CHAPTER 4

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The Institutionalization of Business Ethics

CHAPTER OBJECTIVES

- To distinguish between the voluntary and mandated boundaries of ethical conduct
- To provide specific mandated requirements for legal compliance in specific subject matter areas related to competition, consumers, safety, and the environment
- To specifically address the requirements of the Sarbanes–Oxley legislation and implementation by the Securities and Exchange Commission
- To provide an overview of regulatory efforts to provide incentives for ethical behavior
- To provide an overview of the Federal Sentencing Guidelines for Organizations recommendations and incentives for developing an ethical corporate culture
- To provide an overview of voluntary boundaries and the relationship to social responsibility

CHAPTER OUTLINE

Managing Ethical Risk Through Mandated and Voluntary Programs

Mandated Requirements for Legal Compliance

Laws Regulating Competition

Laws Protecting Consumers

Laws Promoting Equity and Safety

Laws Protecting the Environment

Gatekeepers and Stakeholders

Accountants

Risk Assessment

The Sarbanes–Oxley Act

Public Company Accounting Oversight Board

Conflicts of Interest: Auditor and Analyst Independence

Enhanced Financial Disclosures

Whistle-Blower Protection

Corporate and Criminal Fraud Accountability

Cost of Compliance

Laws That Encourage Ethical Conduct

Federal Sentencing Guidelines for Organizations

Highly Appropriate Core Practices

Philanthropic Contributions

Strategic Philanthropy

AN ETHICAL DILEMMA*

Myron had just graduated from West Coast University with both chemistry–pharmacy and business degrees and was excited to work for Producto International (PI). He loved having the opportunity to discover medicinal products around the world. His wife, Quan, was also enthusiastic about her job as an import–export agent for a subsidiary of PI.

Producto International was the industry leader, with headquarters in Paris. Worldwide, hundreds of small firms were competing with PI; however, only six had equivalent magnitude. These six had cornered 75 percent of world sales. So many interrelationships had developed that competition had become "managed." However, this did not constitute any illegal form of monopolistic behavior as defined by the European Union.

Myron's first assignment was in India and concerned exporting betel nuts to South and perhaps North America. It is estimated that more than 20 million people chew betel nuts in India alone. The betel nut is one of the world's most popular plants, and its leaf is used as a paper for rolling tobacco. The betel nut is also mashed or powdered with other ingredients and rolled up in a leaf and sold as candy. Myron quickly found that regular use of the betel nut, in time, stains the mouth, gums, and teeth a deep red, which in Asia is a positive quality. As Myron was learning more about the betel nut, he came across the following report from the People's Republic of China: "Studies show that the chewing of the spiced betel nut can lead to oral cancer. According to research, 88 percent of China's oral cancer patients are betel nut chewers. Also, people who chew betel nuts and smoke are 90 times more likely to develop oral cancer than nonusers." Myron found that the betel nut primarily affects the central nervous system. It increases respiration while decreasing the workload on the heart (a mild high). Myron also found that demand for it was starting to emerge in the United States as well as in other developed countries.

While Myron was working on the betel nut, David, Myron's boss, also wanted him to work on introducing khat (pronounced "cot") into Asia. Khat is a natural stimulant from a plant grown in East Africa and southern Arabia. Fresh khat leaves, which typically are chewed like tobacco, produce a mild cocaine- or amphetamine-like euphoria. However, the effect is much less intense than that produced by either of those substances, with no reports of a rush sensation or paranoia, for example. Chewing khat produces a strong

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aroma and generates intense thirst. Casual users claim that khat lifts spirits, sharpens thinking, and, when its effects wear off, generates mild lapses into depression similar to those observed among cocaine users. The body appears to have a physical intolerance to khat due in part to limitations in how much can be ingested by chewing. As a result, reports suggest that there are no physical symptoms accompanying withdrawal. Advocates of khat use claim that it eases symptoms of diabetes, asthma, and disorders of the stomach and the intestinal tract. Opponents claim that khat damages health, suppresses appetite, and prevents sleep. In the United States, khat has been classified as a schedule IV substance by the Drug Enforcement Agency (DEA): freshly picked khat leaves (that is, within 48 hours of harvest) are classified as a schedule I narcotic, the most restrictive category used by the DEA.

After doing his research, Myron delivered his report to David and said, "I really think that, given the right marketing to some of the big pharmaceutical companies, we should have two huge revenue makers."

"That's great, Myron, but the pharmaceutical market is only secondary to our primary market—the two billion consumers to whom we can introduce these products."

"What do you mean, David?" Myron asked.

"I mean these products are grown legally around the world, and the countries that we are targeting have no restrictions on these substances," David explained. "Why not tailor the delivery of the product by country? For example, we find out which flavors people want the betel nut in, in North and South America or the Middle East. The packaging will have to change by country as well as branding. Pricing strategies will need to be developed relative to our branding decisions, and of course quantity usages will have to be calculated. For example, single, multiple, and super value sizes need to be explored. The same can be done for khat. Because of your research and your business background, I'm putting you on the marketing team for both. Of course, this means that you're going to have to be promoted and at least for a while live in Hong Kong. I know Quan will be excited. In fact, I told her the news this morning that she would be working on the same project in Hong Kong. Producto International tries to be sensitive to the dual-career family problems that can occur. Plus you'll be closer to relatives. I told Quan that with living allowances and all of the other things that go with international placement, you two should almost triple your salaries! You don't have to thank me, Myron. You've worked hard on these projects, and now you deserve to have some of the benefits."

Myron went back to his office to think about his and Quan's future. He had heard of another employee who had rejected a similar offer, and that person's career had languished at PI. Eventually, that individual left the industry, never to be heard from again.

QUESTIONS • EXERCISES

1. Identify the social responsibility issues in this scenario.
2. Discuss the advantages and disadvantages of each decision that Myron could make.
3. Discuss the issue of marketing products that are legal but have addictive properties associated with them.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

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To understand the institutionalization of business ethics it is important to understand the voluntary and legally mandated dimensions of organizational practices. In addition, there are core practices sometimes called best practices that most responsible firms—trying to achieve acceptable conduct—embrace and

implement. The effective organizational practice of business ethics requires all three dimensions (legal, voluntary, and core practices) to be integrated into an ethics and compliance program. This creates an ethical culture that can effectively manage the risks of misconduct. Institutionalization relates to legal and societal forces that provide both rewards and punishment to organizations based on the stakeholder evaluations of specific conduct. Institutionalization in business ethics relates to established laws, customs, and expected organizational programs that are considered normative in establishing reputation. This means that deviations from expected conduct often are considered ethical issues and therefore concern stakeholders. Institutions provide requirements, structure, and societal expectations to reward and sanction ethical decision making.

In this chapter, we examine the boundaries of ethical conduct and focus on the voluntary, core practices, and mandated requirements for legal compliance—three important areas in developing an ethical culture. In particular, we concentrate on compliance in specific areas related to competition, consumers, safety, and the environment. We also consider the requirements of the Sarbanes–Oxley legislation and its implementation by the Securities and Exchange Commission (SEC) and how its implementation has affected companies. This chapter gives an overview of legislative and administrative actions taken to help the public maintain confidence in the financial system. We also provide an overview of the Federal Sentencing Guidelines for Organizations (FSGO) and give recommendations and incentives for developing an ethical corporate culture. The FSGO, the Sarbanes–Oxley Act, industry trade associations, and societal expectations support core practices. Finally, we examine philanthropic contributions and how strategic philanthropy can be an important core competency to manage stakeholder relationships.

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MANAGING ETHICAL RISK THROUGH MANDATED AND VOLUNTARY PROGRAMS

Table 4–1 provides an overview of the three dimensions of institutionalization. **Voluntary practices** include the beliefs, values, and voluntary contractual obligations of a business. All businesses engage in some level of commitment to voluntary activities to benefit both internal and external stakeholders. Google, Inc. works hard to give its employees a positive work environment through its benefits package. In addition to being a famously great place to work, Google offices offer such health and wellness-boosting amenities as swimming pools, gyms, volleyball courts, ping-pong tables and dance classes, the company even allows employees to bring their dogs to work.[1] Most firms engage in **philanthropy**—giving back to communities and causes.

Core practices are documented best practices, often encouraged by legal and regulatory forces as well as industry trade associations. The **Better Business Bureau** is a leading self-regulatory body that provides directions for managing customer disputes and reviews advertising cases. These practices are appropriate and common practices that help ensure compliance with legal requirements and societal expectations. Although these practices are not enforced, there are consequences for not engaging in these practices when there is misconduct. For example, the Federal Sentencing Guidelines for Organizations (FSGO) suggest that the governing authority (board of directors) be

TABLE 4–1 Voluntary Boundary, Core Practices, and Mandated Boundaries of Ethical Decisions

Voluntary boundary	**A management-initiated boundary of conduct (beliefs, values, voluntary policies, and voluntary contractual obligations)**
Core practice	**A highly appropriate and common practice that helps ensure compliance with legal requirements, industry self-regulation, and societal expectations**
Mandated boundary	**An externally imposed boundary of conduct (laws, rules, regulations, and other requirements)**

Source: Adapted from the "Open Compliance Ethics Group (OCEG) Foundation Guidelines," v1.0, Steering Committee Update, December 2005, Phoenix, AZ.

responsible for and assess an organization's ethical and compliance activities. There is no required reporting of investigations by government regulatory bodies, but there are incentives to the firm that effectively implement this recommendation. If misconduct occurs, there may be opportunities to avoid serious punishment. On the other hand, if there has been no effort by the board to oversee ethics and compliance, this could increase and compound the level of punishment. In this way, the government in institutionalizing core practices provides organizations the opportunity to take their own approach and only takes action if there are violations. **Mandated boundaries** are the externally imposed boundaries of conduct, such as laws, rules, regulations, and other requirements. Antitrust and consumer protection laws create boundaries that must be respected by companies.

There is a need to maintain an ethical culture, and to manage stakeholder expectations for appropriate conduct in an organization. This is achieved through corporate governance compliance, risk management, and voluntary activities. The development of these drivers of an ethical culture has been institutionally supported by government initiatives and the demands of stakeholders. The compliance element represents areas that must conform to existing legal and regulatory requirements. Established laws and regulatory decisions leave limited flexibility to organizations in adhering to these standards. Corporate governance (as discussed in Chapter 2) is structured by a governing authority providing oversight as well as checks and balances to make sure that the organization meets its goals and objectives for ethical performance. Risk management analyzes the probability or chance that misconduct could occur based on the nature of the business and the exposure to risky events. Voluntary activities often represent the values and responsibilities that firms accept in contributing to stakeholder needs and expectations.

Figure 4–1 depicts the key elements of an organizational culture. The elements include values, norms, artifacts, and behavior. An ethical culture creates an environment in which to structure behavior that is then evaluated by stakeholders. Values are broad and are viewed as long-term enduring beliefs about issues such as integrity, trust, openness, diversity, and individual respect and responsibility. Norms dictate and clarify desirable behaviors through principles, rules, policies, and procedures. For example, norms could provide guiding principles for antibribery issues, sustainability, and conflicts of interest. Artifacts are visible, tangible external symbols of values and norms. Websites, codes of ethics, rituals, language, and physical settings are artifacts. These three elements have different impacts on behaviors. For example, norms prescribe specific behaviors in certain situations. Organizational decisions on such issues as governance, core practices, and legal compliance help shape the ethical culture.

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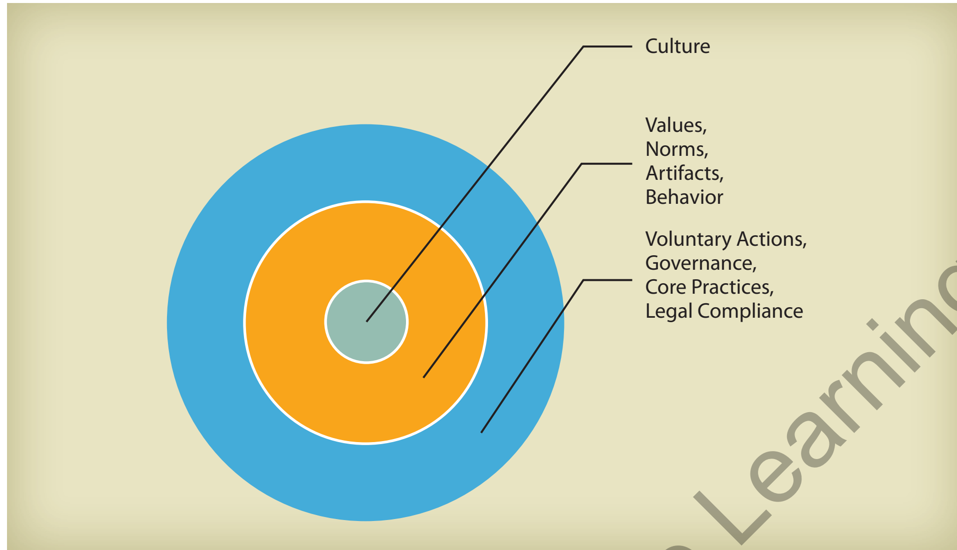
FIGURE 4–1 Elements of an Ethical Culture



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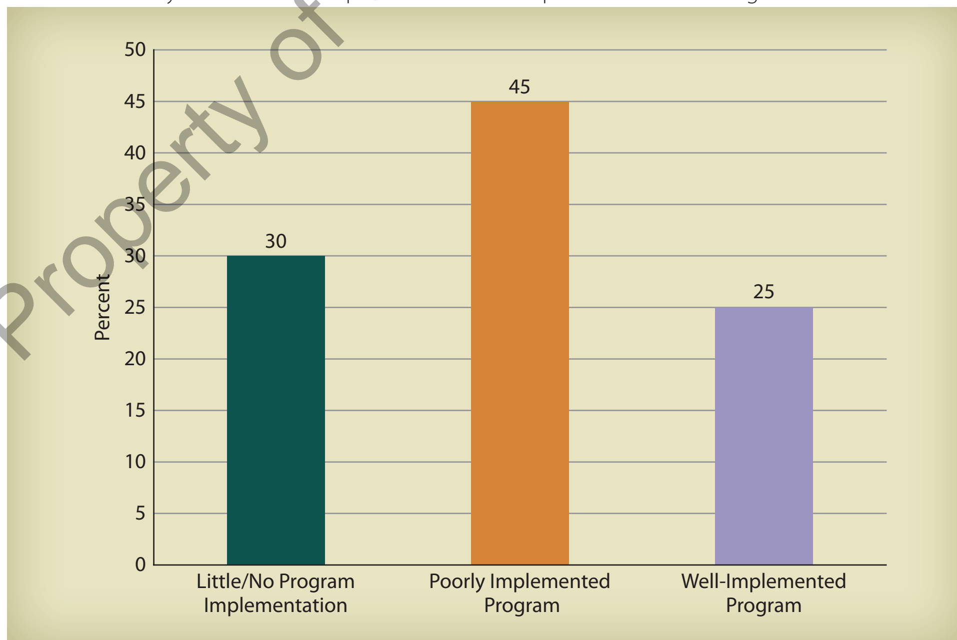
MANDATED REQUIREMENTS FOR LEGAL COMPLIANCE

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Laws regulating business conduct are passed because certain stakeholders believe that business cannot be trusted to do what is right in certain areas, such as consumer safety and environmental protection. Because public policy is dynamic and often changes in response to business abuses and consumer demands for safety and equality, many laws have been passed to resolve specific problems and issues. But the opinions of society, as expressed in legislation, can change over time, and different courts or state legislatures may take diverging views. For example, the thrust of most business legislation can be summed up as follows: Any practice is permitted that does not substantially lessen or reduce competition or harm consumers or society. Courts differ, however, in their interpretations of what constitutes a "substantial" reduction of competition. Laws can help businesspeople determine what society believes at a certain time, but what is legally wrong today may be perceived as acceptable tomorrow, and vice versa. After generations of fame for its top-secret bank accounts, Swiss banks have been forced to disclose information about some of their clients. The rules are changing, however, and countries like Switzerland, Liechtenstein, and Luxembourg now must share information on potential tax dodgers with government agencies like the Internal Revenue Service. One bank alone, UBS, may harbor the secret bank accounts of 52,000 American tax dodgers.[2] However, personal views on legal and illegal activity in this area vary tremendously and explain why accounting firms struggle to advise.[3] Instructions to employees to "just obey the law" are meaningless without effective training and experience in dealing with specific legal risk areas.

Laws are categorized as either civil or criminal. **Civil law** defines the rights and duties of individuals and organizations (including businesses). **Criminal law** not only prohibits specific actions—such as fraud, theft, or securities trading violations—but also imposes fines or imprisonment as punishment for breaking the law. The primary difference between criminal and civil law is that the state or nation enforces criminal laws, whereas individuals (generally, in court) enforce civil laws. Criminal and civil laws are derived from four sources: the U.S. Constitution (constitutional law), precedents established by judges (common law), federal and state laws or 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 to protect consumers, workers, and the environment. State laws and regulatory agencies also exist to achieve these objectives. Amid the fallout from the subprime mortgage and Wall Street financial sector crises, the Securities and Exchange Commission CEO, Mary Schapiro, moved quickly to try to fill in regulatory gaps to prevent further financial crises and bank failures.[4]

The primary method of resolving conflicts and serious business ethics disputes is through lawsuits in which one individual or organization uses civil laws to take another individual or organization to court. To avoid lawsuits and to maintain the standards necessary to reduce risk and create an ethical culture, it is necessary to have both legal and organizational standards enforced. When violations of organizational standards occur, the National Business Ethics Survey (NBES) notes that many employees do not feel that their company has a strong ethics program. In fact, Figure 4–2 demonstrates that only 25 percent of companies in the United States have a well-implemented ethics program. A full 30 percent of companies do not have any ethics program at all to speak of, a serious

FIGURE 4–2 Only One in Four Companies Has a Well-Implemented Ethics Program



Source: 2007 National Business Ethics Survery, p. 20.

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problem in this age of misconduct and ethical violations. It is important for a company to have a functioning program in place long before an ethical disaster strikes.

The role of laws is not so much to distinguish what is ethical or unethical as to determine the appropriateness of specific activities or situations. In other words, laws establish the basic ground rules for responsible business activities. Most of the laws and regulations that govern business activities fall into one of five groups: (1) regulation of competition, (2) protection of consumers, (3) promotion of equity and safety, (4) protection of the natural environment, and (5) incentives to encourage organizational compliance programs to deter misconduct, which we examine later.

Laws Regulating Competition

The issues surrounding the impact of competition on business's social responsibility arise from the rivalry among businesses for customers and profits. When businesses compete unfairly, legal and social responsibility issues can result. Intense competition sometimes makes managers feel that their company's very survival is threatened. In these situations, managers may begin to see unacceptable alternatives as acceptable, and they may begin engaging in questionable practices to ensure the survival of their organizations. Both Intel and Microsoft have been hit with fines amounting to billions of dollars for alleged antitrust activity in Europe, where the companies have been accused of engaging in behavior that prevents smaller companies from competing. The European Union is famous for being tough on companies suspected of antitrust cases, although being aware of antitrust laws is important for all large corporations around the world.

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Size frequently gives some companies an advantage over others. For example, large firms can often generate economies of scale (for example, by forcing their suppliers to lower their prices) that allow them to put smaller firms out of business. Consequently, small companies and even whole communities may resist the efforts of firms like Wal-Mart, Home Depot, and Best Buy to open stores in their vicinity. These firms' sheer size enables them to operate at such low costs that small, local firms often cannot compete. Some companies' competitive strategies may focus on weakening or destroying a competitor, which can harm competition and ultimately reduce consumer choice. When the Chinese government mandated that all computers must be equipped with web-filtering software, lawyers and academics promptly challenged the law. They claimed that the software could be used to filter other content as well, such as political content the government deems unfavorable. They also worried that the measure was anticompetitive because it would favor two companies selected by the government in a nontransparent way to produce the software.[5] Other examples of anticompetitive strategies include sustained price cuts, discriminatory pricing, and price wars. The primary objective of U.S. antitrust laws is to distinguish competitive strategies that enhance consumer welfare from those that reduce it. The difficulty of this task lies in determining whether the intent of a company's pricing policy is to weaken or even destroy a competitor.[6] President Obama has promised to be tough on antitrust violations, and followed through by reversing a Bush-era policy that made it more difficult for the government to pursue antitrust violations. The Bush administration brought an historically low number of antitrust cases to trial.[7] President Obama plans to follow Europe's model for antitrust cases, which marks a return to a historic norm after eight years of Bush's noninterventionism.[8] Intense competition may also lead companies to resort to corporate espionage. Corporate espionage is the act of illegally taking information from a corporation through computer hacking, theft, intimidation, sorting through trash, and through impersonation of

organizational members. Estimates show corporate espionage may cost companies nearly $50 billion annually. Unauthorized information collected includes patents in development, intellectual property, pricing strategies, customer information, unique manufacturing and technological operations, as well as marketing plans, research and development, and future plans for market and customer expansion.[9] Determining an accurate amount for losses is difficult because most companies do not report such losses for fear that the publicity will harm their stock price or encourage further break-ins. Espionage may be carried out by outsiders or by employees—executives, programmers, network or computer auditors, engineers, or janitors who have legitimate reasons to access facilities, data, computers or networks. They may use a variety of techniques for obtaining valuable information such as dumpster diving, whacking, and hacking as discussed in Chapter 3.

Laws have been passed to prevent the establishment of monopolies, inequitable pricing practices, and other practices that reduce or restrict competition among businesses. These laws are sometimes called **procompetitive legislation** because they were enacted to encourage competition and prevent activities that restrain trade (Table 4–2). The Sherman Antitrust Act of 1890, for example, prohibits organizations from holding monopolies in their industry, and the Robinson–Patman Act of 1936 bans price discrimination between retailers and wholesalers.

In law, however, there are always exceptions. Under the McCarran–Ferguson Act of 1944, for example, Congress exempted the insurance industry from the Sherman Antitrust Act and other antitrust laws. Insurance companies were allowed to join together and set insurance premiums at specific industry-wide levels. However, this legal "permission" could still be viewed as irresponsible and unethical if it neutralizes competition and if prices no longer reflect the true costs of insurance protection. This illustrates the point that what is legal is not always considered ethical by some interest groups. Even Major League Baseball has an antitrust exemption dating back to 1922. MLB is the only major sport that has such a sweeping antitrust exemption, although the major effect it has on the game these days is that sports teams cannot relocate without MLB's permission.[10]

Laws Protecting Consumers

Laws that protect consumers require businesses to provide accurate information about products and services and to follow safety standards (Table 4–3). The first **consumer protection law** was passed in 1906, partly in response to a novel by Upton Sinclair. *The Jungle* describes, among other things, the atrocities and unsanitary conditions of the meatpacking industry in turn-of-the-century Chicago. The outraged public response to this book and other exposés of the industry resulted in the passage of the Pure Food and Drug Act. Likewise, Ralph Nader had a tremendous impact on consumer protection laws with his book *Unsafe at Any Speed*. His critique and attack of General Motors' Corvair had far-reaching effects on autos and other consumer products. Other consumer protection laws emerged from similar processes.

Large groups of people with specific vulnerabilities have been granted special levels of legal protection relative to the general population. For example, the legal status of children and the elderly, defined according to age-related criteria, has received greater attention. American society has responded to research and documentation showing that young consumers and senior citizens encounter difficulties in the acquisition, consumption, and disposition of products. Special legal protection provided to vulnerable consumers is considered to be in the public interest.[11] For example, the Children's Online

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TABLE 4–2 Laws Regulating Competition

Sherman Antitrust Act, 1890	Prohibits monopolies.
Clayton Act, 1914	Prohibits price discrimination, exclusive dealing, and other efforts to restrict competition.
Federal Trade Commission Act, 1914	Created the Federal Trade Commission (FTC) to help enforce antitrust laws.
Robinson–Patman Act, 1936	Bans price discrimination between retailers and wholesalers.
Wheeler–Lea Act, 1938	Prohibits unfair and deceptive acts regardless of whether competition is injured.
McCarran–Ferguson Act, 1944	Exempts the insurance industry from antitrust laws.
Lanham Act, 1946	Protects and regulates brand names, brand marks, trade names, and trademarks.
Celler–Kefauver Act, 1950	Prohibits one corporation from controlling another where the effect is to lessen competition.
Consumer Goods Pricing Act, 1975	Prohibits price maintenance agreements among manufacturers and resellers in interstate commerce.
FTC Improvement Act, 1975	Gives the FTC more power to prohibit unfair industry practices.
Antitrust Improvements Act, 1976	Strengthens earlier antitrust laws—Justice Department has more investigative authority.
Trademark Counterfeiting Act, 1980	Provides penalties for individuals dealing in counterfeit goods.
Trademark Law Revision Act, 1988	Amends the Lanham Act to allow brands not yet introduced to be protected through patent and trademark registration.
Federal Trademark Dilution Act, 1995	Gives trademark owners the right to protect trademarks and requires them to relinquish those that match or parallel existing trademarks.
Digital Millennium Copyright Act, 1998	Refines copyright laws to protect digital versions of copyrighted materials, including music and movies.

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Privacy Protection Act (COPPA) requires commercial Internet sites to carry privacy policy statements, obtain parental consent before soliciting information from children under the age of 13, and provide an opportunity to remove any information provided by children using such sites. Critics of COPPA argue that children age 13 and older should not be treated as adults on the Web. In a study of children ages 10 to 17, nearly half indicated that they would give their name, address, and other demographic information in exchange for a gift worth $100 or more. Internet safety among children is another major topic of concern. Research has shown that filtering and age verification are not effective in making the Internet safer—businesses, regulators, and parents are all trying to find answers in how to protect children from dangers ranging from online predators to pornography.[12]

TABLE 4–3 Laws Protecting Consumers

Law	Description
Pure Food and Drug Act, 1906	Prohibits adulteration and mislabeling of foods and drugs sold in interstate commerce.
Federal Hazardous Substances Labeling Act, 1960	Controls the labeling of hazardous substances for household use.
Truth in Lending Act, 1968	Requires full disclosure of credit terms to purchasers.
Consumer Product Safety Act, 1972	Created the Consumer Product Safety Commission to establish safety standards and regulations for consumer products.
Fair Credit Billing Act, 1974	Requires accurate, up-to-date consumer credit records.
Energy Policy and Conservation Act, 1975	Requires auto dealers to have "gas mileage guides" in their showrooms.
Consumer Goods Pricing Act, 1975	Prohibits price maintenance agreements.
Consumer Leasing Act, 1976	Requires accurate disclosure of leasing terms to consumers.
Fair Debt Collection Practices Act, 1978	Defines permissible debt collection practices.
Toy Safety Act, 1984	Gives the government the power to recall dangerous toys quickly.
Nutritional Labeling and Education Act, 1990	Prohibits exaggerated health claims and requires all processed foods to have labels showing nutritional information.
Telephone Consumer Protection Act, 1991	Establishes procedures for avoiding unwanted telephone solicitations.
Children's Online Privacy Protection Act, 1998	Requires the FTC to formulate rules for collecting online information from children under age 13.
Do Not Call Implementation Act, 2003	Directs the FCC and the FTC to coordinate so that their rules are consistent regarding telemarketing call practices including the Do Not Call Registry and other lists, as well as call abandonment.

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Seniors are another highly vulnerable demographic. New laws have taken aim at financial scams on seniors, such as free lunch seminars. The state of Arkansas has taken the forefront on this issue, conducting police sweeps of suspected scams, increasing fines, and amending laws to imposed increased penalties for those who prey on the elderly. Older people are the most vulnerable group when it comes to financial scams, as they rely on their savings for retirement security.[13]

The role of the FTC's Bureau of Consumer Protection is 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 compliance with 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, high-tech and telemarketing fraud, data security, and financial practices.

TABLE 4–4 Laws Promoting Equity and Safety

Law	Description
Equal Pay Act of 1963	Prohibits discrimination in pay on the basis of sex.
Equal Pay Act of 1963 (amended)	Prohibits sex-based discrimination in the rate of pay to men and women working in the same or similar jobs.
Title VII of the Civil Rights Act of 1964 (amended in 1972)	Prohibits discrimination in employment on the basis of race, color, sex, religion, or national origin.
Age Discrimination in Employment Act, 1967	Prohibits discrimination in employment against persons between the ages of 40 and 70.
Occupational Safety and Health Act, 1970	Designed to ensure healthful and safe working conditions for all employees.
Title IX of Education Amendments of 1972	Prohibits discrimination based on sex in education programs or activities that receive federal financial assistance.
Vocational Rehabilitation Act, 1973	Prohibits discrimination in employment because of physical or mental handicaps.
Vietnam Era Veterans Readjustment Act, 1974	Prohibits discrimination against disabled veterans and Vietnam War veterans.
Pension Reform Act, 1974	Designed to prevent abuses in employee retirement, profit-sharing, thrift, and savings plans.
Equal Credit Opportunity Act, 1974	Prohibits discrimination in credit on the basis of sex or marital status.
Age Discrimination Act, 1975	Prohibits discrimination on age in federally assisted programs.
Pregnancy Discrimination Act, 1978	Prohibits discrimination on the basis of pregnancy, childbirth, or related medical conditions.
Immigration Reform and Control Act, 1986	Prohibits employers from knowingly hiring a person who is an unauthorized alien.
Americans with Disabilities Act, 1990	Prohibits discrimination against people with disabilities and requires that they be given the same opportunities as people without disabilities.
Civil Rights Act of 1991	Provides monetary damages in cases of intentional employment discrimination.

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Laws Promoting Equity and Safety

Laws promoting equity in the workplace were passed during the 1960s and 1970s to protect the rights of minorities, women, older persons, and persons with disabilities; other legislation has sought to protect the safety of all workers (Table 4–4). Of these laws, probably the most important to business is Title VII of the Civil Rights Act, originally passed in 1964 and amended several times since. Title VII specifically prohibits discrimination in employment on the basis of race, sex, religion, color, or national origin. The Civil Rights Act also created the Equal Employment Opportunity Commission (EEOC) to help enforce the provisions of Title VII. Among other things, the EEOC helps businesses design affirmative action

programs. These programs aim to increase job opportunities for women and minorities by analyzing the present pool of employees, identifying areas where women and minorities are underrepresented, and establishing specific hiring and promotion goals, along with target dates for meeting those goals.

Other legislation addresses more specific employment practices. The Equal Pay Act of 1963 mandates that women and men who do equal work must receive equal pay. Wage differences are allowed only if they can be attributed to seniority, performance, or qualifications. The Americans with Disabilities Act of 1990 prohibits discrimination against people with disabilities. Despite these laws, inequities in the workplace still exist. According to the U.S. Women's Bureau and National Committee on Pay Equity, women earn 77.8 percent of what men earn.[14] The disparity in wages is even higher for African American, Hispanic, and older women.

Congress has also passed laws that seek to improve safety in the workplace. By far the most significant of these is the Occupational Safety and Health Act of 1970, which mandates that employers provide safe and healthy working conditions for all workers. The **Occupational Safety and Health Administration** (OSHA), which enforces the act, makes regular surprise inspections to ensure that businesses maintain safe working environments.

Even with the passage and enforcement of safety laws, many employees still work in unhealthy or dangerous environments. Safety experts suspect that companies underreport industrial accidents to avoid state and federal inspection and regulation. The current emphasis on increased productivity has been cited as the main reason for the growing number of such accidents. Competitive pressures are also believed to lie behind the increases in manufacturing injuries. Greater turnover in organizations due to downsizing means that employees may have more responsibilities and less experience in their current positions, thus increasing the potential for accidents. The airline industry has become a prime example of tough economic times resulting in overworked, under-trained employees. Many pilots receive low compensation, poor health benefits, and are forced to work long hours—all factors that may have played a part in a tragic crash in Buffalo, New York, in February 2009 that killed all 49 people on board and one person on the ground. Even esteemed Captain Sully Sullenberger, who safely landed a plane on the Hudson River in January 2009 after colliding with some geese, confessed that his pay had been cut 40 percent. Because the industry cannot pay for the best and the brightest, such important factors as experience and skill are less important when hiring new pilots.[15]

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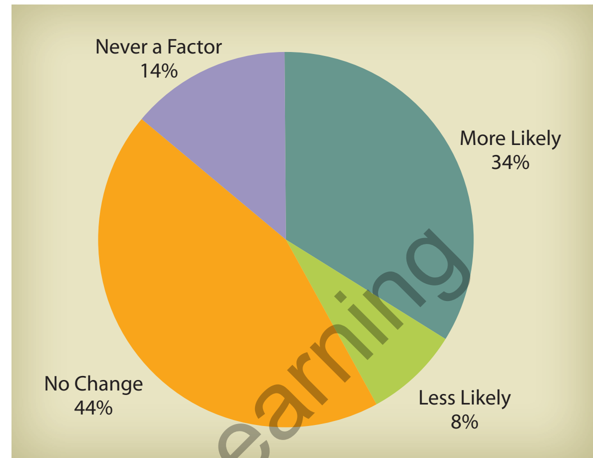
Laws Protecting the Environment

Environmental protection laws have been enacted largely in response to concerns over business's impact on the environment, which began to emerge in the 1960s. **Sustainability** has become a buzzword in recent years, yet many people may not even think about what it means. According to the UN's World Commission on the Environment and Development, sustainable means "meeting the present needs without compromising future generations to meet their own needs."[16] The environment and sustainability are more important topics than ever. Thirty-five percent of people say that they are more interested in environmental issues and expect companies to be more environmentally responsible than they used to be.[17] Consumer interest in sustainability is so great that many firms have even made being green a competitive issue. For example, General Electric and Siemens, two large technology companies, are fighting via their advertisements and reports for title of greenest company. GE has an Ecomagination report that allows consumers to see all the green measures it has

taken. Siemens, on the other hand, claims that it has a much larger environmental report yet has been annoyed by the lack of attention it has received for its actions.[18]

Many people have questioned the cost–benefit analyses often used in making business decisions. Such analyses try to take into account all factors in a situation, represent them with dollar figures, calculate the costs and benefits of the proposed action, and determine whether an action's benefits outweigh its costs. The problem, however, is that it is difficult to arrive at an accurate monetary valuation of environmental damage or physical pain and injury. In addition, people outside the business world often perceive such analyses as inhumane. Figure 4–3 indicates that most consumers view environmental responsibility to be important, even during a recession. In addition, 70 percent of Americans now say that they pay attention to companies' stances toward the environment, even if they cannot afford to buy their products or services.[19]

FIGURE 4–3 Shopping for Environmentally Friendly Products in a Recession



Source: 2009 Cone Consumer Environmental Survey of 1,087 adults, January 29–30.

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The **Environmental Protection Agency** (EPA) was created in 1970 to coordinate environmental agencies involved in enforcing the nation's environmental laws. The major area of environmental concern relates to air, water, and land pollution. Large corporations are being encouraged to establish pollution-control mechanisms and other policies favorable to the environment. Otherwise, these companies could deplete resources and damage the health and welfare of society by focusing only on their own economic interests. For example, 3M voluntarily stopped making Scotchguard, a successful product for 40 years with $300 million in sales, after tests showed that it did not decompose in the environment.[20]

Increases in toxic waste in the air and water, as well as noise pollution, have prompted the passage of a number of laws (Table 4–5). Many environmental protection laws have resulted in the elimination or modification of goods and services. For instance, leaded gasoline was phased out during the 1990s by the EPA because catalytic converters, which reduce pollution caused by automobile emissions and are required by law on most vehicles, do not work properly with leaded gasoline. Increased Corporate Average Fuel Economy (or CAFE) standards are forcing companies to figure out ways for their cars to get better gas mileage. For many carmakers, a major part of this strategy involves increased production and sales of hybrid vehicles, as well as improving electric car and hydrogen fuel-cell technology.

The harmful effects of toxic waste on water life and on leisure industries such as resorts and fishing have raised concerns about proper disposal of these wastes. Few disposal sites meet EPA standards, so businesses must decide what to do with their waste until disposal sites become available. Some firms have solved this problem by illegal or unethical measures: dumping toxic wastes along highways, improperly burying drums containing toxic chemicals, and discarding hazardous waste at sea. For example, a five-year investigation found that ships owned by Royal Caribbean Cruises Ltd. used "secret bypass pipes" to dump waste oil and hazardous materials overboard, often at night. Justice Department officials accused the company of dumping to save the expense of properly disposing of waste at the same time that the cruise line was promoting itself as environmentally

TABLE 4–5 Laws Protecting the Environment

Law	Description
Clean Air Act, 1970	Established air-quality standards; requires approved state plans for implementation of the standards.
National Environmental Policy Act, 1970	Established broad policy goals for all federal agencies; created the Council on Environmental Quality as a monitoring agency.
Coastal Zone Management Act, 1972	Provides financial resources to the states to protect coastal zones from overpopulation.
Federal Water Pollution Control Act, 1972	Designed to prevent, reduce, or eliminate water pollution.
Noise Pollution Control Act, 1972	Designed to control the noise emission of certain manufactured items.
Federal Insecticide, Fungicide and Rodenticide Act, 1972	Provides federal control of pesticide distribution, sale, and use.
Endangered Species Act, 1973	Provides a program for the conservation of threatened and endangered plants and animals and the habitats in which they are found
Safe Drinking Water Act, 1974	Established to protect the quality of drinking water in the United States; focused on all waters actually or potentially designed for drinking use, whether from aboveground or underground sources; established safe standards of purity and required all owners or operators of public water systems to comply with primary (health-related) standards.
Toxic Substances Control Act, 1976	Requires testing and restricts use of certain chemical substances, to protect human health and the environment.
Resource Conservation and Recovery Act, 1976	Gives the EPA authority to control hazardous waste from the "cradle to grave"; includes the generation, transportation, treatment, storage, and disposal of hazardous waste, as well as a framework for the management of nonhazardous waste.
Comprehensive Environmental Response, Compensation, and Liability Act, 1980	Created a tax on chemical and petroleum industries and provides broad federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment.
Emergency Planning and Community Right-to-Know Act, 1986	The national legislation on community safety, designed to help local communities protect public health, safety, and the environment from chemical hazards.
Oil Pollution Act, 1990	Streamlined and strengthened the EPA's ability to prevent and respond to catastrophic oil spills; a trust fund financed by a tax on oil is available to clean up spills when the responsible party is incapable or unwilling to do so.
Pollution Prevention Act, 1990	Focuses industry, government, and public attention on reducing the amount of pollution through cost-effective changes in production, operation, and raw materials use.
Food Quality Protection Act, 1996	Amended the Federal Insecticide, Fungicide and Rodenticide Act and the Federal Food Drug and Cosmetic Act; the requirements included a new safety standard—reasonable certainty of no harm—that must be applied to all pesticides used on foods.

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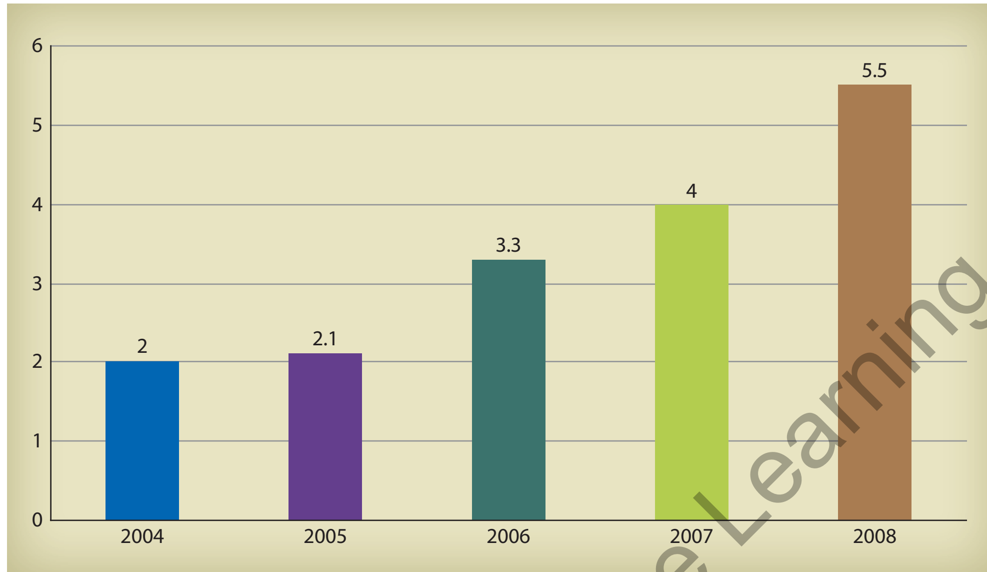
FIGURE 4–4 Growth in Recycling Cell Phones (in millions)



Source: Anne Carey, ReCellular.com

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friendly. The company ultimately pleaded guilty to 21 felony counts, paid $27 million in fines, spent as much as $90,000 per vessel to install new oily water-treatment systems and placed an environmental officer on board each vessel.[21] Congress regularly evaluates legislation to increase the penalties for disposing of toxic wastes in this way. Disposal issues remain controversial because, although everyone acknowledges that the wastes must go somewhere, no community wants them dumped in its own backyard.

One solid-waste problem is the result of rapid innovations in computer hardware, which render machines obsolete after just 18 months. Today, hundreds of millions of computers have reached obsolescence, and tens of millions of these are expected to end up in landfills. Cell phones are another problem, with billions destined for landfills. Computers and cell phones both contain such toxic substances as lead, mercury, and polyvinyl chloride, which can leach into the soil and contaminate groundwater when disposed of improperly. While electronics recycling is not widespread, it has become increasingly available, as Figure 4–4 shows. Websites like electronicsrecycling.org help consumers find locations to recycle their phones and computers. The Environmental Protection Agency hosts its own electronics recycling program, which collects around 67 million pounds of electronics a year. Stores like Staples and Best Buy offer limited recycling programs, and companies like Dell and Samsung are all seeking to extend the availability of recycling for their products.[22]

GATEKEEPERS AND STAKEHOLDERS

Trust is the glue that holds businesses and their stakeholders together. Trust creates confidence and helps to forge relationships of reliance between businesses and stakeholders. Trust also allows businesses to depend upon one another as they make transactions or exchange value. Ethics helps create the foundational trust between two parties in a

transaction. There are many people who must trust and be trusted to make business work properly. Sometimes these parties are referred to as *gatekeepers*. Gatekeepers not only include accountants, who are essential to certifying the accuracy of financial information, but also lawyers, financial rating agencies, and even financial reporting services. All of these groups are critical in providing information that allows stakeholders to gain an understanding of the financial position of an organization. Most of these gatekeepers operate with professional codes of ethics and face legal consequences, or even disbarment, if they fail to operate within agreed-upon principles of conduct. Therefore, there is a strong need for gatekeepers to retain ethical standards and independence using standard methods and procedures that can be audited by other gatekeepers, the regulatory system, and investors.

Accountants

Accountants measure and disclose financial information, with an assurance of accuracy, to the public. Managers, investors, tax authorities, and other stakeholders who make resource allocation decisions are all groups who use the information provided by accountants. Accountants assume certain basic principles about their clients. One assumption is that the corporation is an entity that is separate and distinct from its owners, and that it will continue to operate as such in the future. Another assumption is that a stable monetary system (such as the dollar) is in place and that all necessary information concerning the business is available and presented in an understandable manner. Accountants have their own set of rules, one of which is that, if there is a choice between equally acceptable accounting methods, they should use the one that is least likely to overstate or misdirect. During the 2008–2009 financial meltdown, many people lost trust in accountants and auditors because a few made unscrupulous decisions.

"Gatekeepers such as lawyers, financial rating agencies, and even financial reporting services must have high ethical standards."

Some accountants have not been adhering to their responsibilities to stakeholders. For example, Arthur Andersen was once a standard bearer for integrity. But at Andersen, growth became the priority, and its emphasis on recruiting and retaining big clients came at the expense of quality and independent audits. The company linked its consulting business in a joint cooperative relationship with its audit arm, which compromised its auditors' independence, a quality crucial to the execution of a credible audit. The firm's focus on growth generated a fundamental change in its corporate culture, one in which obtaining high-profit consulting business was regarded as more important than providing objective auditing services. This situation presents a conflict of interest, and posed a problem when partners had to decide how to treat questionable accounting practices discovered at some of Andersen's largest clients. Ultimately, Arthur Andersen was dissolved because of its ties to the Enron scandal. Gatekeepers such as lawyers, financial rating agencies, and even financial reporting services must have high ethical standards. These groups must be trusted by all stakeholders, and most operate with professional codes of ethics.

Risk Assessment

Another critical gatekeeper group in the financial meltdown was risk assessors of financial products. The top three companies in the world that independently assess financial risks are Standard & Poor's, Moody's, and Fitch. They assess risk and express it through letters ranging from "AAA," which is the highest grade, to "C," which is junk. Different rating

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services use the same letter grades, but use various combinations of upper- and lowercase letters to differentiate themselves.

As early as 2003, financial analysts and the three global rating firms suspected that there were some major problems with the way their models were assessing risk. In 2005, Standard & Poor's realized that its algorithm for estimating the risks associated with debt packages was flawed. As a result, it asked for comments on improving its equations. In 2006–2007 many governmental regulators and others started to realize what the rating agencies had known for years: Their ratings were not very accurate. One report stated that the high ratings given to debt were based on inadequate historical data and companies were ratings shopping between companies so as to obtain the best rating possible. It was found that investment banks were among some of the worst offenders, paying for ratings and therefore causing conflicts of interest. The amount of revenue these three companies annually receive is approximately $5 billion.

Further investigations uncovered many disturbing problems. First, Moody's, S&P's, and Fitch had all violated a code of conduct that required analysts to consider only credit factors, not "'the potential impact on Moody's, or an issuer, an investor or other market participant.'" Also, these companies had become overwhelmed by an increase in the volume and sophistication of the securities they were asked to review. Finally, analysts, faced with less time to perform the due diligence expected of them, began to cut corners.

SEC Chairman Mary Schapiro believes that the SEC must take more drastic measures to implement oversight for credit-rating firms—a group that was largely blamed for not catching risky activity in the financial sector sooner. Part of the problem, as Schapiro sees it, is that credit rating firms are paid by the securities that they rank. This creates a conflict of interest problem, and can affect the reliability of the ratings.[23] No organization is exempt from criticism over how transparent it is. While large financial firms have received most of the fury over risk taking and executive pay, even nonprofits are now being scrutinized more carefully.[24]

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THE SARBANES–OXLEY ACT

In 2002, largely in response to widespread corporate accounting scandals, Congress passed the Sarbanes–Oxley Act to establish a system of federal oversight of corporate accounting practices. In addition to making fraudulent financial reporting a criminal offense and strengthening penalties for corporate fraud, the law requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reporting to investors and other stakeholders.

Supported by both Republicans and Democrats, the Sarbanes–Oxley Act was enacted to restore stakeholder confidence after accounting fraud at Enron, WorldCom, and hundreds of other companies resulted in investors and employees losing much of their savings. During the resulting investigations, the public learned that hundreds of corporations had not reported their financial results accurately. Many stakeholders came to believe that accounting firms, lawyers, top executives, and boards of directors had developed a culture of deception to ensure investor approval and gain competitive advantage. Many boards failed to provide appropriate oversight of the decisions of their companies' top officers. At Adelphia Communications, for example, the Rigas family amassed $3.1 billion in off-balance-sheet loans backed by the company. Dennis Kozlowski, CEO of Tyco, was accused of improperly using corporate funds for personal use as well as fraudulent accounting practices.[25] At Kmart, CEO Charles Conaway allegedly hired unqualified executives and consultants for excessive fees. Kmart's board also approved $24 million in loans to various executives, just a month before the retailer filed

for Chapter 11 bankruptcy protection. Conaway and the other executives have since left the company or were fired. Loans of this type are now illegal under the Sarbanes–Oxley Act.[26]

As a result of public outrage over the accounting scandals, the Sarbanes–Oxley Act garnered nearly unanimous support not only in Congress but also by government regulatory agencies, the president, and the general public. When President George W. Bush signed the Sarbanes–Oxley Act into law, he emphasized the need for new standards of ethical behavior in business, particularly among the top managers and boards of directors responsible for overseeing business decisions and activities.

At the heart of the Sarbanes–Oxley Act is the **Public Company Accounting Oversight Board,** which monitors accounting firms that audit public corporations and establishes standards and rules for auditors in accounting firms. The law gave the board investigatory and disciplinary power over auditors and securities analysts who issue reports about corporate performance and health. The law attempts to eliminate conflicts of interest by prohibiting accounting firms from providing both auditing and consulting services to the same client companies without special permission from the client firm's audit committee; it also places limits on the length of time lead auditors can serve a particular client.Table 4–6 summarizes the significant provisions of the law.

TABLE 4–6 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 SEC.
2.	Requires CEOs and CFOs to certify that their companies' financial statements are true and without misleading statements.
3.	Requires that corporate board 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 "whistle-blower 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 ten-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.

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TABLE 4–7 Benefits of the Sarbanes–Oxley Act

1.	**Greater accountability of top managers and boards of directors to employees, investors, communities, and society**
2.	**Renewed investor confidence**
3.	**Clear explanations by CEOs as to why their compensation package is in the best interest of the company; the loss of some traditional senior-management perks such as company loans; greater disclosures by executives about their own stock trades**
4.	**Greater protection of employee retirement plans**
5.	**Improved information from stock analysts and rating agencies**
6.	**Greater penalties for and accountability of senior managers, auditors, and board members**

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The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles. For instance, the law requires top managers to certify that their firms' financial reports are complete and accurate, making CEOs and CFOs personally accountable for the credibility and accuracy of their companies' financial statements. Similar provisions are required of corporate boards of directors, especially audit committees, and senior financial officers are now subject to a code of ethics that addresses their specific areas of risk. Additionally, the law modifies the attorney–client relationship to require lawyers to report wrongdoing to top managers and/or the board of directors. It also provides protection for "whistle-blowing" employees who might report illegal activity to authorities. These provisions provide internal controls to make managers aware of and responsible for legal and ethical problems. Table 4–7 summarizes the benefits of the legislation.

On the other hand, the Sarbanes–Oxley Act has raised a number of concerns. The complex law may impose burdensome requirements on executives; the rules and regulations already run to thousands of pages. Some people also believe that the law will not be sufficient to stop those executives who want to lie, steal, manipulate, or deceive. They believe that a deep commitment to managerial integrity, rather than additional rules and regulations, are the key to solving the current crisis in business.[27] Additionally, the new act has caused many firms to restate their financial reports to avoid penalties. Big public companies spent thousands of hours and an average of $4.4 million each annually to make sure that someone was looking over the shoulder of key accounting personnel at every step of every business process, according to Financial Executives International. Section 404 is a core provision of the 2002 corporate reform law. The number of companies that disclosed serious chinks in their internal accounting controls jumped to more than 586 in 2005 compared to 313 in 2004.[28]

Public Company Accounting Oversight Board

The Sarbanes–Oxley Act establishes an oversight board to oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies. Their duties include (1) registration of public accounting firms; (2) establishment of auditing, quality control, ethics, independence, and other standards relating to preparation of audit reports; (3) inspection of accounting firms; (4) investigations, disciplinary proceedings,

and imposition of sanctions; and (5) enforcement of compliance with accounting rules of the board, professional standards, and securities laws relating to the preparation and issuance of audit reports and obligations and liabilities of accountants.

The board reports to the SEC on an annual basis that includes any new established rules and any final disciplinary rulings. The board works with designated professional groups of accountants and other standard-setting advisory groups in establishing auditing, quality control, ethics, and independence rules.

Auditor and Analyst Independence

The Sarbanes–Oxley Act also seeks to eliminate conflicts of interest among auditors, security analysts, brokers, and dealers and the public companies they serve in order to ensure enhanced financial disclosures of public companies' true condition. To accomplish auditor independence, Section 201 of the act no longer allows registered public accounting firms to provide both non-audit and audit services to a public company. National securities exchanges and registered securities associations have already adopted similar conflict-of-interest rules for security analysts, brokers, and dealers, who recommend equities in research reports. The face of Wall Street is experiencing major changes. In early 2003, 10 of the nation's largest securities firms agreed to pay a record $1.4 billion to settle government charges involving abuse of investors during the stock market bubble of the late 1990s. Wall Street firms routinely issued overly optimistic stock research to investors in order to gain favor with corporate clients and win their lucrative investment-banking business.

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Enhanced Financial Disclosures

With independence, the Sarbanes–Oxley Act is better able to ensure compliance with the enhanced financial disclosures of public companies' true condition. For example, registered public accounting firms are now required to identify all material correcting adjustments to reflect accurate financial statements. Also, all material off-balance-sheet transactions and other relationships with unconsolidated entities that affect current or future financial conditions of a public company must be disclosed in each annual and quarterly financial report. In addition, public companies must also report "on a rapid and current basis" material changes in the financial condition or operations.

Whistle-Blower Protection

Employees of public companies and accounting firms, in general, are also accountable to report unethical behavior. The Sarbanes–Oxley Act intends to motivate employees through whistle-blower protection that would prohibit the employer from taking certain actions against employees who lawfully disclose private employer information to, among others, parties in a judicial proceeding involving a fraud claim. Whistle-blowers are also granted a remedy of special damages and attorneys' fees. Two years after the act, the SEC received approximately 40,000 whistle-blowing reports per month, compared with 6,400 per month in 2001.[29] With only 11,000 publicly-traded companies in the United States, it seems that even though 75 percent of the whistle-blowing reports have no validity, there are still more whistle-blowing reports every month than the number of companies listed.[30]

Also, any act of retaliation that harms informants, 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, will be fined and/or imprisoned for 10 years.

Corporate and Criminal Fraud Accountability

Title VIII of the Sarbanes–Oxley Act, Corporate and Criminal Fraud Accountability, makes the knowing destruction or creation of documents to "impede, obstruct or influence" any existing or contemplated federal investigation a felony. The White-Collar Crime Penalty Enhancements Act of 2002 increased the maximum penalty for mail and wire fraud from 5 to 10 years in prison. It also makes record tampering or otherwise impeding an official a crime. If necessary, the SEC could freeze extraordinary payments to directors, officers, partners, controlling persons, and agents of employees. The U.S. Sentencing Commission reviews sentencing guidelines for securities and accounting fraud.

The act may not prevent future Enron-type businesses from occurring. However, the act's uniqueness from past legislation is its perspective to mandate accountability from the many players in the "game of business," creating more explicit rules in playing fair. The act creates a foundation to strongly discourage wrongdoing and sets ethical standards of what's expected of American business.

> *"The national cost of compliance of the Sarbanes–Oxley Act is estimated at $1 million per $1.7 billion in revenues."*

Cost of Compliance

The national cost of compliance of the Sarbanes–Oxley Act is estimated at $1 million per $1.7 billion in revenues.[31] These costs come from internal costs, external costs, and auditor fees. In a survey by Financial Executives International, nearly all the respondents (94 percent) said that the costs of compliance exceeded the benefits.[32] This act has increased external auditing costs for mid- to large-size companies between 52 and 81 percent. The section that has caused the most cost for companies has been compliance with Section 404. Section 404 has three central issues: It requires that (1) management create reliable internal financial controls, (2) that management attest to the reliability of those controls and the accuracy of financial statements that result from those controls, and (3) that an independent auditor further attests to the statements made by management. Section 404 requires companies to document both the results of financial transactions and the processes they have used to generate them. A company may have thousands of processes that may work, but they have never been written down. Writing down the processes is time consuming and costly.[33] Also, because the cost of compliance is so high for many small companies, some publicly-traded companies are even considering delisting themselves from the U.S. Stock Exchange. Companies based outside the United States have also been weighing the costs of compliance versus the savings of deregistration. Sweden-based Electrolux was among the first to delist from NASDAQ after the Sarbanes–Oxley Act was passed. Many new non-U.S. companies may be avoiding the U.S. market altogether. New listings with the SEC from companies outside the United States have dropped to almost zero since the act passed in 2002.[34] After years of complaints from firms, in spring 2009 the Supreme Court agreed to hear arguments over the constitutionality of

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Sarbanes–Oxley, which has gained new critics as it failed to detect wrongdoing that led to the subprime mortgage crisis and the meltdown on Wall Street in 2008–2009.[35]

However, there are some cases where companies are benefiting from the act's implementation. Apart from the obvious increase in books and materials to help people comply with the act, there is also a growing business for people teaching and implementing ethics programs and hotlines for organizations. Companies such as Global Compliance and EthicsPoint have grown rapidly as companies seek to learn ethics, and a vast new industry of consultants and suppliers has emerged.[36] Other benefits and savings have come in the form of increased efficiency as companies such as Pitney Bowes Inc. find that they can meld various units such as combining four accounts receivable offices into one, saving more than $500,000 a year. At Genentech Inc., simply having detailed reports on financial controls sped up installation, by several months, of a new computer system that consolidates financial data, which meant that it was running months ahead of schedule. The new system allows managers to analyze data from customers rather than just collecting it. Cisco spent $50 million and 240,000 hours on its first-year audit of internal controls. The mind-numbing effort revealed opportunities to streamline steps for ordering products and services, making it easier for customers to do business with Cisco. It forced them to make sure that sales and support were integrated when a customer called, resulting in one-stop shopping for its customers. Other companies have been able to streamline steps for ordering products and services, making it easier for customers to do business with them.[37]

LAWS THAT ENCOURAGE ETHICAL CONDUCT

Violations of the law usually begin when businesspeople stretch the limits of ethical standards, as defined by company or industry codes of conduct, and then choose to engage in schemes that knowingly or unwittingly violate the law. In recent years, new laws and regulations have been passed to discourage such decisions—and to foster programs designed to improve business ethics and social responsibility (Table 4–8). The most important of these are the Federal Sentencing Guidelines for Organizations (FSGO) and the Sarbanes–Oxley Act. One of the goals of both acts is to require employees to

TABLE 4–8 Institutionalization of Ethics through the U.S. Sentencing Guidelines for Organizations

1991	*Law:* U.S. Sentencing Guidelines for Organizations created for federal prosecutions of organizations. These guidelines provide for just punishment, adequate deterrence, and incentives for organizations to prevent, detect, and report misconduct. Organizations need to have an effective ethics and compliance program to receive incentives in the case of misconduct.
2004	*Amendments:* The definition of an effective ethics program now includes the development of an ethical organizational culture. Executives and board members must assume the responsibility of identifying areas of risk, provide ethics training, create reporting mechanisms, and designate an individual to oversee ethics programs.
2007–2008	*Additional definition of a compliance and ethics program:* Firms should focus on due diligence to detect and prevent misconduct and to promote an organizational culture that encourages ethical conduct. More details are provided encouraging the assessment of risk and appropriate steps to design, implement, and modify ethics programs and training to include all employees, top management, and the board or governing authority. These modifications continue to reinforce the importance of an ethical culture in preventing misconduct.

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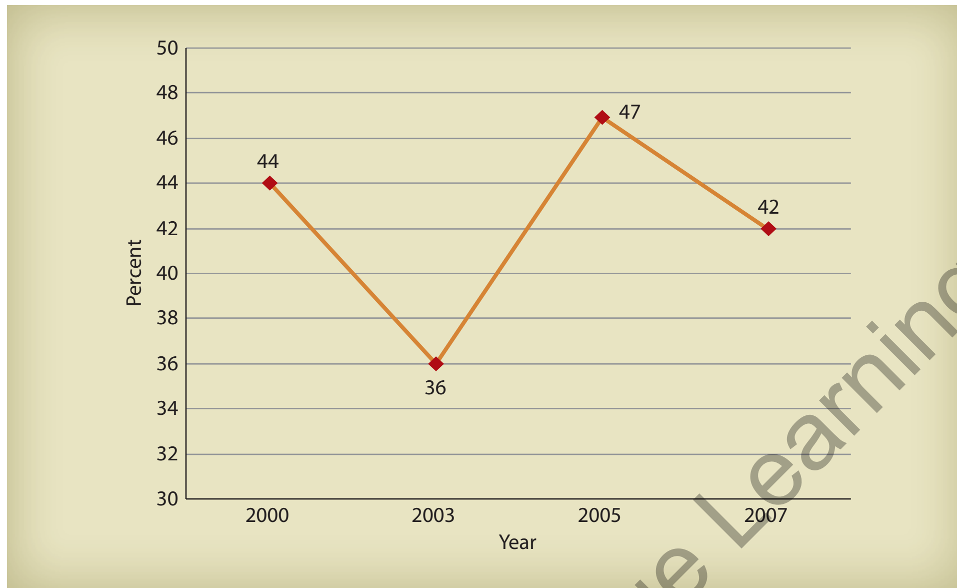
FIGURE 4–5 Percentage of Employees Who Still DO NOT Report Observed Misconduct



Source: 2007 National Business Ethics Survey, p. 17.

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report observed misconduct. The development of reporting systems has advanced with most companies having some method for employees to report observed misconduct. While reported misconduct is up, a sizable percentage of employees still do not report misconduct, as Figure 4–5 shows.

FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS

As mentioned in Chapter 1, Congress passed the FSGO in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance. These guidelines, which were developed by the U.S. Sentencing Commission, apply to all felonies and class A misdemeanors committed by employees in association with their work. As an incentive, organizations that have demonstrated due diligence in developing effective compliance programs that discourage unethical and illegal conduct may be subject to reduced organizational penalties if an employee commits a crime.[38] Overall, the government philosophy is that legal violations can be prevented through organizational values and a commitment to ethical conduct.

The commission delineated seven steps that companies must implement to demonstrate due diligence:

1. A firm must develop and disseminate a code of conduct that communicates required standards and identifies key risk areas for the organization.

2. High-ranking personnel in the organization who are known to abide by the legal and ethical standards of the industry (such as an ethics officer, vice president of human resources, general counsel, and so forth) must have oversight over the program.
3. No one with a known propensity to engage in misconduct should be put in a position of authority.
4. A communications system for disseminating standards and procedures (ethics training) must also be put into place.
5. Organizational communications should include a way for employees to report misconduct without fearing retaliation, such as an anonymous toll-free hotline or an ombudsman. Monitoring and auditing systems designed to detect misconduct are also required.
6. If misconduct is detected, then the firm must take appropriate and fair disciplinary action. Individuals both directly and indirectly responsible for the offense should be disciplined. In addition, the sanctions should be appropriate for the offense.
7. After misconduct has been discovered, the organization must take steps to prevent similar offenses in the future. This usually involves making modifications to the ethical compliance program, additional employee training, and issuing communications about specific types of conduct.

The government expects these seven steps for compliance programs to undergo continuous improvement and refinement.[39]

These steps are based on the commission's determination to emphasize compliance programs and to provide guidance for both organizations and courts regarding program effectiveness. Organizations have flexibility about the type of program they develop; the seven steps are not a checklist requiring that legal procedures be followed to gain certification of an effective program. Organizations implement the guidelines through effective core practices that are appropriate for their firms. The program must be capable of reducing the opportunity that employees have to engage in misconduct.

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. Figure 4–6 provides an overview from NBES about how prepared employees are to respond to various ethical and legal risks. Over three-quarters of employees who encounter risk feel adequately prepared to respond. If board members do not understand the nature, purpose, and methods available to implement an ethics program, the firm is at risk of inadequate oversight in the event of ethical misconduct that escalates into a scandal.[40]

A 2005 Supreme Court decision held that the sentences for violations of law were not mandatory but should serve only as recommendations for judges to use in their decisions. Some legal and business experts believe that this decision might weaken

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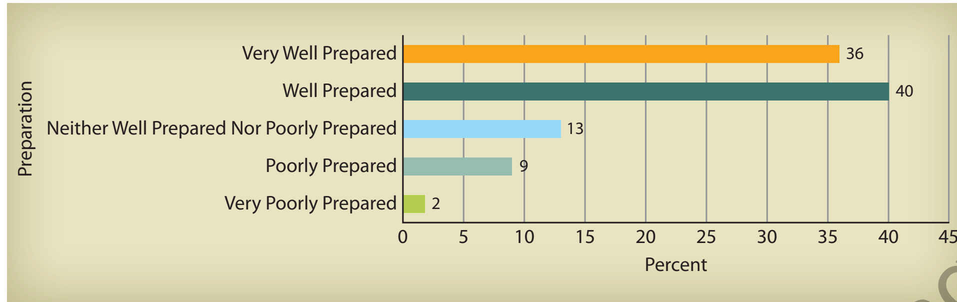
FIGURE 4–6 Employees' Preparation to Respond to Risk



Source: National Business Ethics Survey, *How Employees View Ethics in Their Organizations 1994-2205* (Washington D.C.: Ethics Resource Center, 2005): 39.

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the implementation of the FSGO, but most sentences have remained in the same range as before the Supreme Court decision. The guidelines remain an important consideration in developing an effective ethics and compliance program. An Open Compliance Group Benchmarking survey provided some insights into effective core practices, as illustrated in Table 4-9.

TABLE 4–9 Key Findings from the Open Compliance Ethics Group Benchmarking Survey

Crisis Can Help the Cause	**Companies that have experienced reputation damage in the past see themselves as much further along in terms of program maturity and in relation to their peers—both today and in the future.**
Pay Now or Pay Later	**Companies that have experienced reputation damage invest *three* times more than their nondamaged peers in specific compliance and ethics processes.**
Preference for Proactive and Values-Based Programs	**Compliance and ethics programs are becoming more proactive and values based, allowing companies to prevent ethical and compliance violations before they become a crisis.**
Proactive Skills Training May Need More Emphasis	**To reach the objective of more proactive programs, companies must provide training to the people who are accountable for the compliance and ethics program—training that focuses on more proactive disciplines.**
Set/Align Objectives for More Benefit	**Companies that set explicit objectives for their compliance and ethics programs rate the benefits of their programs more highly and ascribe them more than companies that do not set explicit objectives.**
Integrate/Cooperate for More Benefit	**Additional benefits and performance can be realized when an organization integrates the compliance and ethics program with other aspects of the enterprise and when the program has a good working relationship with other business functions/processes.**
Experience	**Of the companies in this study, 54 percent have implemented a compliance and ethics program relatively recently (within the last five years). *Zero* companies in this study with a program in place for 10 years or more experienced highly visible reputation damage in the last five years, a testament to the important impact these programs can have over time.**

Source: Open Compliance Ethics Group 2005 Benchmarking Study Key Findings, http://www.oceg.org/view/Benchmarking2005 (accessed June 12, 2009). Reprinted with permission.

The 2007–2008 amendments to the FSGO extend the ethics training of individuals to members of the board or governing authority, high-level personnel, employees, and the organizations' agents. This applies not only oversight but mandatory training to all levels of the organization. Merely distributing a code of ethics does not meet the training requirements. The 2007 and 2008 amendments now require most governmental contractors to provide ethics and compliance training. As new FSGO amendments are implemented, more explicit responsibility is being placed on organizations to improve and expand ethics and compliance provisions to include all employees and board members.

The Department of Justice, through the Thompson Memo (Larry Thompson, deputy attorney general, 2003 memo to U.S. Attorneys), advanced general principles to consider in cases involving corporate wrongdoing. This memo makes it clear that ethics and compliance programs are important to detect the types of misconduct most likely to occur in a particular corporation's line of business. Without an effective ethics and compliance program to detect ethical and legal lapses, the firm should not be treated leniently. Also, the prosecutor generally has wide latitude in determining when, whom, and whether to prosecute violations of federal law. U.S. Attorneys are directed that charging for even minor misconduct may be appropriate when the wrongdoing was pervasive by a large number of employees in a particular role—for example, sales staff, procurement officers—or was condoned by upper management. Without an effective program to identify an isolated rogue employee involved in misconduct, serious consequences can be associated with regulatory issues, enforcement, and sentencing.[41] Therefore, there is general agreement both from laws and administrative policy that an effective ethics and compliance program is necessary to prevent conduct and reduce the legal consequences.

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HIGHLY APPROPRIATE CORE PRACTICES

The FSGO and the Sarbanes–Oxley Act provide incentives for developing core practices that help ensure ethical and legal compliance. Core practices move the emphasis from a focus on individuals' moral capability to developing structurally sound organization core practices and developing structural integrity for both financial performance and nonfinancial performance. Although the Sarbanes–Oxley Act provides standards for financial performance, most ethical issues relate to nonfinancial issues such as marketing, human resource management, and customer relationships. Abusive behavior, lying, and conflict of interest are still the top three ethical issues.

The Integrity Institute has developed an integrated model to standardize the measurement of nonfinancial performance. Methodologies have been developed to assess communications, compensation, social responsibility, corporate culture, leadership, risk, and stakeholder perceptions, as well as more subjective aspects of earnings, corporate governance, technology, and other important nonfinancial areas. The model exists to establish a standard that can predict sustainability and success of an organization. The Integrity Institute uses the measurement to an established standard as the basis of certification of integrity.[42]

The majority of executives and board members want to measure nonfinancial performance, but no standards currently exist. The Open Compliance Ethics Group (oceg .org) has developed benchmarking studies available to organizations to conduct self-assessments to develop ethics program elements. Developing organizational systems and processes is a requirement of the regulatory environment, but organizations are given considerable freedom in developing ethics and compliance programs. Core practices do

exist and can be identified in every industry. Trade associations' self-regulatory groups and research studies often provide insights about the expected best core practices. The most important is for each firm to assess its legal and ethical risk areas and then develop structures to prevent, detect, and quickly correct any misconduct.

Consider McDonald's approach to answering critics about nutritional guidance. It announced a move to provide nutritional information on its product packaging worldwide. McDonald's was the first in its industry to post nutritional information on food packaging. McDonald's has been seeking to build trust and loyalty among consumers, something that the company proclaims is highly important to it. McDonald's also introduced a "Balanced Lifestyles" initiative for kids, which involved offering healthier menu options, promoting physical activity, and providing more nutritional information to its customers about its products. In 2004 it withdrew its supersize meals after a damaging portrayal of the company in the film *Super Size Me*. The product sizes available at McDonald's are small, medium, and large, but upgrading to a bigger-portion size remains cheap.[43]

Philanthropic Contributions

Philanthropic issues are another dimension of voluntary social responsibility and relate to a business's contributions to stakeholders. Philanthropy provides four major benefits to society:

1. Philanthropy improves the quality of life and helps make communities places where people want to do business, raise families, and enjoy life. Thus, improving the quality of life in a community makes it easier to attract and retain employees and customers.
2. Philanthropy reduces government involvement by providing assistance to stakeholders.
3. Philanthropy develops employee leadership skills. Many firms, for example, use campaigns by the United Way and other community service organizations as leadership- and skill-building exercises for their employees.
4. Philanthropy helps create an ethical culture and the values that can act as a buffer to organizational misconduct.[44]

> *"Philanthropy helps create an ethical culture"*

The most common way that businesses demonstrate philanthropy is through donations to local and national charitable organizations. Consistently a large philanthropic donor, Wells Fargo & Company contributes around $100 million annually in community grants for nonprofits and schools, contributes $45 million and 100,000 volunteers to Habitat for Humanity and other housing nonprofits, purchases green energy, has a website devoted to financial education, and its employees have donated hundreds of thousands of hours to charities around the nation.[45] Indeed, many companies have become concerned about the quality of education in the United States after realizing that the current pool of prospective employees lacks many basic work skills. Recognizing that today's students are tomorrow's employees and customers, firms such as Kroger, Campbell Soup Company, Eastman Kodak, American Express, Apple Computer, Xerox, and Coca-Cola have donated money, equipment, and employee time to help improve schools in their communities and throughout the nation.

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The Wal-Mart Foundation, the charitable giving branch of Wal-Mart Inc., donated $378 million in 2009 to charities and communities across the globe, making it the largest corporate cash contributor in the nation, according to the Chronicle of Philanthropy. *Forbes Magazine* recognized Wal-Mart as the most generous company in the nation overall.[46] The money supported a variety of causes such as child development, education, the environment, and disaster relief. Wal-Mart feels that it can make the greatest impact on communities by supporting issues and causes that are important to its customers and associates in their own neighborhoods. Wal-Mart relies on its own associates to know which organizations are the most important to their hometowns, and it empowers them to determine how money will be spent in their communities. Wal-Mart is particularly focused on education, workforce development, sustainability, and health and wellness. By supporting communities at the local level, it encourages customer loyalty and goodwill.[47]

Strategic Philanthropy

Tying philanthropic giving to overall strategy and objectives is also known as strategic philanthropy. **Strategic philanthropy** is the synergistic and mutually beneficial use of an organization's core competencies and resources to deal with key stakeholders so as to bring about organizational and societal benefits. For example, last year Bisto, a staple of Britain's meal tables since 1908 with its instant gravy, launched a new marketing campaign. The focus was on families trying to eat one meal together a week. Bisto called it "ahh nights" based on its longtime marketing slogan of "ahh . . . Bisto." Families eat fewer and fewer meals together; this has been identified by social policy experts as playing a key role in a wide range of social problems such as teenage drug abuse, sexual promiscuity, teenage pregnancy, crime, antisocial behavior, truancy, and poor academic performance. Bisto used the new marketing slogan to extol the virtues of eating together as a family while explicitly recognizing the challenges of doing this in the modern world. It used a website, www.aahnight.co.uk, to make it easy for families to have a meal together at least once a week. It used three steps: (1) Download a contract that families can sign and stick on the refrigerator; (2) invite family or friends by e-mail; (3) make a delicious meal with recipes provided using—you guessed it—Bisto.[48]

Home Depot directs much of the money it spends on philanthropy to affordable housing, at-risk youth, the environment, and disaster recovery. In 2008 the company supported thousands of nonprofit organizations with over $50 million in contributions. The company also posts a Social Responsibility Report on its website. Home Depot works with more than 350 affiliates of Habitat for Humanity. In March 2008, Home Depot and Habitat for Humanity announced a five-year $30 million initiative to provide funding for creating at least 5,000 energy-efficient homes. Home Depot also supports YouthBuildUSA, a nonprofit organization that provides training and skill development for young people. After the 9/11 terrorist attacks in 2001, the company set up three command centers to help coordinate relief supplies such as dust masks, gloves, batteries, and tools to victims and rescue workers. After hurricanes Katrina, Rita, and Wilma, Home Depot, the Home Depot Foundation, their suppliers, and The Home Fund contributed $9.3 million in cash and materials to support recovery. Home Depot also donated $500,000 supporting the American Red Cross tsunami relief efforts in South East Asia. More recently, Home Depot donated $300,000 to the American Red Cross for disaster relief for people who suffer from hurricanes. Separately, Home Depot's Home Fund donated $500,000 to 650 associates who had suffered through Hurricane Gustav in 2008.[49]

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SUMMARY

To understand the institutionalization of business ethics, it is important to understand the voluntary and legally mandated dimensions of organizational practices. Core practices are documented best practices, often encouraged by legal and regulatory forces as well as industry trade associations. The effective organizational practice of business ethics requires all three dimensions to be integrated into an ethics and compliance program. This creates an ethical culture that can effectively manage the risks of misconduct. Institutionalization in business ethics relates to established laws, customs, and expected organizational programs that are considered normative in establishing reputation. Institutions provide requirements, structure, and societal expectations to reward and sanction ethical decision making. In this way, society is institutionalizing core practices and providing organizations the opportunity to take their own approach, only taking action if there are violations.

Laws and regulations are established by governments to set minimum standards for responsible behavior—society's codification of what is right and wrong. Civil and criminal laws regulating business conduct are passed because society—including consumers, interest groups, competitors, and legislators—believes that business must comply with society's standards. Such laws regulate competition, protect consumers, promote safety and equity in the workplace, protect the environment, and provide incentives for preventing misconduct.

In 2002, largely in response to widespread corporate accounting scandals, Congress passed the Sarbanes–Oxley Act to establish a system of federal oversight of corporate accounting practices. In addition to making fraudulent financial reporting a criminal offense and strengthening penalties for corporate fraud, the law requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reporting to investors and other stakeholders. The Sarbanes–Oxley Act requires corporations to take greater responsibility for their decisions and to provide leadership based on ethical principles. For instance, the law requires top managers to certify that their firms' financial reports are complete and accurate, making CEOs and CFOs personally accountable for the credibility and accuracy of their companies' financial statements. The act establishes an oversight board to oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies.

Congress passed the Federal Sentencing Guidelines for Organizations (FSGO) in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance. These guidelines, which were developed by the U.S. Sentencing Commission, apply to all felonies and class A misdemeanors committed by employees in association with their work. As an incentive, organizations that have demonstrated due diligence in developing effective compliance programs that discourage unethical and illegal conduct may be subject to reduced organizational penalties if an employee commits a crime.[50] Overall, the government philosophy is that legal violations can be prevented through organizational values and a commitment to ethical conduct. 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

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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.

The FSGO and the Sarbanes–Oxley Act provide incentives for developing core practices that help ensure ethical and legal compliance. Core practices move the emphasis from a focus on the individual's moral capability to developing structurally sound organization core practices and developing structural integrity for both financial performance and nonfinancial performance. The Integrity Institute has developed an integrated model to standardize the measurement of nonfinancial performance. Methodologies have been developed to assess communications, compensation, social responsibility, corporate culture, leadership, risk, and stakeholder perceptions, as well as more subjective aspects of earnings, corporate governance, technology, and other important nonfinancial areas.

Philanthropic issues touch on businesses' social responsibility insofar as businesses contribute to the local community and to society. Philanthropy provides four major benefits to society: improving the quality of life, reducing government involvement, developing staff leadership skills, and building staff morale. Companies contribute significant amounts of money to education, the arts, environmental causes, and the disadvantaged by supporting local and national charitable organizations. Strategic philanthropy involves linking core business competencies to societal and community needs.

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IMPORTANT TERMS FOR REVIEW

- voluntary practices
- philanthropy
- core practices
- Better Business Bureau
- mandated boundaries
- civil law
- criminal law
- procompetitive legislation
- consumer protection law
- Occupational Safety and Health Administration
- sustainability
- Environmental Protection Agency
- Public Company Accounting Oversight Board
- strategic philanthropy

RESOLVING ETHICAL BUSINESS CHALLENGES*

Albert Chen was sweating profusely in his Jaguar on the expressway as he thought about his options and the fact that Christmas and the Chinese New Year were at hand. He and his wife, Mary, who were on their way to meet Albert's parents at New York's John F. Kennedy International Airport, seemed to be looking up from an abyss, with no daylight to be seen. Several visits and phone calls from various people had engulfed both him and Mary.

He had graduated with honors in finance and had married Mary in his senior year. They had both obtained prestigious brokerage jobs in the New York area, and both had been working killer hours to develop their accounts. Listening to other brokers, both had learned that there were some added expenses to their professions. For example,

they were told that brokers need to "look" and "act" successful. So Albert and Mary bought the appropriate clothes and cars, joined the right clubs, and ate at the right restaurants with the right people. They also took the advice of others, which was to identify the "players" of large corporations at parties and take mental notes. "You'd be surprised at what information you hear with a little alcohol in these people," said one broker. Both started using this strategy, and five months later their clients began to see significant profits in their portfolios.

Their good luck even came from strange places. For example, Albert had an uncle whose work as a janitor gave him access to many law offices that had information on a number of companies, especially those about to file for bankruptcy. Mary and Albert were able to use information provided by this uncle to benefit their clients' portfolios. The uncle even had some of his friends use Albert. To Albert's surprise, his uncle's friends often had nest eggs in excess of $200,000. Because some of these friends were quite elderly, Albert was given permission to buy and sell nonrisky stocks at will.

Because both of them were earning good salaries, the Chens soon managed to invest in the market themselves, and their investments included stock in the company for which Mary's father worked. After eighteen months, Albert decided to jump ship and start working for Jarvis, Sunni, Lamar & Morten (JSL&M). JSL&M's reputation was that of a fast mover in the business. "We go up to the line and then measure how wide the line is so that we know how far we can go into it," was a common remark at the brokerage firm.

About six months ago, Mary's father, who was with a major health care company, commented that the management team was running the company into the ground. "If only someone could buy the company and put in a good management team," he mused. After the conversation, Mary investigated the company and discovered that the stock was grossly undervalued. She made a few phone calls and found a company that was interested in doing a hostile takeover. Mary also learned from her father that if a new management were acceptable to the union, the union would do everything in its power to oust the old management—by striking, if necessary—and welcome the new one. As things started to materialize, Mary told several of her best clients, who in turn did very well on the stock. This increased her status in the firm, which kept drawing bigger clients.

Albert soon became a player in initial public stock offerings (IPOs) of new companies. Occasionally, when Albert saw a very hot IPO, he would talk to some of his best venture-capital friends, who then bought the IPOs and gained some very good returns. This strategy helped attract some larger players in the market. By this point in his young career, Albert had made a great many friends.

One of those friends was Barry, who worked on the stock floor. As they were talking, Barry mentioned that if Albert wanted to, he, as a favor, when placing orders to buy shares, would occasionally put Albert's or Mary's trade before the client order.

The first sign of trouble came when Mary told Albert about what was happening at her office. "I'm getting e-mail from some of the brokers with off-color jokes and even some nude photos of women and men. I just don't care for it."

"So what are you doing about it?" Albert asked.

"Well, I've just started not even opening my messages if they come from these people," Mary replied.

"What about messages that request that you send them on? What do you do with those?" queried Albert.

"I just e-mail them along without looking at them," was her response.

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"This isn't good, Mary. A couple of analysts were just fired for doing that at a big firm last week," said Albert.

Several weeks later the people who were sending Mary the obnoxious messages were fired. Mary was also asked to see the head of her division. When she came to his office, he said, "Please shut the door, Mary. I have some bad news. I know that you weren't involved with what was happening with the e-mail scandal; however, you did forward messages that contained such material. As a result, I have no alternative but to give you your two weeks' notice. I know this is unfair, but I have my orders. Because of this mess, the SEC wants to check all your trades for the last eight months. It seems to be a formality, but it will take time, and as you well know, the chances of going to another firm with that hanging over your head are slim. I'm sorry that it's only two months until the holidays." That night Mary fell into a depression.

To exacerbate the situation, Albert's parents were flying in from the People's Republic of China. They were not happy with Albert's marriage to a non-Chinese woman, but they had consoled themselves that Mary had a good job. They had also said that if things should go badly for them in New York, they could always come to the parents' retirement home in Taiwan. However, the idea of leaving the United States, attempting to learn Mandarin, and raising children in an unfamiliar culture did not appeal to Mary.

Albert was also having some problems. Because their income was cut in half, Albert tried to make up for the loss by trading in some high-risk markets, such as commodities and precious metals. However, many of these investments turned sour, and he found himself buying and selling more and more to pull his own portfolio, as well as those of his clients, into the black. He was getting worried because some of his uncle's friends' portfolios were losing significant value. Other matters, however, were causing him even more anxiety. The previous week Barry had called him, asking for some inside information on several companies that he was working with for an IPO. Albert knew that this could be construed as insider information and had said no.

Today, Barry called again and said, "Look, Al, I've been doing you favors for a while. I need to score big because of the holidays. You probably don't know, but what I've been doing for you could be construed as spinning, which is not looked upon favorably. I'm not asking for the IPO information—I'm demanding it. Is that clear enough for you, Al? E-mail it over by tomorrow morning." Then Barry hung up.

An hour later Albert's supervisor came in and said, "Al, I need a favor from you. I want you to buy some stock for a few friends and me. When it goes to $112, I want you to sell it. We'll pay the taxes and give you a little bonus for Christmas as well. I want you to buy tomorrow as soon as the market opens. Here are the account numbers for the transaction. I must run. See you tomorrow."

QUESTIONS • EXERCISES

1. Identify the ethical and legal issues of which Albert needs to be aware.
2. Discuss the advantages and disadvantages of each decision that Albert could make and has made.
3. Identify the pressures that have brought about these issues.

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

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CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

1. Voluntary practices include documented best practices **Yes** **No**
2. The primary method for resolving business ethics disputes is through the criminal court system. **Yes** **No**
3. The FSGO provides an incentive for organizations to conscientiously develop and implement ethics programs. **Yes** **No**
4. The Sarbanes–Oxley Act encourages CEOs and CFOs to report their financial statements accurately. **Yes** **No**
5. Strategic philanthropy represents a new direction in corporate giving that maximizes the benefit to societal or community needs and relates to business objectives. **Yes** **No**

ANSWERS **1. No.** Core practices are documented best practices. **2. No.** Lawsuits and civil litigation are the primary way in which business ethics disputes are resolved. **3. Yes.** Well-designed ethics and compliance programs can minimize legal liability when organizational misconduct is detected. **4. No.** The Sarbanes–Oxley Act *requires* CEOs and CFOs to accurately report their financial statements to a federal oversight committee; they must sign the document and are held personally liable for any inaccuracies. **5. Yes.** Strategic philanthropy helps both society and the organization.

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PART 3
The Decision Making Process

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