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CHAPTER 2: ETHICS AND BUSINESS DECISION MAKING.

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

1A. Ethics and business ethics

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

2A. Ensuring legal and ethical behavior

Ethical leadership is important to create and maintain an ethical workplace. Managers can set standards, and apply those standards to themselves and their firm's employees.

3A. Ethical standards

Duty-based ethical standards are derived from religious precepts or philosophical principles. Outcome-based ethics focus on the consequences of an action, not on the nature of the action or on a set of pre-established moral values or religious beliefs.

4A. Guidelines

Guidelines for evaluating whether behavior is ethical can be found in the law, business rules and procedures, social values, an individual's conscience, an individual's promises and obligations to others, and personal or societal heroes. An action is most likely ethical if it is consistent with the law, or at least the "spirit" of the law, as well as company policies, and if it can survive the scrutiny of one's conscience and the regard of one's heroes without betraying one's commitments to others.

5A. International ethical issues

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

ANSWERS TO CRITICAL ANALYSIS QUESTIONS IN THE FEATURES

ONLINE DEVELOPMENTS—FOR CRITICAL ANALYSIS (PAGE 46)

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

LINKING THE LAW TO MANAGERIAL ACCOUNTING—FOR CRITICAL ANALYSIS (PAGE 48)
Valuable company resources are used to create and publish corporate social responsibility reports. Under what circumstances can a corporation justify such expenditures? Clearly, very small businesses cannot even think about spending resources to create corporate social responsibility reports. In general, also, corporations that are not publicly traded will not spend resources creating corporate social responsibility reports. In other words, unless a company has to file with the Securities and Exchange Commission, there is typically little reason to spend resources on social responsibility reports. Publicly held corporations, in contrast, once they are relatively large, will find that there is some payoff to creating and distributing on a wide basis social responsibility reports. A positive, well-received reputation may help in recruiting better employees. It may create a more positive environment for the corporations' stock price. Finally, being known as a "good corporate citizen" certainly cannot hurt when a company is under investigation by regulators.

ANSWERS TO QUESTIONS AT THE ENDS OF THE CASES

CASE 2.1—QUESTION (PAGE 34)
THE ETHICAL DIMENSION

During Skilling's tenure at Enron, the mood among the employees was upbeat because the company's situation appeared "rosy." Among other things, many employees invested all their pension funds in Enron stock. Is there anything unethical about this situation? Discuss. The lack of ethics in the situation stems from Skilling's use of deceit to create it. Whether or not such conduct supports a criminal conviction—although given the number of federal crimes, it is a distinct possibility—a "rosy" business is bound to collapse like a house of cards and harm all of its stakeholders if its "success" is founded on falsity.

CASE 2.2—QUESTION (PAGE 36)
WHAT IF THE FACTS WERE DIFFERENT?

Suppose that Mathews had not admitted to knowing about the "no lunch" sheet policy. Would the result in this case have been different? Why or why not? The court appears to have relied on Mathews's own testimony that she knew about the "no lunch" sheet policy as evidence that she engaged in "willful misconduct." Even without this testimony, however, B and K might still have been able to meet its burden of proof if it could have presented actual "no lunch" sheets submitted by Mathews on this and other occasions. This evidence, plus the fact that she was responsible for "no lunch" sheets turned in by employees under her supervision, would have been sufficient to show that Mathews knew about the policy.

CASE 2.3—QUESTION (PAGE 38)
WHAT IF THE FACTS WERE DIFFERENT?

Assume that a female employee experienced the same type of treatment that Krasner faced. Would the female employee succeed in a Title VII claim of gender-based discrimination? Why or why not? A female employee with identical complaints to those of Krasner probably would fare no better than Krasner did in trying to satisfy the primary requirement for a case of gender-based discrimination: that the discrimination occurred, in fact, because of the gender of the complainant. In contrast, if a woman had suffered some adverse employment action, such as being demoted or not being promoted, because she refused to give sexual favors to a supervisor, she would definitely have a cause of action for gender-based discrimination.

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

1A. Corporate governance

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

2A. Principle of rights

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

3A. Utilitarian theory

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

4A. Foreign Corrupt Practices Act

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

ANSWERS TO ISSUE SPOTTERS IN THE EXAMPREP FEATURE AT THE END OF THE CHAPTER

1A. Delta Tools, Inc., markets a product that under some circumstances is capable of seriously injuring consumers. Does Delta owe an ethical duty to remove this product from the market, even if the injuries result only from misuse? Why or why not? Maybe. On the one hand, it is not the company's "fault" when a product is misused. Also, keeping the product on the market is not a violation of the law, and stopping sales would hurt profits. On the other hand, suspending sales could reduce suffering and could prevent negative publicity that might result if sales continued.

2A. Acme Corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees. Does this raise an ethical conflict between Acme's employees? Between Acme and its employees? Between Acme and its shareholders? Explain your answers. When a corporation decides to re-spond to what it sees as a moral obliga-tion to correct for past discrimination by adjusting pay differences among its em-ployees, an ethical conflict is raised be-tween the firm and its employees and between the firm and its shareholders (not between the employees). This dilemma arises directly out of the effect of such a decision on the firm's profits. With respect to the employees and the shareholders, the firm arguably has an obligation to stay in business. If adjusting pay differences among employees increases profitability, then staying in business is not an issue, and the dilemma is easily resolved in favor of "doing the right thing."

ANSWERS TO QUESTIONS AND CASE PROBLEMS AT THE END OF THE CHAPTER

2–1A. Business ethics
(LET pages 33–34 & 44–45)

Of course, it was unethical to sell goods that their maker knew were defective and could cause harm. This is the most reasonable and likely conclusion under any set of standards, even if it were possible to eventually obtain a negative result with respect to a defect from testing that repeatedly yielded a positive result. Under the six basic guidelines outlined in the text for making ethical business decisions, this is certainly true. The first consideration under those guidelines is whether a contemplated action is legal. It may have been legal to avoid reporting the initial test results to the Food and Drug Administration, but liability can attach through tort and contract law principles to the sale of goods that the seller knows or should know are defective. Thus, the baker's action in this problem does not pass muster under the first consideration. The second question is whether an action is consistent with company policies and procedures. The facts do not indicate what those policies and procedures are for this bakery, but if the steps taken in the problem are consistent with those directives, they also betray a lack of ethics—a company-mandated procedure to test defective goods until they seem to be adequate and a policy to then sell those goods could only be founded on a lack of concern for the buyers and indirectly the company's other stakeholders. The third guideline asks whether an action could survive publicity. The action in this problem likely could not, because customers would stop buying the products, lawsuits would be filed to recover for the injuries, and a responsible government agency would issue new regulations, if none apply, and begin to investigate. Each of these consequences would undercut business and profits, which are arguably to the reasons for making the goods in the first place. Selling defective goods does not satisfy a promised commitment to their buyers, nor does it fulfill the seller's duty to provide a clean working environment for employees, both of which fall under the fifth guideline. Finally, the sixth consideration is how a hero would regard the action. Unless a villain is the seller's hero, the action is unlikely to be regarded well.

2–2A. QUESTION WITH SAMPLE ANSWER. Ethical duties

Factors for the firm to consider in making its decision include the appropriate ethical standard. Under the utilitarian standard, an action is correct, or "right," when, among the people it affects, it produces the greatest amount of good for the greatest number. When an action affects the majority adversely, it is morally wrong. Applying the utilitarian standard requires the following:

(a) A determination of which individuals will be affected by the action in question;

(b) An assessment, or cost-benefit analysis, of the negative and positive effects of alternative actions on these individuals; and

(c) The choice of the alternative that will produce maximum societal utility.

Ethical standards may also be based on a concept of duty, which postulates that the end can never justify the means and that human beings should not be treated as mere means to an end. But ethical decision making in a business context is not always simple, particularly when an action will have different effects on different groups of people: shareholders, employees, society, and other stakeholders, such as the local community. Thus, another factor to consider is to whom the firm believes it owes a duty.

2–3A. Ethical conduct
(LET pages 32 & 44–45)

Crawford should be denied compensation. He is not entitled to any fees because he was not a "disinterested" party. The moment that Crawford approached Big

Mountain's creditors and broached the subject of his compensation, he was no longer a disinterested party. To be "disinterested" means a person in Crawford's position should not have a material adverse interest to any party to the bankruptcy for any reason. An agreement with a single creditor that links compensation to the creditor's recovery qualifies as such an interest because it creates the risk that a person in Crawford's position will favor one creditor at the expense of other creditors. Opportunities abound for persons paid in this manner to benefit selected creditors at the expense of others. That Crawford reached the agreement in secret only makes matters worse. Crawford's failure to disclose the fee negotiations is a violation of the law, and he should be ordered to remit to Big Mountain any amount that he has already been paid.

2–4A. CASE PROBLEM WITH SAMPLE ANSWER Violation of internal ethical codes

The appeals court stated that "Havensure alleges that Prudential violated its own internal policies and that this violation suffices to render Prudentials's conduct wrongful. This argument has no legal basis. Although violations of 'recognized ethical codes' or 'established customs or practices' may be significant in evaluating the nature of an actor's conduct, Havensure has identified no authority suggesting that a violation of internal policies has … significance." That is, violation of ethical codes may be taken into account, but is not the basis for liability. Further, "Havensure also suggests that Prudential used 'illegal means' because it included hidden broker compensation in the plan that it originally provided to York. Yet, even if such conduct was illegal, it has no bearing upon the present inquiry." That is, such a violation would be a matter of concern for insurance regulators, but does not, in itself, create an obligation to Havensure. The court noted that the hidden broker fee ran up the cost of insurance, thereby making Prudential less competitive. Removal of the fee was not improper. York had the right to choose any policy and any broker.

2–5A. Corporate social responsibility
(LET pages 42–44)

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

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

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

2–6A. Business ethics on a global scale
(LET pages 33–34 & 44–45)

In Pfizer's case, it would appear that the potential for short-run profit maximization, by quickly testing and marketing Trovan, took precedence over any consideration of ethics. This action alone arguably violates ethical standards, particularly in light of its results.

As a corporation, Pfizer might have applied the five-step procedure set out in the text to review the ethical conflicts in a test of Trovan. The first step is to specify the facts, the problem, and the ethical principles at issue. The second step is to discuss potential actions and their effects. The third step is to come to a consensus as to what to do. This consensus should withstand moral scrutiny (the fourth step) and fulfill corporate, community, and individual values (the fifth step). It seems unlikely that a proposed Trovan test on the facts described in the problem would have survived the fourth step, under either a duty-based or an outcome-based ethical standard.

Pfizer's executives or employees who authorized the Trovan test might have evaluated their decision according to the six guidelines noted in the text. Is the action legal? Is it in line with the company's rules? If so, is it in accord with the "spirit" of the law, those policies, and one's conscience? Could it withstand the glare of publicity and satisfy promises made to others? It seems probable that the test would have violated Pfizer's rules and that, as conducted, it could not have withstood publicity, promises to others, or any individual's conscience.

Whether the test was legal is the question at the heart of the problem. The court dismissed the suit, but the U.S. Court of Appeals for the Second Circuit reversed the dismissal, on the ground that the lower court should have looked more extensively at international law, and remanded the case. Meanwhile, Nigeria and one of its states filed criminal charges and civil claims against Pfizer, seeking over $9 billion in damages and restitution—but not as compensation for the children.

2–7A. ***Ethical misconduct***
(LET page 32)

Ethics has to do with the rightness or wrongness of actions. Business ethics focuses on what is right and wrong in the business world. Business ethics can be more complicated than personal ethics. In the situation described in this problem, the son engaged in unethical personal and business conduct. His personal transgressions included the use of his father's Social Security number to obtain a credit card and his collection of unemployment benefits while he was in fact employed. His business misdeeds included the misrepresentation to obtain the $350,000 loan. Producing forged documents to show his father that the loan had been paid was both a personal and a business breach of ethics. In each instance, the son did not tell the truth. The son perpetrated fraud on the lender and on his father. He acted alone—the father did not contribute to the fraud nor ratify the son's misdeeds—and neither the father nor the partnership benefited from the fraud. By confronting the son, the father arguably attempted to repudiate the misconduct. These factors indicate that a judgment in favor of the father is warranted. For the same reasons, a judgment against the son is called for. In the actual case on which this problem is based, the court entered a judgment in favor of Adams against the son, and a judgment in favor of the father against Adams. On Adams's appeal, a state intermediate appellate court affirmed.

2-8A. A QUESTION OF ETHICS. Copyrights

1. Digital editing technology has proven to be both a boon and a bane to the movie industry. The technology eases the legitimate production and editing of films for a wide spectrum of audiences and purposes. But this technology also makes it easier to edit films without the creators' and owners' consent. In the circumstances of this case, for example, CleanFlicks and its competitors bought DVDs of the studios' films, cracked the encryption code on the disks intended to thwart copying, and altered the movies. Using the altered disks as master copies, the firms created new DVDs, which they sold or rented under their trademarks.

With respect to the ethics of the situation, it is noteworthy that in the initial complaint CleanFlicks sought only a ruling that it had a right under the

First Amendment to offer consumers the alternative of an edited version of a studio film for private viewing. It is also important that the studios did not sell their edited versions of their films to consumers, which was CleanFlicks' market, and in the counterclaim the studios were not seeking an award of damages or CleanFlicks' profits, but an injunction against their practices.

If money was not the motivation for the claims of any of the parties to this suit, what was?

With respect to the legality of the parties' conduct in this case, the court concluded that CleanFlicks' "business is illegitimate" and issued a summary judgment in the studios' favor, ordering CleanFlicks and the others to turn over all of the copies of their versions of the studios' films to be destroyed. The court pointed out that "[t]he right to control the content of the copyrighted work . . . is the essence of the law of copyright." This was the impetus for the studios' counterclaim, at least, and in the court's view this was the principle at the heart of this case.

2. The court in this case did not agree with CleanFlicks' argument. The court said, "This argument is inconsequential to copyright law and is addressed in the wrong forum. This Court is not free to determine the social value of copyrighted works. What is protected are the creator's rights to protect its creation in the form in which it was created."

The court also pointed out that Congress enacted the Family Movie Act of 2005 to exempt "the editing of motion pictures by a member of a private household if no fixed copy of the altered version of the motion picture is created." A party could thus legally sell software or hardware to enable private editing. The statute did not, however, exempt creating and reproducing fixed copies of altered works. "Thus, the appropriate branch of government had the opportunity to make the policy choice now urged and rejected it."

The court emphasized that "the intrinsic value of the right to control the content of the copyrighted work . . . is the essence of the law of copyright. Whether these films should be edited in a manner that would make them acceptable to more of the public playing them on DVD in a home environment is more than merely a matter of marketing," or appealing in a particular manner to a certain segment of the market; "it is a question of what audience the copyright owner wants to reach. . . . [T]he infringing parties are exploiting a market for movies that is different from what the Studios have released into and for an audience the Studios have not sought to reach."

2–9A. CRITICAL-THINKING MANAGERIAL QUESTION

It is arguable that ethical behavior generates sufficient good will to warrant practicing it out of a desire for increased profits. Corporate activities that receive wide publicity and are perceived as “positive” may benefit shareholders in the long run, if the enhanced public image of the corporation entices more consumers to buy its product, but such long-run possible benefits are difficult to calculate. Under he same reasoning, “negative” choices may have an impact on a company’s business, but that impact may also be difficult to gauge. This is in part because motive is difficult to determine, especially in the complicated world of business ethics, both with respect to a business and to its market and customers. In the debate between motive and conduct as a measure of ethical behavior, conduct may be the most practical option and the measure that will have the greatest impact. Thus, a firm might choose to do business in a more costly manner—here, by opting out of the less expensive production facility or by paying higher wages—and ultimately realize a healthier return. Of course, making that decision might have different consequences.

ANSWER TO VIDEO QUESTION NO. 2–10

Real World Legal: Pharzine, Scene 1 and Scene 2

1. In Scene 1, employees discuss whether to market their company’s drug as a treatment for other conditions—even though it has only been approved for treating epilepsy. One employee argues that marketing the drug for more than the one treatment will increase the company’s short-term profits and that obtaining approval for the other treatments will take too long. What theory describes this perspective? Short-term profit maximization is the theory discussed in this chapter that describes the man’s perspective. Some people argue that a corporation’s only goal should be profit maximization, which would be reflected in a higher market value. If all firms strictly adhered to the goal of profit maximization, resources would flow to where they are most highly valued by society. But there is an important difference between short- and long-term profit maximization. In the short run, a company may increase its profits by continuing to sell a product, even though, it knows that the product is defective or otherwise unsuitable for a particular use. In the long run, though, because of lawsuits, large settlements, and bad publicity, such unethical conduct will cause profits to suffer. Thus, business ethics is consistent only with long-term profit maximization. An overemphasis on short-term profit maximization is the most common reason that ethical problems occur in business.

2. In Scene 2, a new sales rep discusses the company’s off-label marketing strategy with a veteran sales rep. Is it unethical or illegal for a sales rep to represent that he is a

doctor when he has a doctorate in chemistry but is not actually a physician? Explain. The man has a doctorate degree, but he is not a medical doctor (physician). Although he may not be lying, he is clearly misrepresenting an important fact (about being a doctor) with the intent of getting appointments with busy physician-clients so that he can sell Gensol. It is clearly unethical and possibly illegal (fraud—see Chapter 14).