

*An Introduction to*  
**Business Ethics**

F o u r t h   E d i t i o n



Joseph DesJardins

AN INTRODUCTION TO  
BUSINESS  
ETHICS

Fourth Edition

Joseph DesJardins

College of St. Benedict/St. John's University





AN INTRODUCTION TO BUSINESS ETHICS, FOURTH EDITION

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# About the Author

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# Preface to the Fourth Edition

My overarching goal in the fourth edition of this text remains what it was for the first edition: "to provide a clear, concise, and reasonably comprehensive introductory survey of the ethical choices available to us in business." This book arose from the challenges encountered in my own teaching of business ethics. Over the years I have taught business ethics in many settings and with many formats. I sometimes relied on an anthology of readings, other times I emphasized case studies. I taught business ethics as a lecture course and in a small seminar. Most recently, I taught business ethics exclusively to undergraduates in a liberal arts setting. It is difficult to imagine another discipline that is as multidisciplinary, taught in as many formats and as many contexts, by faculty with as many different backgrounds and with as many different aims, as business ethics.

Yet, although the students, format, pedagogy, and teaching goals change, the basic philosophical and conceptual structure for the field remains relatively stable. There are a range of stakeholders with whom business interacts: employees, customers, suppliers, governments, society. Each of these relationships creates ethical responsibilities and every adult unavoidably will interact with business in several of these roles. A course in business ethics, therefore, should ask students to examine this range of responsibilities from the perspective of employee, customer, and citizen as well as from the perspective of business manager or executive. Students should consider such issues in terms of both the type of lives they themselves wish to lead and the type of public policy for governing business they are willing to support.

My hope was that this book could provide a basic framework for examining the range of ethical issues that arise in a business context. With this basic framework provided, individual instructors would then be free to develop their courses in various ways. I have been grateful to learn that this book is being used in a wide variety of settings. Many people have chosen to use it as a supplement to the instructor's own lectures, an anthologized collection of readings, a series of case studies, or some combination of all three. Others have chosen to use this text to cover the ethics component of another course in such business-related disciplines as management, marketing, accounting, human resources. The book also has been used to provide coverage of business-related topics in

more general courses in applied or professional ethics. I take this variety of uses as evidence that the first edition was reasonably successful in achieving its goals.

## NEW TO THE FOURTH EDITION

In response to the advice of many friends and colleagues who have been using this book in their own classes, this fourth edition has made the following changes:

- Every chapter begins with a new, or significantly revised and updated, discussion case. All of these changes involve cases that have developed in the years since the previous edition, including cases on Bernard Madoff, AIG, subprime lending, predatory lending, Steve Jobs, and Google in China.
- Sustainability topics have been more widely integrated throughout the text, including a new sustainability section in chapter 5 on corporate social responsibility and a sustainability-focused discussion case on marketing in chapter 8.
- Many new cases include material and topics arising from the recent financial meltdown, making this edition more timely and relevant.
- New sections include a model for ethical decision making, philanthropic CSR, and a business case for sustainability.

Another bit of advice that I received, as consistent as it was challenging, was to add this new material without making the book longer or more cumbersome. It has been gratifying to learn that readers have found the book clearly written and accessible to students unfamiliar with the field. To achieve these goals, I have deleted some outdated cases and worked to improve the clarity of the more philosophical sections, especially within chapter 2's discussion of ethical theory.

Readers of previous editions will find a familiar format. Each chapter begins with a discussion case developed from actual events. The intent of these cases is to raise questions and get students thinking and talking about the ethical issues that will be introduced in the chapter. The text of each chapter then tries to do three things:

- Identify and explain the ethical issues involved;
- Direct students to an examination of these issues from the points of view of various stakeholders; and
- Lead students through some initial steps of a philosophical analysis of these issues.

The emphasis remains on encouraging student thinking, reasoning, and decision making rather than on providing answers or promoting a specific set of conclusions. To this end, a new section on ethical decision making at the end of chapter 1 provides one model for decision making that might prove useful throughout the remainder of the text.



## ACKNOWLEDGMENTS

As with previous editions, my greatest debt in writing this book is to those scholars engaged in the academic research of business ethics. I tried to acknowledge their work whenever I relied on it in this text, but in case I have missed anyone I hope this general acknowledgment can serve to repay my debt to the business ethics community. I also acknowledge three members of that community who deserve special mention and thanks. My own work in business ethics has, for over 20 years, benefited from the friendships of John McCall, Ron Duska, and Laura Hartman. They will no doubt find much in this book that sounds familiar. Twenty years of friendship and collaboration tends to blur the lines of authorship, but it is fair to say that I have learned much more from John, Ron, and Laura than they from me.

Previous editions have also benefited from the advice of a number of people who read and commented on various chapters. In particular, I would like to thank Norman Bowie, Ernie Diedrich, Al Gini, Patrick Murphy, Denis Arnold, and Christopher Pynes.

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# 1 CHAPTER

## Why Study Ethics?



### LEARNING OBJECTIVES

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*After reading this chapter, you will be able to:*

- Identify reasons why the study of ethics is important;
  - Explain the nature and meaning of business ethics;
  - Explain the difference between ethical values and other values;
  - Clarify the difference between ethics and the law;
  - Describe the distinction between ethics and ethos;
  - Distinguish between personal morality, virtues, and social ethics;
  - Identify ethical issues within a case description.
-

## DISCUSSION CASE: Bernard Madoff's Ponzi Scheme

One of the largest financial frauds in history came to an end late in 2008 when Bernard Madoff was arrested and charged with operating a major Ponzi scheme through his wealth management company. Madoff pleaded guilty to 11 counts of financial fraud and theft in March 2009 and three months later was sentenced to 150 years in prison. Madoff's fraud was thought to have cost clients more than \$10 billion.

A Ponzi scheme is a fraud that attracts investors with a promise of high returns, which are initially paid out from the investments made by subsequent clients rather than from legitimate profits made from the initial investment. The success of these initial investments entices future investors, and in many cases reinvestment from the original investors. Because the returns are based on the ability to attract future investors into the scheme rather than on legitimate earnings, the scheme can last only as long as the perpetrator is able to attract an increasing number of investors, all of whom expect higher-than-normal returns. A Ponzi scheme is likened to a house of cards that is destined to collapse whenever the flow of money into the scheme declines. The perpetrator benefits either by disappearing with the money before the system collapses or, as in the case of Madoff, living a wealthy lifestyle by skimming money from the significant cash flow generated by the fraud.

The size of Madoff's fraud was only one reason why this case attracted significant media attention. Madoff and his family were also prominent public figures—Madoff was former chairman of the NASDAQ stock exchange—and well-known as very generous philanthropists. The fraud also involved his family; Madoff's wife, two sons, and brother were all implicated in the case. Many of his victims were also prominent people, many were personal friends, and several charitable organizations lost significant money in the fraud.

Another aspect of this case involved the role, many would say the complete failure, of government regulators. Starting as early as 1992, the Securities and Exchange Commission (SEC) had received complaints and tips about Madoff's investments. In most cases, the SEC either didn't investigate or failed to follow through on a cursory investigation. A report issued by the SEC's own inspector general in September 2009 concluded, "Despite numerous credible and detailed complaints, the SEC never properly examined or investigated Madoff's trading and never took the necessary, but basic, steps to determine if Madoff was operating a Ponzi scheme." Coming as it did in the midst of the financial meltdown and recession of 2008–2009, this failure of government regulators was another reminder of the limitations of legal regulations in providing sufficient oversight to unethical business practices.

Madoff apologized at his sentencing, telling the judge: "I am responsible for a great deal of suffering and pain. I understand that. I live in a tormented state now knowing of all the pain and suffering that I have created. I have left a legacy of shame, as some of my victims have pointed out, to my family and my grandchildren. That's something I will live with for the rest of my life. . . . That is a horrible guilt to live with. There is nothing I can do that will make anyone



feel better for the pain and suffering I caused them, but I will live with this pain, with this torment for the rest of my life. I apologize to my victims. I will turn and face you. I am sorry. I know that doesn't help you. Your Honor, thank you for listening to me."

## DISCUSSION QUESTIONS

1. Identify what ethical issues and questions are involved in the Madoff case.
2. Identify all the people you think may have been harmed, and how they were harmed, by the Madoff fraud.
3. Do you think that a scandal such as this is the result mostly of unethical individuals, or are there organizational issues that allowed, encouraged, or were responsible for the harms? To what degree was this case mostly a failure of individuals, or organizational structure, or of government?
4. Can you imagine anything that would have prevented the Madoff fraud?

### 1.1 WHY STUDY BUSINESS ETHICS?

Why should anyone study business ethics? The short answer is that a class in business ethics should not aim simply to help you learn *about* ethics, but it should also aim to help you *do* ethics. That is, the goal of business ethics is more than just teaching and learning about what happens in business. The goal is also to help each of us become more ethical and to help us all create and promote ethical institutions. We can achieve these goals by developing three intellectual capacities: a *better understanding* of ethical issues, a more finely tuned set of *analytical skills* with which to evaluate ethical issues, and a *refined sensitivity* to appreciate the significance of leading an ethical life.

But as recently as the mid-1990s, articles in such major publications as the *Wall Street Journal*, the *Harvard Business Review*, and *U.S. News and World Report* questioned the value of teaching classes in business ethics. Throughout the 1980s and 1990s, this skeptical attitude was as common among business practitioners as it was among students. Few disciplines faced the amount of skepticism that commonly confronted courses in business ethics. Many students believed that, like "jumbo shrimp," business ethics was an oxymoron. Many also viewed ethics as a mixture of sentimentality and personal opinion that would interfere with the efficient functioning of business. After all, who's to say what's right or wrong?

Yet a great deal has changed since then. Beginning in 2001 with the collapse of Enron and Arthur Andersen hardly a month has gone by without a major corporate ethical scandal making headlines. In just the first five years of the twenty-first century, a wave of ethical scandals swept through the corporate world as fraudulent and dishonest practices were uncovered at such firms as WorldCom, Tyco, Aldelphia, Global Crossing, Health South, Qwest, Merrill



Lynch, Citigroup Salomon Smith Barney, Parmalat, Marsh and McLennan, Credit Suisse First Boston, and even the New York Stock Exchange itself. Since the last edition of this text was written in 2007, that list has grown to include such cases as AIG, Bernard Madoff, the financial industry's subprime lending practices, and Fannie Mae and Freddie Mac. Risky investment and lending practices that bordered on incompetence if not malfeasance led to the collapse of such firms as Lehman Brothers, Countrywide Financial, Merrill Lynch, Bear Stearns, Washington Mutual, and Wachovia.

At the start of the second decade of the twenty-first century, today's questions are less about *why* or *should* ethics be a part of business, than about *which* ethics should guide business decisions and *how* ethics can be integrated within business.<sup>1</sup> Students unfamiliar with ethical issues will find themselves as unprepared for careers in business as students who are unfamiliar with accounting and finance. Indeed, it is fair to say that students will not be fully prepared even within fields such as accounting, finance, human resource management, marketing, and management unless they are familiar with the ethical issues that arise specifically within those fields. You simply will not be prepared for a career in accounting, finance, or any area of business if you are unfamiliar with the ethical issues of these fields.

Why has this change come about? To answer this question, consider the phrase used to describe the potential collapse of AIG and other large financial institutions: "too big to fail." This phrase was used to justify the need for trillions of dollars of U.S. government guarantees and bailouts that were used to avoid a more significant economic collapse in 2008–2009. It is not an exaggeration to say that ethical failures have been responsible for some of the most dramatic business failures in the last decade, and that these business failures in turn can jeopardize the economic well-being of the entire country.

On a smaller scale, consider the people who were harmed by the Madoff Ponzi scheme. Investors lost tens of billions of dollars. Hundreds of innocent employees lost their jobs, their retirement funds, and their health care benefits. Innocent charities suffered when they lost their endowments or were asked to return donations made by the Madoffs in a legal process to recover funds for his victims. The wider New York community was also hurt by the loss of a major community benefactor. Families of employees and investors were also hurt. Many of the individuals directly involved will themselves suffer criminal and civil punishment, including jail sentences for some. Indeed, it is hard to imagine anyone who was even loosely affiliated with Madoff who did not suffer harm as a result of his ethical failings. Multiply these harms by the dozens of other companies implicated in similar scandals and one gets an idea of why ethics is no longer dismissed as irrelevant. The consequences of unethical behavior and unethical business institutions are too serious to be ignored.

Today, business managers have many reasons to be concerned with the ethical standards of their organizations. Perhaps the most straightforward reason is that the law requires it. In 2002, the U.S. Congress passed the Sarbanes-Oxley Act to address the wave of corporate and accounting scandals. Section 406 of that law, "Code of Ethics for Senior Financial Officers," requires that

corporations have a code of ethics “applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.” The code must include standards that promote:

1. honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and
3. compliance with applicable governmental rules and regulations.

Beyond these specific legal requirements, contemporary business managers have many other reasons to be concerned with ethical issues. Unethical behavior not only creates legal risks for a business, it creates financial and marketing risks as well. Managing these risks requires managers and executives to remain vigilant about their company's ethics. It is now more clear than ever that a company can lose in the marketplace, it can go out of business, and its employees can go to jail if no one is paying attention to the ethical standards of the firm. Ethical behavior and an ethical reputation can provide a competitive advantage, or disadvantage, in the marketplace and with customers, suppliers, and employees. Consumer boycotts based on allegations of unethical conduct have targeted such well-known firms as Nike, McDonald's, Home Depot, Gap, Shell Oil, Levi-Strauss, Donna Karen, K-Mart, and Walmart. Managing ethically can also pay significant dividends in organizational structure and efficiency. Trust, loyalty, commitment, creativity, and initiative are just some of the organizational benefits that are more likely to flourish within ethically stable and credible organizations.

In 2003, Deloitte polled 5,000 directors of the top 4,000 publicly traded companies and reported that 98 percent believed that an ethics and compliance program was an essential part of corporate governance. Over 80 percent had developed formal codes of ethics beyond those required by Sarbanes-Oxley, and over 90 percent included statements concerning the company's obligations to employees, shareholders, suppliers, customers, and the community at large in their corporate code of ethics.<sup>2</sup> In practice, if not yet in theory, corporate America has adopted the stakeholder model of corporate social responsibility. Contemporary business now takes seriously its ethical responsibilities to a variety of stakeholders other than its shareholders.

For business students, the need to study ethics should now be as clear as the need to study the other subfields of business education. Without this background, students will be unprepared for a career in contemporary business. But even for students not anticipating a career in business management or business administration, familiarity with business ethics is just as crucial. It was not, after all, only Bernard Madoff himself who suffered because of his unethical behavior. Our lives as employees, as consumers, as citizens are effected by decisions made within business institutions, and therefore everyone has good reasons for being concerned with the ethics of those decision makers.

The case for ethics is by now clear and persuasive. Business must take ethics into account and integrate ethics into its organizational structure. Students