is testing...
of cosmetics and drugs on animals, that may be injured or killed as a result. Animal-rights activists, such as People for the Ethical Treatment of Animals (PETA), say such research is morally wrong because it harms living creatures. Consumers who share this sentiment may boycott companies that test products on animals and take their business instead to companies, such as The Body Shop and John Paul Mitchell Systems, that do not use animal testing. However, researchers in the cosmetics and pharmaceutical industries argue that animal testing is necessary to prevent harm to human beings who will eventually use the products. Business practices that harm endangered wildlife and their habitats are another environmental issue.

Pollution. Another major issue in the area of environmental responsibility is pollution. Water pollution results from dumping toxic chemicals and raw sewage into rivers and oceans, oil spills, and the burial of industrial waste in the ground where it may filter into underground water supplies. Fertilizers and insecticides used in farming and grounds maintenance also run off into water supplies with each rainfall. Water pollution problems are especially notable in heavily industrialized areas. Medical waste—such as used syringes, vials of blood, and HIV-contaminated materials—has turned up on beaches in New York, New Jersey, and Massachusetts, as well as other places. Society is demanding that water supplies be clean and healthful to reduce the potential danger from these substances.

Air pollution is usually the result of smoke and other pollutants emitted by manufacturing facilities, as well as carbon monoxide and hydrocarbons emitted by motor vehicles. In addition to the health risks posed by air pollution, when some chemical compounds emitted by manufacturing facilities react with air and rain, acid rain results. Acid rain has contributed to the deaths of many forests and lakes in North America as well as in Europe. Air pollution may also contribute to global warming; as carbon dioxide collects in the earth’s atmosphere, it traps the sun’s heat and pre-
vents the earth’s surface from cooling. It is indisputable that the global surface temperature has been increasing over the past 35 years. Worldwide passenger vehicle ownership has been growing due to rapid industrialization and consumer purchasing power in China, India, and other developing countries with large populations. The most important way to contain climate change is to control carbon emissions. The move to green buildings, higher-mileage cars, and other emissions reductions resulting from better efficiency have the potential to generate up to 50 percent of the reductions needed to keep warming at no more than \( 2^\circ \)C above present temperatures—considered the “safe” level. The 2007 U.S. Federal Energy bill raised average fuel economy (CAFE) standards to 35 mpg for cars by 2020, while Europe has the goal of a 40 mpg standard by the same deadline. Because buildings create half of U.S. greenhouse emissions, there is tremendous opportunity to develop conservation measures. For example, some utilities charge more for electricity in peak demand periods, which encourages behavioral changes that reduce consumption. On the positive side, there are more than 100 million bicycles produced annually worldwide, more than double the passenger vehicles produced.

Going Green
EarthCraft Houses: Crafted for Earth

These days, almost everyone seems to be going green. However, most people seek easy solutions, such as purchasing local organic produce, buying chemical-free household products, or driving a hybrid car. Most of us probably believe that not many people live in homes that are entirely “green.” Although it may not be page-one news, the green trend is growing in today’s housing market. Among those companies promoting green living is EarthCraft House. Founded in 1999 by the Atlanta Home Builders Association and Southface Home, EarthCraft aims to build comfortable homes that reduce utility costs while at the same time benefiting the environment.

As of 2007, EarthCraft House had certified more than 4,000 single-family homes and 1,500 multifamily dwelling units within the Atlanta metro area. Atlanta also boasts six EarthCraft communities. EarthCraft House has expanded beyond Georgia to South Carolina, Alabama, Tennessee, and Virginia. All are supported by local state agencies and home-builder’s associations. Similar organizations exist in Florida (Green Building Coalition) and North Carolina (Healthy Built Homes).

So, what is an EarthCraft house? The house can be newly constructed or renovated and can be tailored to fit price point. To be certified by EarthCraft, a house must meet certain guidelines in energy efficiency, durability, indoor air quality, resource efficiency, waste management, and water conservation. All new homes must meet ENERGY STAR certification criteria and must score at least 150 points on an EarthCraft scoring sheet. Those homes that score 200 or 230 points are awarded select or premium status, respectively.

So, how does an EarthCraft house benefit the environment, and how does it benefit the homeowner? To answer these questions, a little background information is required. Construction and maintenance of homes and offices are major sources of CO\(_2\) emissions. EarthCraft houses, on the other hand, can reduce emissions by more than 1,100 pounds of greenhouse gases per home each year. EarthCraft homes also use many recycled and renewable materials as possible, as well as conserving water and reducing storm water pollution.

Homeowner benefits are twofold. One of the aims of EarthCraft is to create a healthier home. For example, an EarthCraft home can reduce levels of mold, mildew, and dust. Therefore EarthCraft homes can benefit our bodies in addition to reducing our carbon footprint. An EarthCraft home can also benefit our wallets. EarthCraft home buyers can take advantage of two different kinds of mortgage incentives. The Energy Efficient Mortgage increases the buyer’s purchasing power due to the lower operating costs of an energy-efficient home. The Energy Improvement Mortgage can be used to finance energy-efficient upgrades on an existing home. All in all, EarthCraft and similar companies predict that by 2010, 10 percent of all homes will be green.

Discussion Questions
1. In addition to reducing carbon dioxide emissions, what are other reasons to build an energy-efficient, “green” house?
2. What type of incentive would cause you to pay extra for an energy-efficient house?
3. What additional incentives might convince people to go green when building or remodeling their homes?
Land pollution is tied directly to water pollution because many of the chemicals and toxic wastes that are dumped on the land eventually work their way into the water supply. A 2008 study conducted by the Environmental Protection Agency found residues of prescription drugs, soaps, and other contaminants in virtually every waterway in the United States. Effects of these pollutants on humans and wildlife are uncertain, but there is some evidence to suggest that fish and other water-dwellers are starting to suffer serious effects. Land pollution results from the dumping of residential and industrial waste, strip mining, forest fires, and poor forest conservation. In Brazil and other South American countries, rain forests are being destroyed—to make way for farms and ranches, at a cost of the extinction of the many animals and plants (some endangered species) that call the rain forest home. In the second half of 2007 alone, an area the size of Rhode Island was lost in the Brazilian Amazon—a rate that is speeding up as agriculture becomes a more attractive industry. Large-scale deforestation also depletes the oxygen supply available to humans and other animals.

Related to the problem of land pollution is the larger issue of how to dispose of waste in an environmentally responsible manner. Americans are producing more trash, with the average person producing about 5 pounds of trash every day up from about 3.3 pounds in 1970. At the same time, more than 30 percent of Americans recycle, up from 8 percent in 1970. Americans use 100 billion plastic bags each year, which is between 10 and 20 percent of the total global usage (estimated at 500 billion to 1 trillion bags). It takes 1,000 years for the bags to decompose. San Francisco has banned plastic bags; Ireland is now charging a nationwide tax of 15 cents on all supermarket shopping bags; and Australia and China are planning a similar program. Whole Foods, the nation’s leading natural and organic supermarket, ended its use of plastic bags on Earth Day 2008. Whole Foods estimates that this move will keep 150 million new plastic grocery bags out of the environment each year.

Response to Environmental Issues. Partly in response to federal legislation such as the National Environmental Policy Act of 1969 and partly due to consumer concerns, businesses are responding to environmental issues. Many small and large companies, including Walt Disney Company, Chevron, and Scott Paper, have created a new executive position—a vice president of environmental affairs—to help them achieve their business goals in an environmentally responsible manner. A survey indicated that 83.5 percent of Fortune 500 companies have a written environmental policy, 74.7 percent engage in recycling efforts, and 69.7 percent have made investments in waste-reduction efforts. In early 2008, the EPA announced that 53 Fortune 500 companies had exceeded their goals for purchasing green energy credits. Many companies, including Alcoa, Dow Chemical, Phillips Petroleum, and Raytheon, now link executive pay to environmental performance. Some companies are finding that environmental consciousness can save them money. DuPont saved more than $3 billion through energy conservation by replacing natural gas with methane in its industrial boilers in many of its plants.

Many firms are trying to eliminate wasteful practices, the emission of pollutants, and/or the use of harmful chemicals from their manufacturing processes. Other companies are seeking ways to improve their products. Utility providers, for example, are increasingly supplementing their services with

Did You Know? In one year, Americans generated 230 million tons of trash and recycled 23.5 percent of it.
alternative energy sources, including solar, wind, and geothermal power. Duke Power is the third largest corporate emitter of carbon dioxide (after American Electric Power and Southern Companies) in the United States. Duke is proactively going green with 500,000 solar panels on rooftops over a five-state territory. The utility is also installing a $1 billion communication network to optimize the flow of electricity through the grid. The firm is looking to nuclear power plants and a Save-A-Watt program to encourage consumers to use less energy. Environmentalists are concerned that the company is merely greenwashing, or “creating a positive association with environmental issues for an unsuitable product, service, or practice.” Even while preaching conservation as a solution, Duke plans to invest $23 billion in the next five years to build new coal and gas plants. In many places, local utility customers can even elect to purchase electricity from green sources—primarily wind power—for a few extra dollars a month. Austin Energy of Austin, Texas, has an award-winning GreenChoice program that includes many small and large businesses among its customers. Indeed, a growing number of businesses and consumers are choosing “green power” sources where available. New Belgium Brewing, the third largest craft brewer in the United States, is the first all-wind-powered brewery in the country. Many businesses have turned to recycling, the reprocessing of materials—aluminum, paper, glass, and some plastic—for reuse. Such efforts to make products, packaging, and processes more environmentally friendly have been labeled “green” business or marketing by the public and media. Lumber products at Home Depot may carry a seal from the Forest Stewardship Council to indicate that they were harvested from sustainable forests using environmentally friendly methods. Likewise, most Chiquita bananas are certified through the Better Banana Project as having been grown with more environmentally and labor-friendly practices.

It is important to recognize that, with current technology, environmental responsibility requires trade-offs. Society must weigh the huge costs of limiting or eliminating pollution against the health threat posed by the pollution. Environmental responsibility imposes costs on both business and the public. Although people certainly do not want oil fouling beautiful waterways and killing wildlife, they insist on low-cost, readily available gasoline and heating oil. People do not want to contribute to the growing garbage-disposal problem, but they often refuse to pay more for “green” products packaged in an environmentally friendly manner, to recycle as much of their own waste as possible, or to permit the building of additional waste-disposal facilities (the “not in my backyard,” or NIMBY, syndrome). Managers must coordinate environmental goals with other social and economic ones.

Community Relations. A final, yet very significant, issue for businesses concerns their responsibilities to the general welfare of the communities and societies in which they operate. Many businesses simply want to make their communities better places for everyone to live and work. The most common way that businesses exercise their community responsibility is through donations to local and national charitable organizations. Corporations contribute more than $12 billion each year to environmental and social causes. For example, Safeway, the nation’s fourth-largest grocer, has donated millions of dollars to organizations involved in medical research, such as Easter Seals and the Juvenile Diabetes Research Foundation International. The company’s employees have also raised funds to support social
causes of interest.\textsuperscript{75} Avon’s Breast Cancer Awareness Crusade has helped raise $300 million to fund community-based breast cancer education and early detection services. Avon, a marketer of women’s cosmetics, is also known for employing a large number of women and promoting them to top management; the firm has more female top managers (86 percent) than any other \textit{Fortune} 500 company.\textsuperscript{76} Even small companies participate in philanthropy through donations and volunteer support of local causes and national charities, such as the Red Cross and the United Way.

After realizing that the current pool of prospective employees lacks many basic skills necessary to work, many companies have become concerned about the quality of education in the United States. Recognizing that today’s students are tomorrow’s employees and customers, firms such as Kroger, Campbell’s Soup, Kodak, American Express, Apple Computer, Xerox, and Coca-Cola are donating money, equipment, and employee time to help improve schools in their communities and around the nation. They provide scholarship money, support for teachers, and computers for students, and they send employees out to tutor and motivate young students to stay in school and succeed. Target, for example, contributes significant resources to education, including direct donations of $100 million to schools as well as fund-raising and scholarship programs that assist teachers and students. Through the retailer’s Take Charge of Education program, customers using a Target Guest Card can designate a specific school to which Target donates 1 percent of their total purchase price. This program is designed to make customers feel that their purchases are benefiting their community while increasing the use of Target Guest Cards.\textsuperscript{77}

Another tactic taken by some companies is to let consumers decide whether they want to contribute to socially responsible activities. What if Dell sold one notebook computer for $1,000 and the same computer for $1,150, with the understanding that the purchase of this computer would support the fight against AIDS around the world? Dell and Microsoft recently created products for the Product(Red) campaign, joining other large corporations such as The Gap, Apple, and Motorola in support of The Global Fund, an international organization fighting AIDS, tuberculosis, and malaria. The Product(Red) computer sold by Dell is significant to consumers and communicates their support to others.\textsuperscript{79}

Business is also beginning to take more responsibility for the hard-core unemployed. These are people who have never had a job or who have been unemployed for a long period of time. Some are mentally or physically handicapped; some are homeless. Organizations such as the National Alliance of Businessmen fund programs to train the hard-core unemployed so that they can find jobs and support themselves. In addition to fostering self-support, such opportunities enhance self-esteem and help people become productive members of society.
PART 1  Business in a Changing World

So You Want a Job in Business Ethics and Social Responsibility

In the words of Kermit the Frog, “It’s not easy being green.” Maybe it is not easy, however, green business opportunities abound. A popular catch phrase, “Green is the new black,” indicating how fashionable green business is becoming. Consumers are more in tune with and concerned about green products, policies, and behaviors by companies than ever before. Companies are looking for new hires to help them see their business creatively and bring insights to all aspects of business operations. The American Solar Energy Society estimates that the number of green jobs could rise to 40 million in the United States by 2030. Green business strategies not only give a firm a commercial advantage in the marketplace, but help lead the way toward a greener world. The fight to reduce our carbon footprint in an attempt against climate change has opened up opportunities for renewable energy, recycling, conservation and increasing overall efficiency in the way resources are used. New businesses that focus on hydro, wind, and solar power are on the rise and will need talented business people to lead them. Carbon emissions’ trading is gaining popularity as large corporations and individuals alike seek to lower their footprints. A job in this growing field could be similar to that of a stock trader or you could lead the search for carbon efficient companies in which to invest.

In the ethics arena, current trends in business governance strongly support the development of ethics and compliance departments to help guide organizational integrity. This alone is a billion-dollar business, and there are jobs in developing organizational ethics programs, developing company policies and training employees and management. An entry-level position might be as a communication specialist or trainer for programs in a business ethics department. Eventually there’s an opportunity to become an ethics officer that would have typical responsibilities of meeting with employees, the Board of Directors and top management to discuss and provide advice about ethics issues in the industry, developing and distributing a code of ethics, creating and maintaining an anonymous, confidential service to answer questions about ethical issues, taking actions on possible ethics code violations and reviewing and modifying the code of ethics of the organization.

There are also opportunities to help with initiatives to help company’s relate social responsibility to stakeholder interests and needs. These jobs could involve coordinating and implementing philanthropic programs that give back to others important to the organization or developing a community volunteering program for employees. In addition to the human relations function, most companies develop programs to assist employees and their families to improve their quality of life. Companies have found that the healthier and happier employees are the more productive they will be in the workforce.

Social responsibility, ethics, and sustainable business practices are not a trend, they are good for business and the bottom line. Just ask Toyota who sold well over a 1 million hybrid cars worldwide in ten years. New industries are being created and old ones are adapting to the new market demands, opening up many varied job opportunities that will lead to more than a paycheck, but to the satisfaction of making the world a better place.

Review Your Understanding

**Define business ethics and social responsibility and examine their importance.**

Business ethics refers to principles and standards that define acceptable business conduct. Acceptable business behavior is defined by customers, competitors, government regulators, interest groups, the public, and each individual’s personal moral principles and values. Social responsibility is the obligation an organization assumes to maximize its positive impact and minimize its negative impact on society. Socially responsible businesses win the trust and respect of their employees, customers, and society and, in the long run, increase profits. Ethics is important in business because it builds trust and confidence in business relationships. Unethical actions may result in negative publicity, declining sales, and even legal action.
CHAPTER 2  Business Ethics and Social Responsibility

Detect some of the ethical issues that may arise in business.

An ethical issue is an identifiable problem, situation, or opportunity requiring a person or organization to choose from among several actions that must be evaluated as right or wrong. Ethical issues can be categorized in the context of their relation with conflicts of interest, fairness and honesty, communications, and business associations.

Specify how businesses can promote ethical behavior by employees.

Businesses can promote ethical behavior by employees by limiting their opportunity to engage in misconduct. Formal codes of ethics, ethical policies, and ethics training programs reduce the incidence of unethical behavior by informing employees what is expected of them and providing punishments for those who fail to comply.

Explain the four dimensions of social responsibility.

The four dimensions of social responsibility are economic (being profitable), legal (obeying the law), ethical (doing what is right, just, and fair), and voluntary (being a good corporate citizen).

Debate an organization’s social responsibilities to owners, employees, consumers, the environment, and the community.

Businesses must maintain proper accounting procedures, provide all relevant information about the performance of the firm to investors, and protect the owners’ rights and investments. In relations with employees, businesses are expected to provide a safe workplace, pay employees adequately for their work, and treat them fairly. Consumerism refers to the activities undertaken by independent individuals, groups, and organizations to protect their rights as consumers. Increasingly, society expects businesses to take greater responsibility for the environment, especially with regard to animal rights, as well as water, air, land, and noise pollution. Many businesses engage in activities to make the communities in which they operate better places for everyone to live and work.

Evaluate the ethics of a business’s decision.

“Solve the Dilemma” on page xx presents an ethical dilemma at Checkers Pizza. Using the material presented in this chapter, you should be able to analyze the ethical issues present in the dilemma, evaluate Barnard’s plan, and develop a course of action for the firm.

Revisit the World of Business

1. What are some of the advantages of having a corporate code of ethics? Is it important?
2. Who is the reading audience for Ethisphere magazine? How might such a publication help these readers?
3. Think of some methods of benchmarking. How would these tools help a company seeking to improve its code of ethics and compliance systems?

Learn the Terms

bribes 000  business ethics 000  codes of ethics 000
consumerism 000  corporate citizenship 000  ethical issue 000
plagiarism 000  social responsibility 000  whistleblowing 000

Check Your Progress

1. Define business ethics. Who determines whether a business activity is ethical? Is unethical conduct always illegal?
2. Distinguish between ethics and social responsibility.
3. Why has ethics become so important in business?
4. What is an ethical issue? What are some of the ethical issues named in your text? Why are they ethical issues?

5. What is a code of ethics? How can one reduce unethical behavior in business?

6. List and discuss the arguments for and against social responsibility by business (Table 2.8). Can you think of any additional arguments (for or against)?

7. What responsibilities does a business have toward its employees?

Get Involved

1. Discuss some recent examples of businesses engaging in unethical practices. Classify these practices as issues of conflict of interest, fairness and honesty, communications, or business relationships. Why do you think the businesses chose to behave unethically? What actions might the businesses have taken?

2. Discuss with your class some possible methods of improving ethical standards in business. Do you think that business should regulate its own activities or that the federal government should establish and enforce ethical standards? How do you think businesspeople feel?

3. Find some examples of socially responsible businesses in newspapers or business journals. Explain why you believe their actions are socially responsible. Why do you think the companies chose to act as they did?

4. What is an ethical issue? What are some of the ethical issues named in your text? Why are they ethical issues?

5. What is a code of ethics? How can one reduce unethical behavior in business?

6. List and discuss the arguments for and against social responsibility by business (Table 2.8). Can you think of any additional arguments (for or against)?

7. What responsibilities does a business have toward its employees?

8. What responsibilities does business have with regard to the environment? What steps have been taken by some responsible businesses to minimize the negative impact of their activities on the environment?

9. What are a business’s responsibilities toward the community in which it operates?

Build Your Skills

MAKING DECISIONS ABOUT ETHICAL ISSUES

Background
The merger of Lockheed and Martin Marietta created Lockheed Martin, the number-one company in the defense industry—an industry that includes such companies as McDonnell Douglas and Northrop Grumman.

You and the rest of the class are managers at Lockheed Martin Corporation, Orlando, Florida. You are getting ready to do the group exercise in an ethics training session. The training instructor announces you will be playing Gray Matters: The Ethics Game. You are told that Gray Matters, which was prepared for your company’s employees, is also played at 41 universities, including Harvard University, and at 65 other companies. Although there are 55 scenarios in Gray Matters, you will have time during this session to complete only the four scenarios that your group draws from the stack of cards.

Task
Form into groups of four to six managers and appoint a group leader who will lead a discussion of the case, obtain a consensus answer to the case, and be the one to report the group’s answers to the instructor. You will have five minutes to reach each decision, after which time, the instructor will give the point values and rationale for each choice. Then you will have five minutes for the next case, etc., until all four cases have been completed. Keep track of your group’s score for each case; the winning team will be the group scoring the most points.

Since this game is designed to reflect life, you may believe that some cases lack clarity or that some of your choices are not as precise as you would have liked. Also, some cases have only one solution, while others have more than one solution. Each choice is assessed points to reflect which answer is the most correct. Your group’s task is to select only one option in each case.
CHAPTER 2  Business Ethics and Social Responsibility

4 Mini-Case
For several months now, one of your colleagues has been slacking off, and you are getting stuck doing the work. You think it is unfair. What do you do?

Potential Answers
A. Recognize this as an opportunity for you to demonstrate how capable you are.
B. Go to your supervisor and complain about this unfair workload.
C. Discuss the problem with your colleague in an attempt to solve the problem without involving others.
D. Discuss the problem with the human resources department.

7 Mini-Case
You are aware that a fellow employee uses drugs on the job. Another friend encourages you to confront the person instead of informing the supervisor. What do you do?

Potential Answers
A. You speak to the alleged user and encourage him to get help.
B. You elect to tell your supervisor that you suspect an employee is using drugs on the job.
C. You confront the alleged user and tell him either to quit using drugs or you will "turn him in."
D. Report the matter to employee assistance.

36 Mini-Case
You work for a company that has implemented a policy of a smoke-free environment. You discover employees smoking in the restrooms of the building. You also smoke and don’t like having to go outside to do it. What do you do?

Potential Answers
A. You ignore the situation.
B. You confront the employees and ask them to stop.
C. You join them, but only occasionally.
D. You contact your ethics or human resources representative and ask him or her to handle the situation.

40 Mini-Case
Your co-worker is copying company-purchased software and taking it home. You know a certain program costs $400, and you have been saving for a while to buy it. What do you do?

Potential Answers
A. You figure you can copy it too since nothing has ever happened to your co-worker.
B. You tell your co-worker he can’t legally do this.
C. You report the matter to the ethics office.
D. You mention this to your supervisor.

Solve the Dilemma
Customer Privacy
Checkers Pizza was one of the first to offer home delivery service, with overwhelming success. However, the major pizza chains soon followed suit, taking away Checkers’s competitive edge. Jon Barnard, Checkers’s founder and co-owner, needed a new gimmick to beat the competition. He decided to develop a computerized information database that would make Checkers the most efficient competitor and provide insight into consumer buying behavior at the same time. Under the system, telephone customers were asked their phone number; if they had ordered from Checkers before, their address and previous order information came up on the computer screen. After successfully testing the new system, Barnard put the computerized order network in place in all Checkers outlets. After three months of success, he decided to give an award to the family that ate the most Checkers pizza.
Through the tracking system, the company identified the biggest customer, who had ordered a pizza every weekday for the past three months (63 pizzas). The company put together a program to surprise the family with an award, free-food certificates, and a news story announcing the award. As Barnard began to plan for the event, however, he began to think that maybe the family might not want all the attention and publicity.

**Discussion Questions**

1. What are some of the ethical issues in giving customers an award for consumption behavior without notifying them first?
2. Do you see this as a potential violation of privacy? Explain.
3. How would you handle the situation if you were Barnard?

**Build Your Business Plan**

**BUSINESS ETHICS AND SOCIAL RESPONSIBILITY**

Think about which industry you are considering competing in with your product/service. Is there any kind of questionable practices in the way the product has been traditionally sold? Produced? Advertised? Have there been any recent accusations regarding safety within the industry? What about any environmental concerns?

**See for Yourself Videocase**

**IS YOUR SHIRT ORGANIC? THE CLOTHING INDUSTRY GOES GREEN**

Social responsibility is defined as a business's obligation to maximize its positive impact and minimize its negative impact on society; therefore it stands to reason that environmental responsibility may be defined as a business's obligation to maximize its positive impact and minimize its negative impact on the environment. As global warming concerns escalate and threats to wildlife, plants, and humans increase, it is becoming necessary for individuals and businesses to admit the problem and address their environmental responsibility. The clothing industry has long been a large polluter responsible for hefty negative impact on the environment. Environmental groups such as Earth Pledge, a non-profit that encourages sustainable development, have been urging the clothing industry to clean up its act. Finally, it appears as if these pleas may finally be heard, as consumers across the board have begun to lend their support to environmentally responsible companies.

Switching to more eco-friendly clothing materials can do much to benefit the environment. For example, according to Organic Exchange, a nonprofit supporting the use of organic cotton, a single cotton t-shirt produced with conventional cotton requires the application of 1/3 of a pound of chemicals. According to the environmentally responsible outdoor clothier Patagonia, conventional cotton crops in California alone are treated with 6.9 million pounds of chemicals annually. These chemicals can easily seep into the ground, creating a host of environmental and health dangers. Research indicates that synthetic fertilizers, soil additives, defoliants, and other substances do untold damage to soil, water, air, and living organisms.

Even though consumers are beginning to demand environmentally and socially responsible goods, they are also the group inhibiting the clothing industry's transition to greener practices. Regardless of heightened eco-friendly awareness, clothing consumers, on average, still tend to base their purchases primarily on price and style. There is also the green “granola” image to overcome. Many people still do not think that eco-friendly clothing can be fashionable, although a number of top designers and fashion brands like Stella McCartney, Donna Karan, H&M, and Rogan for Target have all released organic lines. Barneys New York, the high end department store, now stocks organic fashions; and popular celebrities such as Bono from U2 and actress Natalie Portman are lending their star power to promoting the cause as well.

Outdoor clothing retailers have less of a challenge, being that their target market spends more time out in nature and may, therefore, care more about environmental responsibility. For example, many of us are familiar with Teva sandals and shoes. Teva's parent company, Deckers
Outdoor, was founded by a river guide who wanted to run a green company from the start. Even so, Teva is just now beginning to become heavily involved in using recycled materials in its shoes. In 2007, the company introduced a new collection of shoes, dubbed the Curbside collection, that is composed of recycled materials such as car tires, factory scrap rubber, and plastic bottles.

A longtime pioneer in eco-friendly practices, Patagonia goes all out to make its clothing as green as possible. The company began creating clothing from recycled soda bottles in 1993. Today it has expanded the materials it uses to include second hand garments and other fabrics. In 1996, the company transitioned to using organic cotton exclusively. This one small change has lessened Patagonia’s dependence on oil, reduced toxic emissions, lessoned its contribution to landfills, and reduced levels of soil, air, and water contamination. In 2005, the company also implemented its Common Threads Garment Recycling program so that customers may return old garments to Patagonia stores for reuse in new clothing.

Although the progress toward eco-friendly clothing and sustainable clothing practices has been slow, fashion is moving in the right direction. Marshall Cohen of the market research firm NDP Group states that the number of consumers interested in eco-friendly products (excluding cars and food) grew 15 percent in 2007. Leslie Hoffman of Earth Pledge, a group supporting sustainable practices in corporations and government, notes that in 2004 clothing designers could make use of only about 50 or 60 renewable, non-polluting materials. Today, she says designers have access to around 700 different eco-friendly materials. Hopefully, consumers will support the environmentally responsible steps taken in the fashion industry in order to further the cause.

Discussion Questions
1. What is driving the transition to more eco-friendly clothing?
2. What are the advantages of switching to environmentally friendly clothing production practices?
3. What are the challenges faced by the fashion industry when making this switch?

Remember to check out our Online Learning Center at www.mhhe.com/ferrell7e.
Appendix A

The Legal and Regulatory Environment

Business law refers to the rules and regulations that govern the conduct of business. Problems in this area come from the failure to keep promises, misunderstandings, disagreements about expectations, or, in some cases, attempts to take advantage of others. The regulatory environment offers a framework and enforcement system in order to provide a fair playing field for all businesses. The regulatory environment is created based on inputs from competitors, customers, employees, special interest groups, and the public’s elected representatives. Lobbying by pressure groups who try to influence legislation often shapes the legal and regulatory environment.

Sources of Law

Laws are classified as either criminal or civil. Criminal law not only prohibits a specific kind of action, such as unfair competition or mail fraud, but also imposes a fine or imprisonment as punishment for violating the law. A violation of a criminal law is thus called a crime. Civil law defines all the laws not classified as criminal, and it specifies the rights and duties of individuals and organizations (including businesses). Violations of civil law may result in fines but not imprisonment. The primary difference between criminal and civil law is that criminal laws are enforced by the state or nation, whereas civil laws are enforced through the court system by individuals or organizations.

Criminal and civil laws are derived from four sources: the Constitution (constitutional law), precedents established by judges (common law), federal and state statutes (statutory law), and federal and state administrative agencies (administrative law). Federal administrative agencies established by Congress control and influence business by enforcing laws and regulations to encourage competition and protect consumers, workers, and the environment. The Supreme Court is the ultimate authority on legal and regulatory decisions for appropriate conduct in business.

Courts and the Resolution of Disputes

The primary method of resolving conflicts and business disputes is through lawsuits, where one individual or organization takes another to court using civil laws. The legal system, therefore, provides a forum for businesspeople to resolve disputes based on our legal foundations. The courts may decide when harm or damage results from the actions of others.

Because lawsuits are so frequent in the world of business, it is important to understand more about the court system where such disputes are resolved. Both financial restitution and specific actions to undo wrongdoing can result from going before a court to resolve a conflict. All decisions made in the

Marcia & Bill Baker found Heinz was underfilling their 20-oz. ketchup bottles by 1.5 oz. Heinz paid civil penalties and costs of $180,000 and had to overfill all ketchup bottles in California by 1/8 oz. for a year.
courts are based on criminal and civil laws derived from the legal and regulatory system.

A businessperson may win a lawsuit in court and receive a judgment, or court order, requiring the loser of the suit to pay monetary damages. However, this does not guarantee the victor will be able to collect those damages. If the loser of the suit lacks the financial resources to pay the judgment—for example, if the loser is a bankrupt business—the winner of the suit may not be able to collect the award. Most business lawsuits involve a request for a sum of money, but some lawsuits request that a court specifically order a person or organization to do or to refrain from doing a certain act, such as slamming telephone customers.

**The Court System**

**Jurisdiction** is the legal power of a court, through a judge, to interpret and apply the law and make a binding decision in a particular case. In some instances, other courts will not enforce the decision of a prior court because it lacked jurisdiction. Federal courts are granted jurisdiction by the Constitution or by Congress. State legislatures and constitutions determine which state courts hear certain types of cases. Courts of general jurisdiction hear all types of cases; those of limited jurisdiction hear only specific types of cases. The Federal Bankruptcy Court, for example, hears only cases involving bankruptcy. There is some combination of limited and general jurisdiction courts in every state.

In a **trial court** (whether in a court of general or limited jurisdiction and whether in the state or the federal system), two tasks must be completed. First, the court (acting through the judge or a jury) must determine the facts of the case. In other words, if there is conflicting evidence, the judge or jury must decide who to believe. Second, the judge must decide which law or set of laws is pertinent to the case and must then apply those laws to resolve the dispute.

An **appellate court** can choose arbitrators who are knowledgeable about the particular area of business at issue.

An appellate court, on the other hand, deals solely with appeals relating to the interpretation of law. Thus, when you hear about a case being appealed, it is not retried, but rather reevaluated. Appellate judges do not hear witnesses but instead base their decisions on a written transcript of the original trial. Moreover, appellate courts do not draw factual conclusions; the appellate judge is limited to deciding whether the trial judge made a mistake in interpreting the law that probably affected the outcome of the trial. If the trial judge made no mistake (or if mistakes would not have changed the result of the trial), the appellate court will let the trial court’s decision stand. If the appellate court finds a mistake, it usually sends the case back to the trial court so that the mistake can be corrected. Correction may involve the granting of a new trial. On occasion, appellate courts modify the verdict of the trial court without sending the case back to the trial court.

**Alternative Dispute Resolution Methods**

Although the main remedy for business disputes is a lawsuit, other dispute resolution methods are becoming popular. The schedules of state and federal trial courts are often crowded; long delays between the filing of a case and the trial date are common. Further, complex cases can become quite expensive to pursue. As a result, many businesspeople are turning to alternative methods of resolving business arguments: mediation and arbitration, the mini-trial, and litigation in a private court.

**Mediation** is a form of negotiation to resolve a dispute by bringing in one or more third-party mediators, usually chosen by the disputing parties, to help reach a settlement. The mediator suggests different ways to resolve a dispute between the parties. The mediator’s resolution is nonbinding—that is, the parties do not have to accept the mediator’s suggestions; they are strictly voluntary.

**Arbitration** involves submission of a dispute to one or more third-party arbitrators, usually chosen by the disputing parties, whose decision usually is final. Arbitration differs from mediation in that an arbitrator’s decision must be followed, whereas a mediator merely offers suggestions and facilitates negotiations. Cases may be submitted to arbitration because a contract—such as a labor contract—requires it or because the parties agree to do so. Some consumers are barred from taking claims to court by agreements drafted by banks, brokers, health plans, and others. Instead, they are required to take complaints to mandatory arbitration. Arbitration can be an attractive alternative to a lawsuit because it is often cheaper and quicker, and the parties frequently can choose arbitrators who are knowledgeable about the particular area of business at issue.

A method of dispute resolution that may become increasingly important in settling complex disputes is the **mini-trial**, in which both parties agree to present a summarized version of their case to an independent
third party. That person then advises them of his or her impression of the probable outcome if the case were to be tried. Representatives of both sides then attempt to negotiate a settlement based on the advisor’s recommendations. For example, employees in a large corporation who believe they have muscular or skeletal stress injuries caused by the strain of repetitive motion in using a computer could agree to a mini-trial to address a dispute related to damages. Although the mini-trial itself does not resolve the dispute, it can help the parties resolve the case before going to court. Because the mini-trial is not subject to formal court rules, it can save companies a great deal of money, allowing them to recognize the weaknesses in a particular case.

In some areas of the country, disputes can be submitted to a private nongovernmental court for resolution. In a sense, a private court system is similar to arbitration in that an independent third party resolves the case after hearing both sides of the story. Trials in private courts may be either informal or highly formal, depending on the people involved. Businesses typically agree to have their disputes decided in private courts to save time and money.

### TABLE A.1 The Major Regulatory Agencies

<table>
<thead>
<tr>
<th>Agency</th>
<th>Major Areas of Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Trade Commission (FTC)</td>
<td>Enforces laws and guidelines regarding business practices; takes action to stop false and deceptive advertising and labeling.</td>
</tr>
<tr>
<td>Food and Drug Administration (FDA)</td>
<td>Enforces laws and regulations to prevent distribution of adulterated or misbranded foods, drugs, medical devices, cosmetics, veterinary products, and particularly hazardous consumer products.</td>
</tr>
<tr>
<td>Consumer Product Safety Commission (CPSC)</td>
<td>Ensures compliance with the Consumer Product Safety Act; protects the public from unreasonable risk of injury from any consumer product not covered by other regulatory agencies.</td>
</tr>
<tr>
<td>Interstate Commerce Commission (ICC)</td>
<td>Regulates franchises, rates, and finances of interstate rail, bus, truck, and water carriers.</td>
</tr>
<tr>
<td>Federal Communications Commission (FCC)</td>
<td>Regulates communication by wire, radio, and television in interstate and foreign commerce.</td>
</tr>
<tr>
<td>Environmental Protection Agency (EPA)</td>
<td>Develops and enforces environmental protection standards and conducts research into the adverse effects of pollution.</td>
</tr>
<tr>
<td>Federal Energy Regulatory Commission (FERC)</td>
<td>Regulates rates and sales of natural gas products, thereby affecting the supply and price of gas available to consumers; also regulates wholesale rates for electricity and gas, pipeline construction, and U.S. imports and exports of natural gas and electricity.</td>
</tr>
<tr>
<td>Federal Aviation Administration (FAA)</td>
<td>Oversees the policies and regulations of the airline industry.</td>
</tr>
<tr>
<td>Federal Highway Administration (FHA)</td>
<td>Regulates vehicle safety requirements.</td>
</tr>
<tr>
<td>Occupational Safety and Health Administration (OSHA)</td>
<td>Develops policy to promote worker safety and health and investigates infractions.</td>
</tr>
<tr>
<td>Securities and Exchange Commission (SEC)</td>
<td>Regulates corporate securities trading and develops protection from fraud and other abuses; provides an accounting oversight board.</td>
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Regulatory Administrative Agencies

Federal and state administrative agencies (listed in Table A.1) also have some judicial powers. Many administrative agencies, such as the Federal Trade Commission, decide disputes that involve their regulations. In such disputes, the resolution process is usually called a “hearing” rather than a trial. In these cases, an administrative law judge decides all issues.

Federal regulatory agencies influence many business activities and cover product liability, safety, and the regulation or deregulation of public utilities. Usually, these bodies have the power to enforce specific laws, such as the Federal Trade Commission Act, and have some discretion in establishing operating rules and regulations to guide certain types of industry practices. Because of this discretion and overlapping areas of responsibility, confusion or conflict regarding which agencies have jurisdiction over which activities is common.

Of all the federal regulatory units, the Federal Trade Commission (FTC) most influences business activities related to questionable practices that create disputes between businesses and their customers. Although the FTC regulates a variety of business practices, it allocates a large portion of resources to curbing false advertising, misleading pricing, and deceptive packaging and labeling. When it receives a complaint or otherwise has reason to believe that a firm is violating a law, the FTC issues a complaint stating that the business is in violation.

If a company continues the questionable practice, the FTC can issue a cease-and-desist order, which is an order for the business to stop doing whatever has caused the complaint. In such cases, the charged firm can appeal to the federal courts to have the order rescinded. However, the FTC can seek civil penalties in court—up to a maximum penalty of $10,000 a day for each infraction—if a cease-and-desist order is violated. In its battle against unfair pricing, the FTC has issued consent decrees alleging that corporate attempts to engage in price fixing or invitations to competitors to collude are violations even when the competitors in question refuse the invitations. The commission can also require companies to run corrective advertising in response to previous ads considered misleading.

The FTC also assists businesses in complying with laws. New marketing methods are evaluated every year. When general sets of guidelines are needed to improve business practices in a particular industry, the FTC sometimes encourages firms within that industry to establish a set of trade practices voluntarily. The FTC may even sponsor a conference bringing together industry leaders and consumers for the purpose of establishing acceptable trade practices.

Unlike the FTC, other regulatory units are limited to dealing with specific products, services, or business activities. The Food and Drug Administration (FDA) enforces regulations prohibiting the sale and distribution of adulterated, misbranded, or hazardous food and drug products. For example, the FDA outlawed the sale and distribution of most over-the-counter hair-loss remedies after research indicated that few of the products were effective in restoring hair growth.

The Environmental Protection Agency (EPA) develops and enforces environmental protection standards and conducts research into the adverse effects of pollution. The Consumer Product Safety Commission recalls about 300 products a year, ranging from small, inexpensive toys to major appliances. The Consumer Product Safety Commission’s Web site provides details regarding current recalls.

The Consumer Product Safety commission has fallen under increasing scrutiny in the wake of a number of product safety scandals involving children’s toys. The most notable of these issues was lead paint discovered in toys produced in China. Other problems have included the manufacture of toys that include small magnets that pose a choking hazard, and lead-tainted costume jewelry.

Important Elements of Business Law

To avoid violating criminal and civil laws, as well as discouraging lawsuits from consumers, employees, suppliers, and others, businesses need to be familiar with laws that address business practices.

The Uniform Commercial Code

At one time, states had their own specific laws governing various business practices, and transacting business across state lines was difficult because of
Consider Ethics and Social Responsibility

Pfizer: Puffery or Deception?

Pfizer Inc. is a well-known drug company that produces a number of popular medications. Its blockbuster cholesterol-reducing product, Lipitor, has been proven to lower cholesterol. However, increased competition brought on by the introduction of a generic version of Merck & Co.’s Zocor cholesterol medication prompted Pfizer to rethink its advertising strategy. In order to promote this product, the company hired Robert Jarvik, inventor of a kind of artificial heart, to star in new ads for the drug. Although a doctor, Jarvik is not a practicing physician and this has called into question the validity and morality of the endorsement. The ads had been running since 2006 when the company abruptly pulled them in January 2008, in the wake of a federal investigation into the matter.

The accusations do not call into question the importance of Jarvik’s accomplishments or the effectiveness of the medication. They do, however, question Jarvik’s credentials, as he is not a practicing physician. They also question whether or not the ads sought to mislead consumers in a fraudulent way. One of the television advertisements shows Jarvik at a lake discussing the benefits of Lipitor. In the ad he states, “just because I’m a doctor doesn’t mean I don’t worry about by cholesterol,” thereby potentially leading the audience to believe that he is a physician.

Exaggerated marketing claims are known as puffery, which is defined by the FTC as “exaggerations reasonably to be expected of a seller” where “truth or falsity cannot be precisely determined”. Advertising moves beyond puffery into the realm of deceptive, or false, advertising if it gives consumers untrue or unrealistic ideas about the product being promoted. False advertising can range from straight out misrepresenting the product, advertising the maximum or best features rather than the basic or standards ones, or using fillers or oversized packaging to make the consumer think that he or she is buying more. Deceptive advertising can be considered fraud, which is illegal. The House Committee on Energy and Commerce probe has called into question the validity of the claims asserted by Jarvik in the ad, and is considering whether the ads should be considered deceptive, or merely puffery. This distinction can be difficult to determine. According to the Better Business Bureau’s Code of Advertising, “subjective claims are not subject to test of their truth or accuracy,” meaning there is no objective test of such claims. Some believe that the best approach for Pfizer would be to move towards advertising that utilizes scientific data over emotional appeals.

Discussion Questions
1. If the information conveyed in the ads is truthful, should it matter that Dr. Jarvik is associated with development of an artificial heart but is not a practicing physician?
2. What advertising approaches do you think that Pfizer should take in the future in order to avoid the same kind of scrutiny and criticism engendered by the Jarvik Lipitor ads?
3. How might one determine when a company has crossed the line between puffery and outright deception?

Sales Agreements. Article II of the Uniform Commercial Code covers sales agreements for goods and services but does not cover the sale of stocks and bonds, personal services, or real estate. Among its many provisions, Article II stipulates that a sales agreement can be enforced even though it does not specify the selling price or the time or place of delivery. It also requires that a buyer pay a reasonable price for goods at the time of delivery if the buyer and seller have not reached an agreement on price. Specifically, Article II addresses the rights of buyers and sellers, transfers of ownership, warranties, and the legal placement of risk during manufacture and delivery.

Article II also deals with express and implied warranties. An express warranty stipulates the specific terms the seller will honor. Many automobile manufacturers, for example, provide three-year or 36,000-mile warranties on their vehicles, during which period they will fix any and all defects specified in the warranty. An implied warranty is imposed on the producer or seller by law, although it may not be a written document provided at the time of sale. Under Article II, a consumer may assume that the product for sale has a clear title (in other words, that it is not stolen) and that the product will both serve the purpose for which it was made and sold as well as function as advertised.
The Law of Torts and Fraud

A **tort** is a private or civil wrong other than breach of contract. For example, a tort can result if the driver of a Domino’s Pizza delivery car loses control of the vehicle and damages property or injures a person. In the case of the delivery car accident, the injured persons might sue the driver and the owner of the company—Domino’s in this case—for damages resulting from the accident.

**Fraud** is a purposeful unlawful act to deceive or manipulate in order to damage others. Thus, in some cases, a tort may also represent a violation of criminal law. Health care fraud has become a major issue in the courts.

An important aspect of tort law involves **product liability**—businesses’ legal responsibility for any negligence in the design, production, sale, and consumption of products. Product liability laws have evolved from both common and statutory law. Some states have expanded the concept of product liability to include injuries by products whether or not the producer is proven negligent. Under this strict product liability, a consumer who files suit because of an injury has to prove only that the product was defective, that the defect caused the injury, and that the defect made the product unreasonably dangerous. For example, a carving knife is expected to be sharp and is not considered defective if you cut your finger using it. But an electric knife could be considered defective and unreasonably dangerous if it continued to operate after being switched off.

Reforming tort law, particularly in regard to product liability, has become a hot political issue as businesses look for relief from huge judgments in lawsuits. Although many lawsuits are warranted—few would disagree that a wrong has occurred when a patient dies because of negligence during a medical procedure or when a child is seriously injured by a defective toy, and that the families deserve some compensation—many suits are not. Because of multimillion-dollar judgments, companies are trying to minimize their liability, and sometimes they pass on the costs of the damage awards to their customers in the form of higher prices. Some states have passed laws limiting damage awards and some tort reform is occurring at the federal level. Table A.2 lists the state courts systems the U.S. Chamber of Commerce’s Institute for Legal Reform has identified as being “friendliest” and “least friendly” to business in terms of juries’ fairness, judges’ competence and impartiality, and other factors.

**The Law of Contracts**

Virtually every business transaction is carried out by means of a **contract**, a mutual agreement between two or more parties that can be enforced in a court if one party chooses not to comply with the terms of the contract. If you rent an apartment or house, for example, your lease is a contract. If you have borrowed money under a student loan program, you have a contractual agreement to repay the money. Many aspects of contract law are covered under the Uniform Commercial Code.

### Table A.2 State Court Systems’ Reputations for Supporting Business

<table>
<thead>
<tr>
<th>Most Friendly to Business</th>
<th>Least Friendly to Business</th>
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<tbody>
<tr>
<td>Delaware</td>
<td>Mississippi</td>
</tr>
<tr>
<td>Nebraska</td>
<td>West Virginia</td>
</tr>
<tr>
<td>Virginia</td>
<td>Alabama</td>
</tr>
<tr>
<td>Iowa</td>
<td>Louisiana</td>
</tr>
<tr>
<td>Idaho</td>
<td>California</td>
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<tr>
<td>Utah</td>
<td>Texas</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>Illinois</td>
</tr>
<tr>
<td>Minnesota</td>
<td>Montana</td>
</tr>
<tr>
<td>Kansas</td>
<td>Arkansas</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>Missouri</td>
</tr>
</tbody>
</table>

Source: U.S. Chamber of Commerce Institute for Legal Reform, in Martin Kasindorf, “Robin Hood Is Alive in Court, Say Those Seeking Lawsuit Limits,” USA Today, March 8, 2004, p. 4A.
A "handshake deal" is in most cases as fully and completely binding as a written, signed contract agreement. Indeed, many oil-drilling and construction contractors have for years agreed to take on projects on the basis of such handshake deals. However, individual states require that some contracts be in writing to be enforceable. Most states require that at least some of the following contracts be in writing:

- Contracts involving the sale of land or an interest in land.
- Contracts to pay somebody else's debt.
- Contracts that cannot be fulfilled within one year.
- Contracts for the sale of goods that cost more than $500 (required by the Uniform Commercial Code).

Only those contracts that meet certain requirements—called elements—are enforceable by the courts. A person or business seeking to enforce a contract must show that it contains the following elements: voluntary agreement, consideration, contractual capacity of the parties, and legality.

For any agreement to be considered a legal contract, all persons involved must agree to be bound by the terms of the contract. Voluntary agreement typically comes about when one party makes an offer and the other accepts. If both the offer and the acceptance are freely, voluntarily, and knowingly made, the acceptance forms the basis for the contract. If, however, either the offer or the acceptance are the result of fraud or force, the individual or organization subject to the fraud or force can void, or invalidate, the resulting agreement or receive compensation for damages.

The second requirement for enforcement of a contract is that it must be supported by consideration—that is, money or something of value must be given in return for fulfilling a contract. As a general rule, a person cannot be forced to abide by the terms of a promise unless that person receives a consideration. The something-of-value could be money, goods, services, or even a promise to do or not to do something.

Contractual capacity is the legal ability to enter into a contract. As a general rule, a court cannot enforce a contract if either party to the agreement lacks contractual capacity. A person's contractual capacity may be limited or nonexistent if he or she is a minor (under the age of 18), mentally unstable, retarded, insane, or intoxicated.

Legality is the state or condition of being lawful. For an otherwise binding contract to be enforceable, both the purpose of and the consideration for the contract must be legal. A contract in which a bank loans money at a rate of interest prohibited by law, a practice known as usury, would be an illegal contract, for example. The fact that one of the parties may commit an illegal act while performing a contract does not render the contract itself illegal, however.

Breach of contract is the failure or refusal of a party to a contract to live up to his or her promises. In the case of an apartment lease, failure to pay rent would be considered breach of contract. The breaching party—the one who fails to comply—may be liable for monetary damages that he or she causes the other person.

The Law of Agency

An agency is a common business relationship created when one person acts on behalf of another and under that person's control. Two parties are involved in an agency relationship: The principal is the one who wishes to have a specific task accomplished; the agent is the one who acts on behalf of the principal to accomplish the task. Authors, movie stars, and athletes often employ agents to help them obtain the best contract terms.

An agency relationship is created by the mutual agreement of the principal and the agent. It is usually not necessary that such an agreement be in writing, although putting it in writing is certainly advisable.

An agency relationship continues as long as both the principal and the agent so desire. It can be terminated by mutual agreement, by fulfillment of the purpose of the agency, by the refusal of either party to continue in the relationship, or by the death of either the principal or the agent. In most cases, a principal grants authority to the agent through a formal power of attorney, which is a legal document authorizing a person to act as someone else's agent. The power of attorney can be used for any agency relationship, and its use is not limited to lawyers. For instance, in real estate transactions, often a lawyer or real estate agent is given power of attorney with the authority to purchase real estate for the buyer. Accounting firms often give employees agency relationships in making financial transactions.

Both officers and directors of corporations are fiduciaries, or people of trust, who use due care and loyalty as an agent in making decisions on behalf of
the organization. This relationship creates a duty of care, also called duty of diligence, to make informed decisions. These agents of the corporation are not held responsible for negative outcomes if they are informed and diligent in their decisions. The duty of loyalty means that all decisions should be in the interests of the corporation and its stakeholders. Scandals at Enron, Tyco, and WorldCom are associated with officers and directors who failed to carry out their fiduciary duties. Lawsuits from shareholders called for the officers and directors to pay large sums of money from their own pockets.

The Law of Property

Property law is extremely broad in scope because it covers the ownership and transfer of all kinds of real, personal, and intellectual property. Real property consists of real estate and everything permanently attached to it; personal property basically is everything else. Personal property can be further subdivided into tangible and intangible property. Tangible property refers to items that have a physical existence, such as automobiles, business inventory, and clothing. Intangible property consists of rights and duties; its existence may be represented by a document or by some other tangible item. For example, accounts receivable, stock in a corporation, goodwill, and trademarks are all examples of intangible personal property. Intellectual property refers to property, such as musical works, artwork, books, and computer software, that is generated by a person's creative activities.

Copyrights, patents, and trademarks provide protection to the owners of property by giving them the exclusive right to use it. Copyrights protect the ownership rights on material (often intellectual property) such as books, music, videos, photos, and computer software. The creators of such works, or their heirs, generally have exclusive rights to the published or unpublished works for the creator's lifetime, plus 50 years. Patents give inventors exclusive rights to their invention for 17 years. The most intense competition for patents is in the pharmaceutical industry. Most patents take a minimum of 18 months to secure.

A trademark is a brand (name, mark, or symbol) that is registered with the U.S. Patent and Trademark Office and is thus legally protected from use by any other firm. Among the symbols that have been so protected are McDonald's golden arches and Coca-Cola's distinctive bottle shape. It is estimated that large multinational firms may have as many as 15,000 conflicts related to trademarks. Companies are diligent about protecting their trademarks both to avoid confusion in consumers' minds and because a term that becomes part of everyday language can no longer be trademarked. The names aspirin and nylon, for example, were once the exclusive property of their creators but became so widely used as product names (rather than brand names) that now anyone can use them.

As the trend toward globalization of trade continues, and more and more businesses trade across national boundaries, protecting property rights, particularly intellectual property such as computer software, has become an increasing challenge. While a company may be able to register as a trademark a brand name or symbol in its home country, it may not be able to secure that protection abroad. Some countries have copyright and patent laws that are less strict than those of the United States; some countries will not enforce U.S. laws. China, for example, has often been criticized for permitting U.S. goods to be counterfeited there. Such counterfeiting harms not only the sales of U.S. companies but also their reputations if the knockoffs are of poor quality. Thus, businesses engaging in foreign trade may have to take extra steps to protect their property because local laws may be insufficient to protect them.

The Law of Bankruptcy

Although few businesses and individuals intentionally fail to repay (or default on) their debts, sometimes they cannot fulfill their financial obligations. Individuals may charge goods and services beyond their ability to pay for them. Businesses may take on too much debt in order to finance growth or business events such as an increase in the cost of commodities can bankrupt a company. An option of last resort in these cases is bankruptcy, or legal insolvency. For example, a number of prominent airlines have recently filed for bankruptcy as a result of a weakening economy and problems inherent to the industry. Frontier Airlines is among those experiencing trouble. In order to attempt a recovery, the airline filed for Chapter 11 bankruptcy in April 2008. The airline blames its recent financial troubles on its credit card processing company, which has begun to claim a larger proportion of Frontier’s revenues. This problem combined with fuel prices that rose 74 percent between 2007 and 2008, high-profile safety issues on
a number of planes, and falling demand have created an environment difficult for even the strongest of carriers. In March 2008, Aloha Airlines took a more drastic step, filing for Chapter 7 bankruptcy. After filing, the carrier quickly closed for business—while United Airlines and Hawaiian Airlines stepped in to honor Aloha’s tickets and reservations. Prior to bankruptcy, the carrier was the island state’s 10th-largest employer, with 3,400 employees.84

Individuals or companies may ask a bankruptcy court to declare them unable to pay their debts and thus release them from the obligation of repaying those debts. The debtor’s assets may then be sold to pay off as much of the debt as possible. In the case of a personal bankruptcy, although the individual is released from repaying debts and can start over with a clean slate, obtaining credit after bankruptcy proceedings is very difficult. About 2 million households in the United States filed for bankruptcy in 2005, the most ever. However, a new, more restrictive law went into effect in late 2005, and fewer consumers are using bankruptcy to eliminate their debts. The law makes it harder for consumers to prove that they should be allowed to clear their debts for what is called a “fresh start” or Chapter 7 bankruptcy. Although the person or company in debt usually initiates bankruptcy proceedings, creditors may also initiate them. The subprime mortgage crisis of early 2008 caused a string of bankruptcies among individuals; and chapter 7 and 11 bankruptcies among banks, and other businesses as well. Tougher bankruptcy laws and a slowing economy converged on the subprime crisis to create a situation where bankruptcy filings skyrocketed.

Table A.3 describes the various levels of bankruptcy protection a business or individual may seek.

### Laws Affecting Business Practices

One of the government’s many roles is to act as a watchdog to ensure that businesses behave in accordance with the wishes of society. Congress has enacted a number of laws that affect business practices; some of the most important of these are summarized in Table A.4. Many state legislatures have enacted similar laws governing business within specific states.

The **Sherman Antitrust Act**, passed in 1890 to prevent businesses from restraining trade and monopolizing markets, condemns “every contract, combination, or conspiracy in restraint of trade.” For example, a request that a competitor agree to fix prices or divide markets would, if accepted, result in a violation of the Sherman Act. Recently antitrust authorities have investigated the chocolate industry for evidence of price fixing. Over 50 civil suits have been filed against Hershey and other chocolate makers accusing the companies of collusion in order to boost profits.85 Proof of intent plays an important role in attempted monopolization cases under the Sherman Act. Enforced by the Antitrust Division of the Department of Justice, the Sherman Antitrust Act applies to firms operating in interstate commerce and to U.S. firms operating in foreign commerce. For example, in early 2008 the American company, Intel Corp., found its German offices raided by European

### Table A.3 Types of Bankruptcy

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Requirements</th>
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<tbody>
<tr>
<td>Chapter 7</td>
<td>Requires that the business be dissolved and its assets liquidated, or sold, to pay off the debts. Individuals declaring Chapter 7 retain a limited amount of exempt assets, the amount of which may be determined by state or federal law, at the debtor’s option. Although the type and value of exempt assets varies from state to state, most states’ laws allow a bankrupt individual to keep an automobile, some household goods, clothing, furnishings, and at least some of the value of the debtor’s residence. All nonexempt assets must be sold to pay debts.</td>
</tr>
<tr>
<td>Chapter 11</td>
<td>Temporarily frees a business from its financial obligations while it reorganizes and works out a payment plan with its creditors. The indebted company continues to operate its business during bankruptcy proceedings. Often, the business sells off assets and less-profitable subsidiaries to raise cash to pay off its immediate obligations.</td>
</tr>
<tr>
<td>Chapter 13</td>
<td>Similar to Chapter 11 but limited to individuals. This proceeding allows an individual to establish a three- to five-year plan for repaying his or her debt. Under this plan, an individual ultimately may repay as little as 10 percent of his or her debt.</td>
</tr>
</tbody>
</table>
### TABLE A.4 Major Federal Laws Affecting Business Practices

<table>
<thead>
<tr>
<th>Act (Date Enacted)</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sherman Antitrust Act (1890)</td>
<td>Prohibits contracts, combinations, or conspiracies to restrain trade; establishes as a misdemeanor monopolizing or attempting to monopolize.</td>
</tr>
<tr>
<td>Clayton Act (1914)</td>
<td>Prohibits specific practices such as price discrimination, exclusive dealer arrangements, and stock acquisitions in which the effect may notably lessen competition or tend to create a monopoly.</td>
</tr>
<tr>
<td>Federal Trade Commission Act (1914)</td>
<td>Created the Federal Trade Commission; also gives the FTC investigatory powers to be used in preventing unfair methods of competition.</td>
</tr>
<tr>
<td>Robinson-Patman Act (1936)</td>
<td>Prohibits price discrimination that lessens competition among wholesalers or retailers; prohibits producers from giving disproportionate services of facilities to large buyers.</td>
</tr>
<tr>
<td>Wheeler-Lea Act (1938)</td>
<td>Prohibits unfair and deceptive acts and practices regardless of whether competition is injured; places advertising of foods and drugs under the jurisdiction of the FTC.</td>
</tr>
<tr>
<td>Lanham Act (1946)</td>
<td>Provides protections and regulation of brand names, brand marks, trade names, and trademarks.</td>
</tr>
<tr>
<td>Celler-Kefauver Act (1950)</td>
<td>Prohibits any corporation engaged in commerce from acquiring the whole or any part of the stock or other share of the capital assets of another corporation when the effect substantially lessens competition or tends to create a monopoly.</td>
</tr>
<tr>
<td>Fair Packaging and Labeling Act (1966)</td>
<td>Makes illegal the unfair or deceptive packaging or labeling of consumer products.</td>
</tr>
<tr>
<td>Magnuson-Moss Warranty (FTC) Act (1975)</td>
<td>Provides for minimum disclosure standards for written consumer product warranties; defines minimum consent standards for written warranties; allows the FTC to prescribe interpretive rules in policy statements regarding unfair or deceptive practices.</td>
</tr>
<tr>
<td>Antitrust Improvements Act (1976)</td>
<td>Requires large corporations to inform federal regulators of prospective mergers or acquisitions so that they can be studied for any possible violations of the law.</td>
</tr>
<tr>
<td>Trademark Counterfeiting Act (1980)</td>
<td>Provides civil and criminal penalties against those who deal in counterfeit consumer goods or any counterfeit goods that can threaten health or safety.</td>
</tr>
<tr>
<td>Trademark Law Revision Act (1988)</td>
<td>Amends the Lanham Act to allow brands not yet introduced to be protected through registration with the Patent and Trademark Office.</td>
</tr>
<tr>
<td>Nutrition Labeling and Education Act (1990)</td>
<td>Prohibits exaggerated health claims and requires all processed foods to contain labels with nutritional information.</td>
</tr>
<tr>
<td>Telephone Consumer Protection Act (1991)</td>
<td>Establishes procedures to avoid unwanted telephone solicitations; prohibits marketers from using automated telephone dialing system or an artificial or prerecorded voice to certain telephone lines.</td>
</tr>
<tr>
<td>Federal Trademark Dilution Act (1995)</td>
<td>Provides trademark owners the right to protect trademarks and requires relinquishment of names that match or parallel existing trademarks.</td>
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TABLE A.4  continued

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<thead>
<tr>
<th>Act (Date Enacted)</th>
<th>Purpose</th>
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<tbody>
<tr>
<td>Digital Millennium Copyright Act (1998)</td>
<td>Refined copyright laws to protect digital versions of copyrighted</td>
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<tr>
<td></td>
<td>materials, including music and movies.</td>
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<tr>
<td>Children's Online Privacy Protection Act</td>
<td>Regulates the collection of personally identifiable information (name,</td>
</tr>
<tr>
<td>(2000)</td>
<td>address, e-mail address, hobbies, interests, or information collected</td>
</tr>
<tr>
<td></td>
<td>through cookies) online from children under age 13.</td>
</tr>
<tr>
<td>Sarbanes-Oxley Act (2002)</td>
<td>Made securities fraud a criminal offense; stiffened penalties for</td>
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<tr>
<td></td>
<td>corporate fraud; created an accounting oversight board; and</td>
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<tr>
<td></td>
<td>instituted numerous other provisions designed to increase corporate</td>
</tr>
<tr>
<td></td>
<td>transparency and compliance.</td>
</tr>
<tr>
<td>Do Not Call Implementation Act (2003)</td>
<td>Directs FCC and FTC to coordinate so their rules are consistent</td>
</tr>
<tr>
<td></td>
<td>regarding telemarketing call practices, including the Do Not Call</td>
</tr>
<tr>
<td></td>
<td>Registry.</td>
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Union Antitrust regulators. The firm had been suspected of running a cartel, and attempting to squeeze out smaller competitors through its position as market leader. The 2008 raids were part of an ongoing series of international anti-trust allegations aimed at Intel. The Sherman Antitrust Act, still highly relevant 100 years after its passage, is being copied throughout the world as the basis for regulating fair competition.

Because the provisions of the Sherman Antitrust Act are rather vague, courts have not always interpreted it as its creators intended. The Clayton Act was passed in 1914 to limit specific activities that can reduce competition. The Clayton Act prohibits price discrimination, tying and exclusive agreements, and the acquisition of stock in another corporation where the effect may be to substantially lessen competition or tend to create a monopoly. In addition, the Clayton Act prohibits members of one company’s board of directors from holding seats on the boards of competing corporations. The act also exempts farm cooperatives and labor organizations from antitrust laws.

In spite of these laws regulating business practices, there are still many questions about the regulation of business. For instance, it is difficult to determine what constitutes an acceptable degree of competition and whether a monopoly is harmful to a particular market. Many mergers were permitted that resulted in less competition in the banking, publishing, and automobile industries. In some industries, such as utilities, it is not cost effective to have too many competitors. For this reason, the government permits utility monopolies, although recently, the telephone, electricity, and communications industries have been deregulated. Furthermore, the antitrust laws are often rather vague and require interpretation, which may vary from judge to judge and court to court. Thus, what one judge defines as a monopoly or trust today may be permitted by another judge a few years from now. Businesspeople need to understand what the law says on these issues and try to conduct their affairs within the bounds of these laws.

The Internet: Legal and Regulatory Issues

Our use and dependence on the Internet is increasingly creating a potential legal problem for businesses. With this growing use come questions of maintaining an acceptable level of privacy for consumers and proper competitive use of the medium. Some might consider that tracking individuals who visit or “hit” their Web site by attaching a “cookie” (identifying you as a Web site visitor for potential recontact and tracking your movement throughout the site) is an improper use of the Internet for business purposes. Others may find such practices acceptable and similar to the practices of non-Internet retailers who copy information from checks or ask customers for their name, address, or phone number before they will process a transaction. There are few specific laws that regulate business on the Internet, but the standards for acceptable behavior that are reflected in the basic laws and regulations designed for traditional businesses can be applied to business on the Internet.
as well. On law aimed specifically at advertising on the Internet is the CAN-SPAM Act of 2004. The law restricts unsolicited email advertisements by requiring the consent of the recipient. Furthermore, the CAN-SPAM Act follows the “opt-out” model wherein recipients can elect to not receive further emails from a sender simply by clicking on a link.  

The central focus for future legislation of business conducted on the Internet is the protection of personal privacy. The present basis of personal privacy protection is the U.S. Constitution, various Supreme Court rulings, and laws such as the 1971 Fair Credit Reporting Act, the 1978 Right to Financial Privacy Act, and the 1974 Privacy Act, which deals with the release of government records. With few regulations on the use of information by businesses, companies legally buy and sell information on customers to gain competitive advantage. Sometimes existing laws are not enough to protect people, and the ease with which information on customers can be obtained becomes a problem. For example, identity theft has increased due to the proliferation of the use of the Internet. In March 2008, two grocery-store chains, Hannaford Bros and Sweetbay, both experienced a security breach that potentially exposed 4.2 million customers’ cards. By mid March, the companies were aware of 1,800 fraudulent charges stemming from the security incident. Without proper legislation to protect information on the Internet, issues like this will continue to plague businesses. It has been suggested that the treatment of personal data as property will ensure privacy rights by recognizing that customers have a right to control the use of their personal data.

Internet use is different from traditional interaction with businesses in that it is readily accessible, and most online businesses are able to develop databases of information on customers. Congress has restricted the development of databases on children using the Internet. The Children’s Online Privacy Protection Act of 2000 prohibits Web sites and Internet providers from seeking personal information from children under age 13 without parental consent.

The Internet has also created a copyright dilemma for some organizations that have found that the Web addresses of other online firms either match or are very similar to their company trademark. “Cybersquatters” attempt to sell back the registration of these matching sites to the trademark owner. Companies such as Taco Bell, MTC, and KFC have paid thousands of dollars to gain control of domain names that match or closely parallel company trademarks. The Federal Trademark Dilution Act of 1995 helps companies address this conflict. The act provides trademark owners the right to protect trademarks, prevents the use of trademark-protected entities, and requires the relinquishment of names that match or closely parallel company trademarks. The reduction of geographic barriers, speed of response, and memory capability of the Internet will continue to create new challenges for the legal and regulatory environment in the future.

Legal Pressure for Responsible Business Conduct

To ensure greater compliance with society’s desires, both federal and state governments are moving toward increased organizational accountability for misconduct. Before 1991, laws mainly punished those employees directly responsible for an offense. Under new guidelines established by the Federal Sentencing Guidelines for Organizations (FSGO), however, both the responsible employees and the firms that employ them are held accountable for violations of federal law. Thus, the government now places responsibility for controlling and preventing misconduct squarely on the shoulders of top management. The main objectives of the federal guidelines are to train employees, self-monitor and supervise employees, and ensure the implementation of policies and procedures to prevent violations.
conduct, deter unethical acts, and punish those organizational members who engage in illegal acts.

A 2004 amendment to the FSGO requires that a business’s governing authority be well informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm’s leadership, usually the board of directors. The board must ensure that there is a high-ranking manager accountable for the day-to-day operational oversight of the ethics program. The board must provide for adequate authority, resources, and access to the board or an appropriate subcommittee of the board. The board must ensure that there are confidential mechanisms available so that the organization’s employees and agents may report or seek guidance about potential or actual misconduct without fear of retaliation. Finally, the board is required to oversee the discovery of risks and to design, implement, and modify approaches to deal with those risks.

If an organization’s culture and policies reward or provide opportunities to engage in misconduct through lack of managerial concern or failure to comply with the seven minimum requirements of the FSGO (provided in Table A.5), then the organization may incur not only penalties but also the loss of customer trust, public confidence, and other intangible assets. For this reason, organizations cannot succeed solely through a legalistic approach to compliance with the sentencing guidelines; top management must cultivate high ethical standards that will serve as barriers to illegal conduct. The organization must want to be a good citizen and recognize the importance of compliance to successful workplace activities and relationships.

The federal guidelines also require businesses to develop programs that can detect—and that will deter employees from engaging in—misconduct. To be considered effective, such compliance programs must include disclosure of any wrongdoing, cooperation with the government, and acceptance of responsibility for the misconduct. Codes of ethics, employee ethics training, hotlines (direct 800 phone numbers), compliance directors, newsletters, brochures, and other communication methods are typical components of a compliance program. The ethics component, discussed in Chapter 2, acts as a buffer, keeping firms away from the thin line that separates unethical and illegal conduct.

Despite the existing legislation, a number of ethics scandals in the early 2000s led Congress to pass—almost unanimously—the Sarbanes-Oxley Act, which criminalized securities fraud and strengthened penalties for corporate fraud. It also created an accounting oversight board that requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reports to investors and other interested parties. Additionally, the law requires top corporate executives to sign off on their firms’ financial reports, and they risk fines and jail sentences if they misrepresent their companies’ financial position. Table A.6 summarizes the major provisions of the Sarbanes-Oxley Act.

The Sarbanes-Oxley Act has created a number of concerns and is considered burdensome and expensive to corporations. Large corporations report spending more than $4 million each year to comply with the Act according to Financial Executives International. The Act has caused more than 500 public companies a year to report problems in their accounting systems.

### TABLE A.5 Seven Steps to Compliance

1. Develop standards and procedures to reduce the propensity for criminal conduct.
2. Designate a high-level compliance manager or ethics officer to oversee the compliance program.
3. Avoid delegating authority to people known to have a propensity to engage in misconduct.
4. Communicate standards and procedures to employees, other agents, and independent contractors through training programs and publications.
5. Establish systems to monitor and audit misconduct and to allow employees and agents to report criminal activity.
6. Enforce standards and punishments consistently across all employees in the organization.
7. Respond immediately to misconduct and take reasonable steps to prevent further criminal conduct.

More than 1,000 businesspersons have been convicted of corporate crimes since the law was passed in 2002. This means that the overwhelming majority of businesses are in compliance with the law.

On the other hand, there are many benefits, including greater accountability of top managers and boards of directors, that improve investor confidence and protect employees, especially their retirement plans. It is believed that the law has more benefits than drawbacks—with the greatest benefit being that boards of directors and top managers are better informed. Some companies such as Cisco and Pitney Bowes report improved efficiency and cost savings from better financial information.

**TABLE A.6** Major Provisions of the Sarbanes-Oxley Act

1. Requires the establishment of a Public Company Accounting Oversight Board in charge of regulations administered by the Securities and Exchange Commission.
2. Requires CEOs and CFOs to certify that their companies’ financial statements are true and without misleading statements.
3. Requires that corporate boards of directors’ audit committees consist of independent members who have no material interests in the company.
4. Prohibits corporations from making or offering loans to officers and board members.
5. Requires codes of ethics for senior financial officers; code must be registered with the SEC.
6. Prohibits accounting firms from providing both auditing and consulting services to the same client without the approval of the client firm’s audit committee.
7. Requires company attorneys to report wrongdoing to top managers and, if necessary, to the board of directors; if managers and directors fail to respond to reports of wrongdoing, the attorney should stop representing the company.
8. Mandates “whistleblower protection” for persons who disclose wrongdoing to authorities.
9. Requires financial securities analysts to certify that their recommendations are based on objective reports.
10. Requires mutual fund managers to disclose how they vote shareholder proxies, giving investors information about how their shares influence decisions.
11. Establishes a 10-year penalty for mail/wire fraud.
12. Prohibits the two senior auditors from working on a corporation’s account for more than five years; other auditors are prohibited from working on an account for more than seven years. In other words, accounting firms must rotate individual auditors from one account to another from time to time.