

maintain an apartment building for low-income Chicagoans. In exchange, the government guaranteed a steady stream of rent. But now the contract on Rienzi Plaza is set to expire. Baskin could make a larger profit on the building by either selling it, converting it to condominiums, or renting to unsubsidized tenants who could pay more. What does Baskin owe to his investors?

The Rienzi tenants and community groups have begun looking for a white knight—someone who could buy the building and preserve its low-income housing—but so far no luck. Meanwhile, Baskin asked government officials how much more rent they would pay if he extended his contract for five years. Officials said they would have to hire an outside consultant to do a market study, a task that would take months—long past the deadline by which federal regulations require Baskin to announce his decision.¹

Business is an enormously powerful tool that corporate managers can use to accomplish many goals. They may wish to earn a good living, even to become wealthy, but they can also use their business skills to cure the ill, feed the hungry, entertain the bored, and in many other ways affect their community, their country, and their world.

This book is primarily about the impact of law on business. But law is only one set of rules that governs business; ethics is another. **Ethics** is the study of how people ought to act. Law and ethics are often in harmony. Most reasonable people agree that murder should be prohibited. But law and ethics are not always compatible. In some cases, it might be *ethical* to commit an *illegal* act; in others, it might be *unethical* to be *legal*. Here are two examples in which law and ethics might conflict: A 75-year-old man confined to a wheelchair robbed a bank in San Diego of \$70 so that he could buy heart medicine. That was illegal—was it unethical?

Or what about Martin Luther King, Jr., who was arrested in Birmingham, Alabama, in 1963, for leading illegal sit-ins and marches to protest laws that discriminated against African Americans. When eight local clergymen criticized his activities, King offered this defense:

[W]hen you suddenly find your tongue twisted as you seek to explain to your six-year-old daughter why she can't go to the public amusement park that has just been advertised on television, and see tears welling up when she is told that Funtown is closed to colored children. . . . [W]hen you take a cross-country drive and find it necessary to sleep night after night in the uncomfortable corners of your automobile because no motel will accept you. . . . How can [we] advocate breaking some laws and obeying others? I agree with St. Augustine that "an unjust law is not law at all."²

Ethics

Ethics is the study of how people ought to act.

¹ Based on Jonathan Eig, "Landlord's Dilemma: Help Poor Tenants or Seek More Profits," *Wall Street Journal*, July 17, 2001, p. 1.

² Martin Luther King, Jr., "Letter from Birmingham Jail," *The Christian Century*, June 12, 1963. Copyright © 1963 Dr. Martin Luther King, Jr.; Copyright © renewed 1991 Coretta Scott King. Reprinted by arrangement with The Heirs to the Estate of Martin Luther King Jr., c/o Writers House as agent for the proprietor, New York, NY.

The other chapters of this book focus on legal issues, but this chapter concentrates on ethics. In all of the examples in this chapter, the activities are *legal*, but are they *ethical*?

▪ WHY BOTHER WITH ETHICS? ▪

Business schools teach students how to maximize the profitability of an enterprise, large or small. Some people argue that, in the long run, ethical behavior does indeed pay. But they must mean the very long run, because to date there is little evidence that ethical behavior *necessarily* pays financially, either in the short or the long run.

For instance, when a fire destroyed the Malden Mills factory in Lawrence, Massachusetts, its 70-year-old owner, Aaron Feuerstein, could have shut down the business, collected the insurance money, and sailed off into retirement. But a layoff of the factory's 3,000 employees would have been a major economic blow to the region. So instead Feuerstein kept the workers on the payroll, making the company's patented Polartec fabric, while he rebuilt the factory. However, five years after the fire, Malden Mills filed bankruptcy papers. The company was not able to pay off the loans it had incurred to keep the business going.

In contrast, unethical behavior is no bar to financial success. The first antitrust laws in America were designed, at least in part, to restrain John D. Rockefeller's unethical activities. Yet, four generations later, his name is still synonymous with wealth and his numerous heirs can live comfortably on their inheritance from him.

If ethical behavior does not necessarily pay and unethical behavior sometimes does, why bother with ethics?

SOCIETY AS A WHOLE BENEFITS FROM ETHICAL BEHAVIOR

John Akers, the former chairman of IBM, argues that without ethical behavior, a society cannot be economically competitive. He puts it this way:

Ethics and competitiveness are inseparable. No society anywhere will compete very long or successfully with people stabbing each other in the back; with people trying to steal from each other; with everything requiring notarized confirmation because you can't trust the other fellow; with every little squabble ending in litigation; and with government writing reams of regulatory legislation, tying business hand and foot to keep it honest. There is no escaping this fact: the greater the measure of mutual trust and confidence in the ethics of a society, the greater its economic strength.³

MONEY DOES NOT BUY HAPPINESS

Researchers who study happiness find that people expect material goods to make them happier than they actually do. Sure, you enjoy driving that snappy new car home from the dealership, but afterwards your happiness quickly returns to its natural base level. People find themselves on the so-called "hedonic treadmill"—struggling to buy more and more things so they can get that buyer's high, only to discover that they can never buy enough to maintain the thrill. Almost no matter how much people earn, they feel they would be happier if their income were just a little bit

³ David Grier, "Confronting Ethical Dilemmas," unpublished manuscript of remarks at the Royal Bank of Canada, Sept. 19, 1989.

higher. So what does make people happy in the long run? Good relationships, satisfying work, ties to the community—all available at no additional cost.

PEOPLE FEEL BETTER WHEN THEY BEHAVE ETHICALLY

Every businessperson has many opportunities to be dishonest. Consider how one person felt when he resisted temptation:

Occasionally a customer forgot to send a bill for materials shipped to us for processing. . . . It would have been so easy to rationalize remaining silent. After all, didn't they deserve to lose because of their inefficiency? However, upon instructing our staff to inform the parties of their errors, I found them eager to do so. Our honesty was beneficial in subtle ways. The "inefficient" customer remained loyal for years. . . . [O]ur highly moral policy had a marvelously beneficial effect on our employees. Through the years, many an employee visited my office to let me know that they liked working for a "straight" company.⁴

Profitability is generally not what motivates managers to care about ethics. Managers want to feel good about themselves and the decisions they have made; they want to sleep at night. Their decisions—to lay off employees, install safety devices in cars, burn a cleaner fuel—affect people's lives.)

UNETHICAL BEHAVIOR CAN BE VERY COSTLY

Unethical behavior is a risky business strategy—it may lead to disaster. An engaged couple made a reservation, and put down a \$1,500 deposit, to hold their wedding reception at a New Hampshire restaurant. Tragically, the bride died of asthma four months before the wedding. Invoking the terms of the contract, the restaurant owner refused to return the couple's deposit. In a letter to the groom, he admitted, "Morally, I would of course agree that the deposit should be returned." When newspapers reported this story, customers deserted the restaurant and it was forced into bankruptcy—over a \$1,500 disagreement.⁵ Unethical behavior does not always damage a business, but it certainly has the potential of destroying a company overnight. So why take the risk?

Even if unethical behavior does not devastate a business, it can cause other, subtler damage. In one survey, a majority of those questioned said that they had witnessed unethical behavior in their workplace and that this behavior had reduced productivity, job stability, and profits. Unethical behavior in an organization creates a cynical, resentful, and unproductive workforce.

So why bother with ethics? Because society benefits when managers behave ethically. Because money does not buy happiness. Because ethical managers have happier, more satisfying lives. Because unethical behavior can destroy a business faster than a snake can bite. And because, in the end, ethical behavior is more likely to pay off.

▪ WHAT IS ETHICAL BEHAVIOR? ▪

It is one thing to decide, in theory, that being ethical is good; in practice, it can be much more difficult to make the right decisions. Supreme Court Justice Potter Stewart once said that he could not define pornography, but he knew it when he saw it. Many people feel the same way about ethics—that somehow, instinctively, they know what is right and wrong. In real life,

⁴ Hugh Aaron, "Doing the Right Thing in Business," *Wall Street Journal*, June 21, 1993, p. A10.

⁵ John Milne, "N.H. Restaurant Goes Bankrupt in Wake of Wedding Refund Flap," *Boston Globe*, Sept. 9, 1994, p. 25.

however, ethical dilemmas are often not black and white, but many shades of gray. The purpose of this section is to analyze the following ethics checklist as an aid to managers in making tough decisions:

- What are the facts?
- What are the critical issues?
- Who are the stakeholders?
- What are the alternatives?
- What are the ethical implications of each alternative?
 - Is it legal?
 - How would it look in the light of day?
 - What are the consequences?
 - Does it violate important values?
 - What kind of world would this be if everyone behaved this way?

ANALYZING THE ETHICS CHECKLIST

What Are the Facts?

Although this question seems obvious, people often forget in the heat of battle to listen to (and, more importantly, to *hear*) all the different viewpoints. It is crucial to discover the facts, firsthand, from the people involved.

What Are the Critical Issues?

In analyzing ethical dilemmas, expand your thinking to include *all* the important issues. Avoid a narrow focus that encompasses only one or two aspects. In the case of the New Hampshire restaurant that refused to refund a deposit, the owner focused on the narrow legal issue. His interpretation of the *contract* was correct. But if the owner had expanded his thinking to include consideration for his customers, he might have reached a different decision.

Who Are the Stakeholders?

Stakeholders are all the people potentially affected by the decision. That list might include subordinates, bosses, shareholders, suppliers, customers, members of the community in which the business operates, society as a whole, or even more remote stakeholders, such as future generations.

What Are the Alternatives?

The next step is to list the reasonable alternatives. A creative manager may find a clever solution that is a winner for everyone. What alternatives might be available to Sheldon Baskin, the landlord who faced a dilemma in the opening scenario?

What Are the Ethical Implications of Each Alternative?

Is the Alternative Legal? Illegal may not always be synonymous with unethical, but, as a general rule, you need to think long and hard about the ethics of any illegal activities.

How Would the Alternative Look in the Light of Day? If your activities were reported on the evening news, how would you feel? Proud? Embarrassed? Horrified? Undoubtedly, sexual harassment would be virtually eliminated if people thought that their parents, spouse, or partner would shortly see a video replay of the offending behavior.

What Are the Consequences of This Alternative? Ask yourself: Am I hurting anyone by this decision? Which alternative will cause the greatest good (or the least harm) to the most people? For example, you would like to fire an incompetent employee. That decision will

clearly have adverse consequences for him. But the other employees in your division will benefit and so will the shareholders of your company. You should look with a particularly critical eye if an alternative benefits you while harming others. Suppose that you become CEO of a company whose headquarters are located in a distant suburb. You would like to move the headquarters closer to your home to cut your commuting time. Of course, such a decision would be expensive for shareholders and inconvenient for other employees. Do you simply impose your will on the company or consider the consequences for everyone?

Does the Alternative Violate Important Values? In addition to consequences, consider fundamental values. It is possible to commit an act that does not harm anyone else, but is still the wrong thing to do. Suppose, for instance, that you are away from home and have the opportunity to engage in a one-night stand. You are absolutely certain that your spouse will never find out and your partner for the night will have no regrets or guilt. There would be no negative consequences, but you believe that infidelity is wrong, *regardless of the consequences*, so you resist temptation.

Some people question whether, as a diverse, heterogeneous society (not to mention, world), we have common values. But throughout history, and across many different cultures, common values do appear, such as: compassion, courage, fairness, integrity, responsibility, and self-control. Although reasonable people may disagree about a precise list of important values, most would agree that values matter. Try compiling your own list of values and then check it periodically to see if you are living up to it in your business and personal life.

An organization has responsibilities to customers, employees, shareholders, and society . . .

What Kind of World Would This Be if Everyone Behaved This Way? Is this the kind of world in which you would want to live? Imagine that you could cheat on an exam without getting caught. You might gain some short-term benefit—a higher grade. But what would happen if everyone cheated? The professor would have to make the exams harder or curve everyone's grade down. If your school developed a reputation for cheating, you might not be able to find a job after graduation. Cheating works only if most people are honest. To take advantage of everyone else's honesty is contemptible.

APPLYING THE ETHICS CHECKLIST: MAKING DECISIONS

An organization has responsibilities to customers, employees, shareholders, and society generally, both here and overseas. The purpose of this section is to apply the ethics checklist to business dilemmas. The checklist does not lead to one particular solution; rather it is a method to use in thinking through ethics problems. The goal is for you to reach a decision that satisfies you.

Organization's Responsibility to Society

Facts In the United States, teenagers routinely list alcohol commercials among their favorite advertisements. Adolescents who frequently see ads for alcohol are more likely to believe that drinkers are attractive, athletic, and successful. They are also more likely to drink, drink excessively, and drink in hazardous situations such as driving a car.

While Secretary of Health and Human Services, Louis W. Sullivan publicly denounced the test marketing of Uptown, a high-tar cigarette targeted at African Americans. He called it "contemptible that the tobacco industry has sought to increase their market" among minorities because this population was "already bearing more than its fair share of smoking-related illness and mortality." Comedian Jay Leno joked that R. J. Reynolds named the cigarette Uptown "because the word 'Genocide' was already taken."⁶

⁶ Richard W. Pollay, Jung S. Lee, and David Carter-Whitney, "Separate, but Not Equal: Racial Segmentation in Cigarette Advertising," *Journal of Advertising*, Mar. 1992, vol. 21, no. 1, p. 45.

At a time when doctors are concerned that too many children are fat, one-third of all advertisements shown during children's television programs are for just the sort of foods that encourage obesity: those high in fat, sugar, and salt but low in nutrition.

Critical Issues What are the obligations of advertising executives and marketing managers to those who see their ads? Is it ethical to entice teenagers into drinking or African Americans into smoking? If these ads sell product, is that justification enough?

Stakeholders Ad designers are primarily responsible to their firms and the firms' clients. After all, designers are paid to sell product, not to make the world a better place. But what about the people who see the advertisements? Do the designers have any responsibility to them? Or to society as a whole?

Alternatives Firms have at least four alternatives in dealing with issues of ethics in advertising. They can

- Ignore ethics and simply strive to create promotions that sell the most product, whatever the underlying message;
- Try, in a general way, to minimize racism, sexism, and other exploitation;
- Include, as part of the development process, a systematic, focused review of the underlying messages contained in their advertisements; or
- Refuse to create any ads that are potentially demeaning, insensitive, or harmful, recognizing that such a stand may lead to a loss of clients.

Ethical Implications All of these alternatives are perfectly legal. And, far from the ad executives being embarrassed if the ads see the light of day, the whole purpose of ads is to be seen. As for the consequences, the ads may help clients sell their products. But the ads may also harm those who see them. A manager might question whether these ads violate fundamental values. Are they showing consideration for others? Do they encourage self-control? Are they creating the kind of world in which the managers want to live?

EXAM Strategy

Question: Under Indian custom, many families pay a staggering dowry when their daughters marry. To avoid this burdensome debt, hundreds of thousands of pregnant women each year pay for an ultrasound to determine the gender of their fetus and then abort females. This practice has become such a problem that Indian law prohibits doctors from revealing a fetus's gender, but many doctors violate the law. In some areas of India, fewer than 800 girls are born for every 1,000 boys. General Electric Co. (GE) is the largest seller of ultrasound machines in the Indian market. Indeed, there is some evidence that GE targets doctors in small towns where this problem is most severe. If you were the head of the Ultrasound Division of GE, what would you do?

Strategy: Begin by reviewing the ethics checklist. Stakeholders include GE shareholders and citizens of India. Are there alternatives? What could GE do to ensure that its machines are not used improperly? What are the consequences? Thousands of young men without mates could lead to an increase in prostitution and perhaps even to social unrest, with worldwide implications. Is GE being a responsible member of the world community? Do managers want to live in a world in which female fetuses are aborted because of their gender? Are some values in conflict? If so, which values are most important?

Result: That is for you to decide.

Organization's Responsibility to Its Customers

In this chapter's opening scenario, landlord Sheldon Baskin faced a dilemma: his contract with the federal government was set to expire, so he would soon have the right to evict the poor and elderly tenants in Rienzi Plaza. What would you do if you were Baskin? What obligation does he have to the tenants? To his investors? Is it fair to them if he decides to subsidize the rents of low-income tenants? What about the community? Does it benefit from having elderly members? How will Baskin feel about himself if he puts these elderly tenants out on the street? Or if *The Wall Street Journal* runs a front-page article about his eviction plans? On the other hand, could he argue that it is the government's responsibility to house the poor and elderly? Is there any compromise solution?

Organization's Responsibility to Its Employees

When James Kilts became CEO of Gillette Co., the consumer products giant had been a mainstay of the Boston community for a hundred years. But the organization was going through hard times: Its stock was trading at less than half its peak price. In four short years, Kilts turned Gillette around—strengthening its brands, cutting jobs, and paying off debt. With its stock up 61 percent, Kilts had added \$20 billion in shareholder value.

Then suddenly Kilts sold Gillette to Procter & Gamble Co. (P&G) for \$57 billion. So short was Kilts's stay in Boston that he never moved his family from their home in Rye, New York. Shareholders benefited—the company's stock price went up 13 percent in one day. And so did Kilts—his payoff was \$153 million, including a \$36.5 million sweetener for having made the deal. In addition, P&G agreed to pay him \$8 million a year to serve as vice chairman after the merger. When he retires, his pension will be \$1.2 million per year. Moreover, two of his top lieutenants were paid a total of \$57 million.

Any downside to this deal? Four percent of the Gillette workforce—6,000 employees—were fired. If the payouts to the top three Gillette executives were divided among these 6,000, each unemployed worker would receive \$35,000. The loss of this many employees (4,000 of whom live in New England) had a ripple effect throughout the area economy. Although Gillette shareholders certainly benefited in the short run from the sale, their profit would have been even greater without this \$210 million payout to the executives. Moreover, about half the increase in Gillette revenues during the time that Kilts was running the show were attributable to currency fluctuations. A cheaper dollar increased revenue overseas. If the dollar had moved in the opposite direction, there might not have been any increase in revenue. Indeed, for the first two years after Kilts joined Gillette, the stock price declined. It wasn't until the dollar turned down that the stock price improved.

Should CEOs be paid so much when many employees will lose their jobs? One study found that CEOs who receive sweeteners negotiate a lower sale price than those who do not.⁷ But shareholders certainly profited during his tenure.

Organization's Responsibility to Its Shareholders

Staples, Inc. is the world's largest office products company. It also strives to be socially responsible. The company has prepared a document entitled "Staples Soul: It's what moves us" that reports on its corporate responsibility efforts. (This report is available at the company website.) For example, 20 percent of its energy consumption in the United States is from renewable sources. The company has reconfigured its fleet of vehicles to save 500,000 gallons of fuel a year. It donates to hundreds of worthy organizations. If you were a shareholder of Staples, would you approve of these efforts?

Milton Friedman, a Nobel Laureate in economics, famously observed, "The one and only social responsibility of business is to increase its profits."⁸ He argued that an executive should act

⁷ Mark Maremont, "No Razor Here: Gillette Chief to Get a Giant Payday," *Wall Street Journal*, Jan. 31, 2005, p. 1.

⁸ Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," *New York Times Magazine*, Sept. 13, 1970, p. 32.

for the benefit of the owners of the company. His primary responsibility is to them. If an individual wishes to support other responsibilities, such as a charity, a church, a city, or a country, let him do so with his own time and money, not that of the shareholders.

Look at some of the Staples corporate responsibility initiatives listed on its website. Is that how you would choose to spend your money? If you were a Staples shareholder, perhaps you would prefer to earn higher returns on your stock so that you could give money to other projects you consider more compelling. If the air needs to be cleaner or the schools richer, why shouldn't private donors or public institutions be responsible, not one company's shareholders?⁹

Reading deeper into the "Staples Soul" report, you would discover that the total giving to community organizations was \$26 million out of \$5.2 billion in revenue. Then you might have the opposite feeling—\$26 million out of \$5 billion? Should the company be *more* generous? How should companies balance their obligation to their shareholders and their world?

Organization's Responsibility Overseas

An American company's ethical obligations do not end at the border. What ethical duties does an American manager owe to stakeholders in countries where the culture and economic circumstances are very different?

Here is a typical story from Guatemala:

My father left home a long time ago. My mother supported me and my five brothers and sisters by selling tortillas and corn. Our house was a tin shack on the side of the road. We were crowded with all of us in one room. One day the police came and cleared us all out saying that we couldn't come back unless we paid rent. How could we afford that? I was 12 and my mother said it was time for me to work. Lots of other kids shine shoes or beg, but I heard that the maquila [clothing factory] was willing to hire children if we would work as hard as older people.

I can keep up with the grown-ups. We work from 6:00 in the morning to 6:30 at night, with half an hour break at noon. We have no other breaks the whole rest of the day. If I don't work fast enough, they hit me, not too hard, and threaten to fire me. Sometimes, if there is too much work to do, they'll lock the doors and not let us out until everything is finished. I earn \$30 a week and without that money, we would not have enough to eat. My mother hopes all of my brothers and sisters can get jobs in the factory, too. Of course, I'd rather be in school where I could wear a uniform and have friends. Then I could get a job as a clerk at the medical clinic. I would find people's files and tell them how long before the doctor could see them.¹⁰

This description paints a distasteful picture indeed: children being beaten as they work 12-hour days. Should American companies (and consumers) buy goods that are produced in sweatshop factories? Jeffrey Sachs, a leading economist and adviser to developing nations, says, "My concern is not that there are too many sweatshops but that there are too few."¹¹ Why would he support sweatshops and child labor?

Historically, poor children have worked to help support their family. In England in 1860, almost 40 percent of 14-year-old boys worked, and that was not just a few hours at Burger Box, but more likely 60 hours a week. That percentage is higher than in Africa or India today. For a child in a desperately poor family, the choice is not work or school, it is work, starvation, or prostitution.

Industrialization has always been the first stepping stone out of dire poverty—it was in England, it is now in the Third World. Eventually, higher productivity leads to higher wages. During the past 50 years, Taiwan and South Korea welcomed sweatshops while India resisted

⁹ See, for instance, David Henderson, "Misguided Virtue: False Notions of Corporate Social Responsibility," Hobart Paper 142, Institute of Economic Affairs, London, cited in *The Economist*, Nov. 17, 2001, p. 70.

¹⁰ Adapted from the *Boston Globe*, June 15, 1997.

¹¹ Allen R. Meyerson, "In Principle, a Case for More 'Sweatshops,'" *New York Times*, June 22, 1997, p. E5.

what it perceived to be foreign exploitation. Although all three countries started at the same economic level, Taiwan and South Korea today have much lower levels of infant mortality and much higher levels of education than India.¹²

When governments or customers try to force Third World factories to pay higher wages, the factory owners typically either relocate to lower wage countries or mechanize, thereby reducing the need for workers. In either case, the local economy suffers.

The difference, however, between the twenty-first and the nineteenth centuries is that now there are wealthy countries able to help their poorer neighbors. In the nineteenth century, England was among the richest countries, so it was on its own to solve its economic problems. Is America ethically obligated to assist the people around the world who live in abject poverty? Already, owing to pressure from activists, many companies have introduced better conditions in their factories. Workers are less likely to be beaten. They can go to the bathroom without asking permission. They might even receive rudimentary medical care. Manufacturing processes use fewer dangerous chemicals. Factories are cleaner, with better lighting and more ventilation. But hours are still long and wages low.

Many of these sweatshops produce clothing. As a consumer, how much would be you willing to pay in higher clothing prices to eliminate sweatshops and child labor? As a taxpayer, how much are you willing to pay in taxes to subsidize Third World incomes so that sweatshops and child labor are no longer necessary?

EXAM Strategy

Question: Many of America's largest consumer product companies, such as Wal-Mart, Nike, and Land's End, buy fabric produced in China by Fountain Set Holdings Ltd. Chinese government investigators recently discovered that Fountain Set has contaminated a local river by dumping dye waste into it. What responsibility do U.S. companies have to ensure safe environmental practices by overseas suppliers?

Strategy: Look at the ethics checklist. Citizens of China are stakeholders of American companies. Although it is legal to buy fabric from a company that is polluting overseas, this is surely information that Nike would not want to be well known. Does the company have values? What does its website say? Do any of us want to live in a world where Chinese children are poisoned so that our running shoes cost less?

Result: Do Wal-Mart and Nike have an obligation to source their products more carefully?

¹² The data in this and the preceding paragraph are from Nicholas D. Kristof and Sheryl WuDunn, "Two Cheers for Sweatshops," *New York Times Magazine*, Sept. 24, 2000, p. 70.

CHAPTER CONCLUSION

Even employees who are ethical in their personal lives may find it difficult to uphold their standards at work if those around them behave differently. Managers wonder what they can do to create an ethical environment in their companies. The surest way to infuse ethics throughout an organization is for top executives to behave ethically themselves. Few employees will bother to "do the right thing" unless they observe that their bosses value and support such behavior. To ensure a more ethical world, managers must be an example for others, both within and outside their organizations.