

4 Chapter

Ethics

Although ethics in business has been an issue for centuries, today there are numerous examples of corporations and individuals who have run into legal and financial trouble due to their questionable ethics. Martha Stewart is an example of an individual whose ethics have been called into question. The accusation that she lied when asked if she participated in insider trading, a violation of Securities and Exchange Commission (SEC) regulations, brought her to court and made her the center of a negatively charged media frenzy. While she is accused of committing the violation with her personal investments, the question of character has already cast a shadow on her business. She stepped down from her role as CEO of her company, Martha Stewart Living Omnimedia, Inc., and Kmart, which carried her brand-name products, is bringing a lawsuit against her. This is a clear situation where ethical standards, whether it is the individual representing the company or the company itself, are tied to the company's bottom line.

ENRON

An example of a company that committed serious ethical violations was Enron, the energy trading company. In 15 years Enron grew

to be one of the largest companies in the United States, with more than 20,000 employees in over 40 countries. But by December of 2001 it became clear that Enron was involved in a huge accounting scandal, the ramifications of which were the largest Chapter 11 bankruptcy filings in U.S. history and subsequent government hearings were conducted to evaluate just how severe the wrongdoing was.

As a result of Enron's deceptive accounting practices, thousands of Enron employees lost their retirement savings, while several Enron executives received multimillion-dollar bonuses.

WORLD COM

The largest financial fraud in U.S. history began to unravel WorldCom in 2002. WorldCom had overstated its income by more than \$9 billion by means of its misleading accounting practices, and the CEO at the time was granted \$400 million in loans with the approval of the company's board of directors. By July 2002, WorldCom was forced into bankruptcy and laid off thousands of workers.

WorldCom changed its name to MCI and hired a chief ethics officer in 2003. The company now requires that all 55,000 remaining employees take an online ethics course, and more than 2,000 MCI employees have participated in a full-day ethics training seminar. MCI is being closely watched by the government and by competitors for any future ethical errors, and the company is not willing to take any chances.

ETHICS—A DEFINITION

Ethics are the moral standards used to judge right from wrong. In the business setting, ethics are the standards of moral values and conduct that govern decisions made and actions carried out in the work environment.

Unethical decisions are often made for the benefit of the decision

maker as opposed to the organization's stakeholders. Some examples of unethical behavior in business practice are:

- ✓ Saying things that you know not to be true.
- ✓ Taking something that doesn't belong to you.
- ✓ Buying influence.
- ✓ Hiding or divulging information.

CORPORATE GOVERNANCE

Often thought of as the system by which organizations are directed and controlled, corporate governance has come to take on more of an ethical slant over the past decade. According to World Bank president James Wolfenson, "Corporate governance is about promoting corporate fairness, transparency, and accountability."

CREATING AN ETHICAL STANDARD

Deciding what is right and what is wrong is not always clear-cut. The subjective nature of ethics creates the need for organizations to define their ethical standards. Company leaders often set the example for ethical standards. As discussed in Chapter 3, the job of the leader is to serve as a role model for employees. This is part of the reason why Martha Stewart's personal financial dealings are a concern to the company bearing her name.

Creating an ethical standard is an important way for a leader to spread his or her ethical beliefs throughout an organization. Often the ethical standards will cover a wide range of business areas.

Interorganizational Relations

An organization's ethics policies cover the areas of internal policies, which explain the company's responsibility to employees. These policies often include equal opportunities, sexual harassment, diversity, and employee safety.

Equal opportunity employment is protected by the Civil Rights Act of 1964, which prohibits employers from discriminating against prospective employees due to their race, religion, gender, or national origin. Today, employers include sexual preference as being protected by this act as well. Many companies have enacted policies of affirmative action to increase the employment opportunities for minorities and women within their organization. The Equal Employment Opportunity Commission (EEOC) enforces equal opportunity employment. Employees who feel their civil rights have been violated can file an official complaint with this organization.

Sexual harassment lawsuits have been much publicized over the past 20 years, and for that reason many companies have enacted stringent policies and comprehensive employee training. These measures have been taken in order to increase employee awareness of what behaviors are not acceptable, as well as to make employees aware of their rights for dealing with sexual harassment by fellow employees.

Diversity in the workplace refers to the numbers of women and minorities employed by an organization. Many organizations hold diversity seminars in order to break down barriers and to increase cultural awareness and understanding among employees.

External Organizational Relations

Many firms also create an ethical standard that covers issues concerning the organization's effect on the outside world, including its responsibility to shareholders, customers, and the community.

One of the firm's responsibilities to shareholders is to make decisions with the best interest of the shareholders in mind. Many organizations encourage shareholder activism, which gives the shareholders the opportunity to influence management practices. As ethical concerns have been embraced by shareholders, activism has also included influencing practices such as employee relations, social awareness, environmental practices, and other socially oriented concerns.

An organization has an obligation to its customers with regard to its production practices. Customers expect that a company will not produce a product or provide a service that has inherent defects or safety issues. Companies also will establish a standard for sales practices that discourages deceptive or aggressive sales methods, en-

sureing that employees understand what is acceptable and not acceptable behavior.

The social obligation that a company has can include environmentally sound practices. Environmental obligations include preventing air, water, and land pollution. A growing movement suggests that a company's social obligation also includes producing products that somehow benefit society or are not harmful.

Importance of Written Standards for Ethical Policies

Many organizations opt for a written document that not only outlines the company's ethical policies, but also follows government regulations. This document is then distributed throughout the organization so that there can be no question of what the company policies are. This standard will often include guidelines for internal company behavior as well as for product quality and customer relations.

ETHICS TRAINING

As noted in the case of MCI, with increasing frequency companies are conducting ethics training sessions with employees. These training sessions involve the discussion and analysis of ethical dilemmas. Ethics training seminars are helpful in providing employees with the tools to make the right decisions in situations where their ethics are being tested.

CONSEQUENCES OF POOR ETHICAL DECISIONS

Enron illustrates how large-scale ethics violations can cause the downfall of a company and legal entanglements for executives. Enron filed for Chapter 11 bankruptcy and sold off many of its holdings. Several executives face trial. The ethics violations did not stop with Enron, but spread to its accounting firm, Arthur Andersen, whose reputation was also irreparably tarnished for covering up Enron's accounting wrongdoings.

Despite the attention that has been given to ethics abuse by large

corporations, smaller businesses suffer most from fraudulent activities. Small organizations reported losses of up to 25 percent more than those of larger organizations due to fraud.

MONITORING COMPLAINTS AND ENCOURAGING FEEDBACK

Companies can deal with ethical violations by monitoring complaints and encouraging feedback. Companies monitor complaints against the company made by customers, shareholders, and employees. Many companies also encourage feedback by having toll-free telephone lines for customers to call or by providing suggestion boxes for employees. This system of feedback makes customers, employees, and shareholders feel as though the executives are hearing their voices. Organizations that have hotlines set up were able to cut their losses from fraud by 50 percent, according to a 2002 survey by the Association of Certified Fraud Examiners.

GOVERNMENT REGULATIONS

As is the case when a social harm is identified, the federal government will step in and design regulations that will prevent further damage by unethical companies. Currently the government protects consumers from unethical companies in several ways.

The Federal Trade Commission (FTC) monitors advertising to ensure that companies are not misleading the public with false advertising. The goal is to stamp out deceptive practices. Another government agency, the Food and Drug Administration (FDA), protects consumers by monitoring the safety and quality of many products. Additionally, the government has many policies in place to encourage competition in the market in order to ensure that consumers will not be charged unfair prices for goods and services. To this end, the government's antitrust statutes prevent monopolies from forming. The government has also protected consumers from unfair pricing by deregulating industries, such as the telecom industry, in order to allow more competition to enter the market.

WHISTLE-BLOWING

A common method for detection of occupational fraud is employee tips. While many employees choose to handle fraud accusations internally by reporting wrongdoings to executives, whistle-blowing is the employee's disclosure to the media or government of a company's unethical activities. Before employees step forward with information, there are several factors that they must consider.

- ✓ Can the ethical problems that a company is having be better handled internally?
- ✓ Is it worth staying with a company that does not value ethics?
- ✓ Does the unethical damage that has been done outweigh the risk of retaliation by the company?
- ✓ Can the whistle-blower risk the possibility of being harassed, disciplined, or fired, in spite of regulatory protection?

There are some state and federal regulations that have been put in place to protect whistle-blowers once they have decided to step forward. According to the Sarbanes-Oxley Act of 2002:

(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

(www.sarbanes-oxley.com)

ETHICS TODAY

Enron and WorldCom have caused many citizens to take a skeptical view of large corporations. The managerial negligence that has been brought to light in recent years has caused global distrust of the U.S. financial markets. The economic impact of these scandals, combined with distrust, has taken a financial toll on many U.S. investors.

As evident in the Sarbanes-Oxley Act, the U.S. government is doing more these days to protect citizens against unethical corporations. Attempts have been made by creating new regulations, requiring more stringent accounting practices, encouraging an increase in transparency, and protecting those who step forward with information regarding corporate wrongdoings.

The cynical view of business ethics in the United States has caused organizations to go above and beyond what was done in the past to ensure that ethics are being enforced. As seen with MCI, corporations are now creating positions for chief ethics officers. Tyco is another company whose past questionable ethics led it to create this position in the organization.

But will these moves toward stringent ethical policies be enough to convince the world that U.S. companies are ethical? A new term has been created: “Enron ethics,” meaning an ironic difference between a company’s outwardly ethical appearance and its internal ethical failure. From the outside, Enron appeared to be a model company, with its corporate social responsibility practices and thick book of ethical guidelines that was handed out to employees, while on the inside, the company was falling apart due to its faulty accounting practices. But Enron managed to pull the wool over the public’s eyes for years. It’s difficult for people to trust that other companies are not doing the same.

BEST PRACTICES

Some businesses stand out from others as far as their attempts at good corporate governance and business ethics are concerned.

General Mills

In 2003 *Business Ethics* magazine ranked the 100 Best Corporate Citizens. General Mills, the Minnesota-based producer of cereals and other food products, ranked number one on the list. So what is this company doing that sets it apart from other companies?

At General Mills, the corporate culture is based on business ethics and corporate social responsibility. Employees are successful

at being ethical because they follow their own standards and adhere to their core values. Employees are supplied with the company's written code of ethics and are expected to uphold the values of the corporation:

- We strive for the highest quality in our products, services, and relationships.
- We set and maintain the highest standards for all aspects of our work.
- We advance and grow our businesses honestly and ethically, taking no shortcuts that might compromise our high standards.
- We comply with local laws in every nation where we operate. We recognize and respect the cultures, customs, and practices of our consumers and customers in nations around the world.
- We steer clear of conflicts of interest and work to avoid even the perception of conflict.
- We set very high expectations for ourselves—and for the integrity of our company. We will not compromise those standards.
- We deliver on our promises.
- We are ever mindful of the trust our consumers, customers, partners, and employees place in General Mills. We will never knowingly or willfully undermine that trust.

(www.generalmills.com/corporate/about/ethics/)

Hewlett-Packard

Another company that has been recognized internationally for its outstanding corporate governance and ethics is Hewlett-Packard (HP), the computer and accessory manufacturer. HP has set high ethical standards to which employees are expected to adhere. Its core ethical values are:

- **Honesty** in communicating within the company and with our business partners, suppliers, and customers, while at the same time protecting the company's confidential information and trade secrets.

- **Excellence** in our products and services, by striving to provide high-quality products and services to our customers.
- **Responsibility** for our words and actions.
- **Compassion** in our relationships with our employees and the communities affected by our business.
- **Citizenship** in our observance of all the laws of any country in which we do business, respect for environmental concerns and our service to the community by improving and enriching community life.
- **Fairness** to our fellow employees, stakeholders, business partners, customers, and suppliers through adherence to all applicable laws, regulations, and policies, and a high standard of behavior.
- **Respect** for our fellow employees, stakeholders, business partners, customers, and suppliers while showing willingness to solicit their opinions and value their feedback.

(www.hp.com/hpinfo/globalcitizenship/ethics/index.html)

CORPORATE SOCIAL RESPONSIBILITY AND CITIZENSHIP

Corporate social responsibility (CSR) can be defined as the concern of a business for society as a whole that goes beyond contractual or legal obligations. Many firms today are taking on CSR initiatives because, although they may not appear to help the company's bottom line in the short term, they often coincide with long-term sustainability and profitability.

Areas for Corporate Social Responsibility

CSR covers a wide range of issues, including, but not limited to the following areas:

Unfair Business Practices. Firms will adhere to fair selling tactics, produce quality products, and price their products fairly. They will obey laws regarding business practices.

Workplace and Employee Issues. This includes upholding the rights of employees' individual freedoms, equal opportunity employment, and protecting employees from sexual harassment. It also involves paying employees fair wages, adhering to legal employment statutes, and ensuring employee safety. Firms may also try to promote a balance of family life and work for employees by offering family leave, flexible hours, or day care services.

Organizational Governance. As outlined earlier, it is necessary that the firm be governed ethically. Leadership must be ethical and spread the message of ethics from the top down.

Environmental Impact. Firms must ensure that their impact on the environment is at a minimum. This includes using environmentally sound manufacturing processes and producing products that do not damage the environment. Many companies have found that they can be successful financially while also being ecologically sound.

Marketplace and Consumer Issues. This involves ensuring consumer safety with the products that are produced and may involve monitoring and responding to consumer complaints. It may also involve ensuring fairness in the marketplace, giving consumers a choice, and pricing products fairly.

Social Development. Companies can aid the social development of communities by creating jobs and contributing resources.

Community Involvement

Corporate social responsibility also involves becoming active in the communities where the company operates. Activities may include funding local charitable organizations, sponsoring cultural events, or having volunteer days for employees to go into the community and participate in community service projects. An organization may also choose to create its own philanthropic arm, such as the Gap Corporation's Gap Foundation, which matches employee giving to philanthropic organizations.

Another term used frequently is *corporate citizenship*, the concept

of companies holding to high ethical standards, demonstrating environmental responsibility, providing safe and reliable products, and working to improve conditions in the community. Corporate citizenship encompasses business ethics, but also has an element that goes above and beyond the legal and contractual obligations, similar to CSR.

A theory that has been cropping up recently is called the “triple bottom line.” The basis of this theory is that companies should be working just as hard at increasing their social and environmental worth as they do with their financial results. The three bottom lines are society, economy, and environment, and the lines are interdependent. But how can working hard at social and environmental worth benefit a company’s bottom line financially?

Benefits of Corporate Citizenship

According to the World Economic Forum white paper *The Business Case for Corporate Citizenship*, there are eight areas where corporations can benefit from good governance and corporate citizenship:

1. *Reputation management.* Companies can avoid a damaged reputation by adhering to ethical practices.
2. *Risk profile and risk management.* Companies that adhere to more stringent policies (environmental, for example) are less likely to pose as much risk for investors because they are not taking chances with their reputations.
3. *Employee recruitment, motivation, and retention.* Companies that are better corporate citizens are more attractive to potential employees; companies whose reputations are tarnished may have much difficulty recruiting new employees.
4. *Investor relations and access to capital.* Recent studies have shown that companies with sound environmental policies and environmentally safe products have been able to increase their earnings per share and are more likely to win contracts.
5. *Learning and innovation.* Adopting corporate citizenship principles can lead to creativity and employee innovation because

it requires finding solutions to problems while enhancing the company's bottom line.

6. *Competitiveness and market positioning.* Today, consumers are very concerned about trusting companies and their products. Being a good corporate citizen will make a company more competitive and will help its position in the market.
7. *Operational efficiency.* Becoming more environmentally efficient often means reducing material use and waste, which enhances a company's bottom line.
8. *License to operate.* Companies that are good citizens are more likely to be given a second chance in case of a slipup than companies that have a negative image in the minds of citizens.

SUMMARY

Ethics and corporate social responsibility are very important topics in today's business environment. With the recent ethical downfall of Enron and the ethical violations of telecom giant WorldCom, citizens are wary of investing in U.S. markets. Companies must do their best today to adhere to ethical standards. These ethical standards are a top-down effort from leadership. Ethics and good corporate governance can lead to success in business. Organizations have also found that being a good corporate citizen can benefit the company's bottom line, while protecting it from a damaged reputation if minor ethical infractions do occur. Companies are realizing that in order to achieve sustainability, they must become more socially aware and ethically conscious in the post-Enron business climate.

REFERENCES

- Gunther, Mark. "Tree Huggers, Soy Lovers and Profits." *Fortune* (June 23, 2003).
- Joyner, Brenda E., and Dinah Payne. "Evolution and Implementation: A Study of Values, Business Ethics and Corporate Social Responsibility." *Journal of Business Ethics* (December 2002).

- Leonard, Dennis, and Rodney McAdam. "Corporate Social Responsibility." *Quality Progress* (October 2003).
- Mehta, Stephanie M. "MCI: Is Being Good Good Enough?" *Fortune* (October 27, 2003).
- Mellema, Greg. "Responsibility, Taint and Ethical Distance in Business Ethics." *Journal of Business Ethics* (October 2003).
- Petrack, Joseph A., and Robert F. Scherer. "The Enron Scandal and the Neglect of Management Integrity Capacity." *Mid-American Journal of Business* (Spring 2003).
- Roberts, Sara, Justin Keeble, David Brown, and Arthur D. Little. The Business Case for Corporate Citizenship. White paper prepared for World Economic Forum, Geneva, Switzerland.
- Sims, Robert R., and Johannes Brinkmann. "Enron Ethics (or Culture Matters More Than Codes)." *Journal of Business Ethics* (July 2003).
- Verschoor, Curtis C. "New Evidence of Effective Ethics Systems." *Strategic Finance* (May 2003).