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BUSINESS ETHICS

Richard T. De George

Sixth Edition

SIXTH EDITION

BUSINESS ETHICS

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PREFACE

In the many years since the first edition of this book appeared, courses in business ethics have become firmly established in colleges, business schools, and MBA programs. Such courses took root in the post-Watergate era and were nurtured by successive exposés involving executive fraud, bribes and kickbacks, illegal political contributions, airplane disasters, and the sale of defective tires, automobiles, and other products. Consumerism, the cry for increased governmental control, and a changing attitude of large numbers of people toward business and its social responsibility have made questions of business ethics topics of general and current concern. Business ethics is no longer considered a contradiction in terms and most large corporations have taken measures to incorporate at least some of the trappings of ethics into their structures.

This book is an attempt to cover the field in a systematic and reasonably comprehensive way. It deals first with the techniques of moral reasoning and argumentation that are needed to analyze moral issues in business. It then raises basic questions about the morality of economic systems, especially that of the United States. It next discusses a variety of current and pressing moral issues in business from corporate governance to workers' rights to legitimate computer use. Because business has changed, this edition attempts to mirror the ethical issues raised by those changes, foremost of which are ethical questions that stem from information technology and the globalization of business.

This is not simply a book in general ethics that takes its examples from the business world. Ethics as a discipline has a long and venerable history. But students do not need to know that history, nor do they need to know the large number of disputed questions with which that discipline abounds, in order to engage in moral thinking. Moral issues are pressing, and people must grapple with them using the best tools available at the time. I try, therefore, to introduce the student to as much of the technical aspect of ethics as is necessary in order to approach moral issues intelligently and to take part in the ongoing debate about the morality of certain social and business practices. The aim of my initial chapters is a practical one, and to achieve this end I necessarily ignore or pass over lightly some of the theoretical issues on which much of contemporary professional ethical thought is focused. Students, I assume, come to classes in business ethics with a good deal of moral background. They are not nonmoral beings who must be made moral but rather moral beings who can be helped to think through moral issues and to argue cogently and effectively for their moral views. The present edition highlights how to apply the standard ethical approaches in analyzing issues, problems, and cases.

The traditional approach to ethics is an individualistic one. Our notions of morality, moral worth, and moral praise and blame have grown up primarily from consideration of the human person as a moral agent. We know what it means to call a person moral or his actions morally praiseworthy. The present edition adds the dimension of virtue, character, and caring to the discussion, three concepts that have taken on increasing importance in recent years. Yet economic systems do not act in a way comparable to the way human individuals act; and corporations and nations act only figuratively and through the agency of human intermediaries. Moral language must be used with care and caution when applied outside of the realm of human individuals and their actions. Special problems arise when considering the morality of corporations, nations, and people—problems that concern the meaning of moral terms, and problems that must be faced and clarified if we are to be clear about our moral judgments in these areas. I assume that there is little need to argue that murder is wrong, that stealing and lying are in general wrong, or that discrimination on the basis of sex, race, or creed is immoral in business as in other areas of life. There is no need therefore for a course in business ethics to arrive at or justify those conclusions. But many of the questions of business ethics that involve corporate governance, reverse discrimination, truth in advertising, whistle blowing, and disclosure, among others, are not clear-cut. They require careful analysis and a weighing of appropriate facts and applicable principles in order to arrive at justifiable answers. Our society is clearer on some of these issues than on others. I have tried to present the complexities of each problem and to weigh the opposing views on an issue. When I have taken sides, I have given my reasons for doing so; if an argument is inconclusive I have indicated where and why. On broad social issues no argument will be the final one, and my hope is that students using this text will, by reading it, be encouraged and emboldened to help continue and advance the public debate on these issues.

I do not think it is sufficient simply to identify moral problems in business, to determine what actions are right and wrong, and to demand that people be moral heroes in doing what is required of them. If practices are immoral and if people are faced with the obligation of sacrificing their jobs and their security to fulfill their moral obligations, then those practices should be changed. I therefore attempt not only to discuss what is morally required of a person in a firm—a worker, a manager, a member of the board of directors—but also what structures are conducive to a person's accepting moral responsibility and fulfilling his or her moral obligations. How firms can be reorganized so as to preclude the necessity for whistle blowing is as pressing (if not more pressing) a question as asking when a person is morally obliged to blow the whistle.

Business is a social activity and, like all social activity, could not function unless certain moral prerequisites were fulfilled. Recent experience in some of the states of the former Soviet Union has demonstrated this clearly. An analysis of needed prerequisites and of the social and business structures conducive to morality form, I believe, an important and frequently neglected aspect of business ethics. At each stage of investigation, therefore, I raise and attempt to answer not only the question of whether a particular practice is moral or immoral but also the question of what alternative can and should be pursued with respect to immoral practices. The morality of individuals should not be separated from the morality of business procedures and institutions, and in what follows I handle them together to the extent possible.

I start each chapter with a case or two that raises an issue pertinent to the contents of that particular chapter. I have also incorporated in a number of chapters actual and fictitious case studies to illustrate specific principles, to exemplify ways of analyzing moral problems, and to contrast varying approaches to an issue. For those who wish additional cases, the daily newspaper carries ample materials for analysis and current, specific, timely examples of moral issues in business.

Although I have written this book so that it develops a total view through successive chapters, each chapter can be studied apart from the others. Those who wish to omit the analysis of some issues and concentrate on a selected few can do so without a loss of intelligibility. Those wishing to read further on a topic will find suggestions in the footnotes and references to material on both sides of controversial questions.

Each chapter is followed by study questions that highlight the contents of the chapter and can be taken as a guide to the chapter. The questions also contain one or two cases or brief issues not explicitly covered in the chapter, which may be used for discussion, reflection, or written paper assignments. Each successive edition of this book has attempted to take into account the significant research that has appeared in the intervening years as well as the pertinent developments in business and society. The present edition of this book continues to do so. In addition to cases and footnotes, all the chapters have been updated, many have been significantly revised, and new cases have been added. The chapter order has been slightly changed. I have redone the chapters on accounting and finance and added a discussion of corporate governance and the Sarbanes-Oxley Act. The chapters on the Information Age and on Computers and the Internet are mostly new. The chapters on international business have all been redone in the light of globalization. Despite these changes, the book's aim, approach, and theme remain the same. American business can be made more moral. This book is an attempt to help its readers think about how this goal might be accomplished.

Because so much information is now available on the Internet, I have added many references to material found there. Although such references make going to the sources cited much easier for most users of the book, Web sites are notorious for disappearing and for dropping items that are no longer current. I have tried to use sources that were likely to continue to exist for a number of years to come, and all the references were current at the time of publication.

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Prentice Hall with ABC News is pleased to provide this collection of videos from ABC News' award-winning programs that relate the concepts of Business Ethics to real-life stories and events. The programs present substantial content that will work well in the classroom and give the student a deeper understanding of the application of Business Ethics in the workplace. The programs included are: *Enron; Unocal; AIDS; Microsoft Antitrust Trial; To Drill or Not to Drill; Ford and Firestone; Ralph's; Saipan.* The videos are available on CD-ROM and a copy of the CD-ROM is included in every new copy of the textbook. Questions pertaining to these videos are included in the Instructor's Manual.

I would like to thank the following reviewers for their helpful comments regarding this edition: Ira Sprotzer, Rider University; Scott D. Gelfand, Oklahoma State University; David A. Albrecht, Concordia University; and Phil Cox, University of Massachusetts at Dartmouth.

R. T. De George

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Introduction

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ETHICS AND BUSINESS

Horatio Alger and Stock Options

In the last decades of the nineteenth century the novels by Horatio Alger caught the imagination of young Americans. The stories presented a "rags to riches" plot, involving the energetic and dedicated work of the hero. The novels gave flesh to the widespread belief that America was the land of opportunity in which those who worked hard could make it big. Hard work and a little luck were all that was required.

The belief continued through the twentieth century in one form or another, despite the Great Depression and other evidence to the contrary. Oddly, alongside that belief was another contradictory one that anyone who was or became rich must have done so by unethical activity and behavior. The first belief received a perhaps unexpected impetus a hundred years after Horatio Alger in the newly developing high tech industry. Microsoft is the best known example. After its inception it soon became known for hiring only the brightest and most dedicated workers. It attracted them not by offering them generous wages. On the contrary, their pay was in many respects noncompetitive, and they were expected to work extremely hard and long hours. But they were given stock options—a perk usually reserved only for the top executives of companies. The stock options allowed them to buy the company's stock at a set price in the future, even if the stock had grown in value far beyond that price. And in its early years Microsoft grew at an incredibly fast rate. The result was a company with millionaire workers. At one point in the 1990s it was estimated that one out of every ten Microsoft employees was a millionaire. Horatio Alger's dream had been realized.

Stock options as a part of worker compensation had multiple benefits. Not only did it mean potentially huge gains for employees, but it also cut down on the expenses of the company. It allowed Microsoft to pay lower wages, and it did not have to count the options as part of its expenses. On the downside, giving away millions of options diluted the stock and hence the worth of the shares held by shareholders. But the stock appreciated so rapidly that shareholders did not seem to mind, and did not complain. If the technique helped the company grow and its shares increase in value, so much the better.

Beginning in 2000, however, the high tech bubble burst and the stock market, especially the stock of high tech companies plummeted. Options were no longer attractive, since the falling market made the exercise or strike price higher than the market price for shares. At companies like Microsoft, there began to be two levels of workers—those who had enjoyed the gravy train of growth and those hired later who did not. Some felt this was not fair to the latecomers. More generally, there were also two questions raised about the fairness of options. Since options were not counted as an expense, the financial reports of the company did not reflect its actual financial condition to potential investors. Second, even if the shareholders did not complain, the value of their stock was nonetheless diluted when the options were exercised. As of June 30, 2002, Microsoft had 1.6 billion options outstanding.[1]

In 2003, Mircosoft made headlines in many newspapers by announcing that it was discontinuing its employee stock option program, that it would start expensing any options it gave, and that it would introduce for its workers a stock plan, under which they would receive shares of restricted stock rather than options.[2] If the value of the stock decreased, the employees would still have the value of the stock at any given time. In the case of options, in the event of a decline below the strike price, the workers had nothing. In an up-market the workers would not gain as much as they might with stock options, but they would enjoy the increase enjoyed by all shareholders. The interests of the workers were therefore more closely linked with the interests of the shareholders. In good times both profited. In bad times both lost. But they did so together.

The decision was seen as being more equitable for workers and as better accounting, eliminating the questionable practice of not expensing options in the annual report and noting them only in a footnote. Some companies that used stock options for employees followed Microsoft's lead.

Not all companies followed Microsoft's lead. Some companies, once an employees stock options were "under water" or the strike price was below the market price and so worthless, repriced the old options with a new exercise price. The argument they presented was that unless they did so, they would lose their experienced employees. However, the options were originally intended as an incentive to work hard to raise the price of the stock. While it is true that if the options

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[1]Jathon Sapsford and Ken Brown, "Microsoft Pulls the Plug on Stock-Options Era," *The Wall Street Journal*, July 9, 2003, p. C1.

[2]Robert A. Guth and Joann S. Lublin, "Microsoft Ushers Out Era of Options," *The Wall Street Journal*, July 9, 2003, p. A1.