Contents

TO THE INSTRUCTOR .............................................................................................................................. v
SYLLABUS .............................................................................................................................................. vii

CHAPTER RESOURCES
CHAPTER 1 – THE IMPORTANCE OF BUSINESS ETHICS ................................................................. 1
CHAPTER 2 – STAKEHOLDER RELATIONSHIPS, SOCIAL RESPONSIBILITY, AND CORPORATE GOVERNANCE ........................................................................................................... 8
CHAPTER 3 – EMERGING BUSINESS ETHICS ISSUES ................................................................. 14
CHAPTER 4 – THE INSTITUTIONALIZATION OF BUSINESS ETHICS ............................................... 20
CHAPTER 5 – ETHICAL DECISION MAKING AND ETHICAL LEADERSHIP ................................ 26
CHAPTER 6 – INDIVIDUAL FACTORS: MORAL PHILOSOPHIES AND VALUES ................................ 31
CHAPTER 7 – ORGANIZATIONAL FACTORS: THE ROLE OF ETHICAL CULTURE AND RELATIONSHIPS ................................................................. 36
CHAPTER 8 – DEVELOPING AN EFFECTIVE ETHICS PROGRAM ............................................... 41
CHAPTER 9 – MANAGING AND CONTROLLING ETHICS PROGRAMS ........................................... 46
CHAPTER 10 – GLOBALIZATION OF ETHICAL DECISION MAKING ........................................... 54

CASE NOTES
GUIDELINES FOR BUSINESS ETHICS CASE ANALYSIS ................................................................. 61
CASE 1 – MONSANTO ATTEMPTS TO BALANCE STAKEHOLDER INTERESTS .................................. 62
CASE 2 – STARBUCKS’ MISSION: SOCIAL RESPONSIBILITY AND BRAND STRENGTH ............... 67
CASE 3 – WALMART: THE FUTURE IS SUSTAINABILITY ................................................................. 70
CASE 4 – BP STRUGGLES TO RESOLVE SUSTAINABILITY DISASTER ............................................ 76
CASE 5 – NEW BELGIUM BREWING: ETHICAL AND ENVIRONMENTAL RESPONSIBILITY ........... 80
CASE 6 – COPING WITH FINANCIAL AND ETHICAL RISKS AT AMERICAN INTERNATIONAL GROUP (AIG) ......................................................................................................................... 82
CASE 7 – MICROSOFT MANAGES LEGAL AND ETHICAL ISSUES .................................................... 88
CASE 8 – COUNTRYWIDE FINANCIAL: THE SUBPRIME MELTDOWN ............................................ 91
CASE 9 – ENRON: QUESTIONABLE ACCOUNTING LEADS TO COLLAPSE ...................................... 95
CASE 10 – HOME DEPOT IMPLEMENTS STAKEHOLDER ORIENTATION .................................... 102
CASE 11 – THE FRAUD OF THE CENTURY: THE CASE OF BERNARD MADOFF .................................. 105
CASE 12 – INSIDER TRADING AT THE GALLEON GROUP ............................................................. 107
CASE 13 – GLAXOSMITHKLINE EXPERIENCES HIGH COST OF PRODUCT QUALITY ISSUES ........ 110

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CASE 14 – HOSPITAL CORPORATION OF AMERICA: LEARNING FROM PAST MISTAKES? ..........113
CASE 15 – THE COCA-COLA COMPANY STRUGGLES WITH ETHICAL CRISSES .........................115
CASE 16 – RECREATION EQUIPMENT INCORPORATED (REI): A RESPONSIBLE RETAIL COOPERATIVE ............................................................................................................................118
CASE 17 – BETTER BUSINESS BUREAU: PROTECTING CONSUMERS AND DEALING WITH ORGANIZATIONAL ETHICS CHALLENGES .................................................................121
CASE 18 – THE AMERICAN RED CROSS FACES ORGANIZATIONAL CHALLENGES ....................124
CASE 19 – NIKE: MANAGING ETHICAL MISSTEPS—SWEATSHOPS TO LEADERSHIP IN EMPLOYMENT PRACTICES ..............................................................................................................127
CASE 20 – BEST BUY FIGHTS AGAINST ELECTRONIC WASTE ..................................................129

BEHAVIORAL SIMULATIONS FOR CLASS EXERCISES

WHY USE SIMULATIONS? .................................................................133
INSTRUCTIONS FOR CLASSROOM USE .........................................................134
SIMULATION ONE: SOY-DRI ........................................................................137
SIMULATION TWO: NATIONAL FARM AND GARDEN ......................................146
SIMULATION THREE: VIDEOPOLIS ...............................................................157
SIMULATION FOUR: SEXUAL HARASSMENT: CORDOZA V. FOODSERVICE, INC., CREATIVE MARKETING SOLUTIONS, AND HARRISON ..........................................................167
SIMULATION FIVE: DEER LAKE MARINA: FOREVER PROUD? ..............................175
SIMULATION SIX: PARCEL INTERNATIONAL EXPRESS .........................................180

SUPPLEMENTAL/EXAMINATION CASES

SUPPLEMENTAL CASE 1 – GREAT STATE WHEAT FLAKES CAN’T BE BEAT .................188
SUPPLEMENTAL CASE 2 – ACME TITLE PAWN ....................................................193
SUPPLEMENTAL CASE 3 – THE PLAYSKOOL TRAVEL-LITE CRIB .........................197
To the Instructor

This *Instructor’s Resource Manual for Business Ethics: Ethical Decision Making and Cases*, Ninth Edition, by O. C. Ferrell, John Fraedrich, and Linda Ferrell is designed to assist the instructor teaching from our text. We provide the following teaching aids:

- **Detailed lecture outlines** to guide class lectures. The outlines can be used to quickly review a chapter before class or to gain an overview of the entire book.
- A **syllabus guide** with suggestions for using the text materials in a business ethics class.
- Guides to discussing “An Ethical Dilemma” (chapter-opening scenarios), Debate Issues, and “Resolving Ethical Business Challenges” (end-of-chapter minicases).
- **Case notes**, which provide additional insight about the cases, will help you evaluate or lead case analysis and discussions. We do not suggest answers to the case questions in the text, but our notes should help you identify key issues, alternatives, and insights to critical thinking.
- **Role-play exercises** for class simulations of ethical dilemmas. These role-playing exercises are designed to help students understand the real world challenges of ethical decision making. We provide both options for implementation and teaching overviews for the six simulations.
- Three **additional cases** for classroom purposes. In addition to the cases in the textbook, we provide three additional cases in this manual: “Great State Wheat Flakes Can’t Be Beat,” “Acme Title Pawn,” and “The Playskool Travel-Lite Crib.”
- **Case notes for online minicases.** The ninth edition also features five additional minicases that are available online.
- Even more cases can be accessed through the Aspen Institute’s website www.caseplace.org. As of publication, these cases were free of charge and dealt with ethics and social responsibility issues in organizations.
- **Videos** on ethics and social responsibility topics, 15 of which are new to this edition and 11 are classic cases. Each was selected to complement the material in the textbook and cases and help to bring real-world examples and skill-building scenarios into the classroom.
- **ProfessorJournal.com.** Go to this website to sign up for the *Wall Street Journal* online Educator’s Reviews. These reviews, written by O.C. Ferrell, are designed to help you easily integrate *Journal* content into your classes. Each review highlights three *Wall Street Journal* articles and includes article summaries, discussion questions, and WSJ.com links. These email reviews are sent out weekly. Members can also access an archive of past article selections.
- Go to http://www.e-businessethics.com and http://danielsethics.mgt.unm.edu/ to access additional teaching resources such as PowerPoint presentations, articles, cases, debate issues, an online teaching business ethics resource manual, among other useful information.

The *Instructor’s Resource Manual* provides a flexible menu of material to assist you, depending on your goals and time schedule. For instructors using the book as a supplement in Business and Society, Business Policy, Marketing Strategy, Accounting, or other management, marketing, or finance courses,
we suggest several alternatives. Instructors who spend only a few weeks covering business ethics may incorporate a combination of lectures from the chapters along with an examination. We suggest that instructors who want to cover business ethics, but do not have the class time, have students read the book, then use objective or essay test items to evaluate student comprehension.

Instructors using this book in Business Ethics courses should enhance learning by covering as many elements of the Business Ethics text as possible. Our case notes do not provide specific right or wrong solutions, but rather provide additional insights that should help you with the case discussions in class. By encouraging discussions of material from the text and the cases, an intelligent dialogue can emerge that should focus on approaches to ethical decision making, not the emotional aspects of personal ethical beliefs. Each chapter has “An Ethical Dilemma” at the beginning and “Resolving Ethical Business Challenges” at the end. The questions accompanying each of these elements should stimulate discussion. Students should be encouraged to discuss the ethical issues raised by these dilemmas and situations, and relate the issues to the material in the chapter.

The simulation role-play exercises allow students to assume various roles within an organization and to operate as representatives of different functional areas in order to assist in addressing specific ethical issues. The simulations require minimal instructor effort to implement and allow students to utilize their creative problem solving skills in real-world situations. Since these are designed as “pen and paper” exercises, there is no need for computer access or outside research. If you have never used a simulation exercise, we highly encourage you to try it. As it actively engages the students, we think you will find it to be an effective teaching device. Business ethics issues often require a rapid strategic response from an organizational group or team. These exercises simulate this experience, and students are given an opportunity to apply the concepts discussed in class.

Business ethics is a fairly new area of discovery for many students and instructors. While it is one of the most important business topics today, there are many different points of view on the best way to teach business ethics in class (whether it should be a stand-alone course or incorporated into other courses). We believe that business ethics can be covered in class just like other business courses. Our goal is to give you the freedom to add your own perspective to our teaching materials.

We sincerely appreciate the extreme diligence of Jennifer Jackson in developing and editing the material in the Instructor’s Resource Manual, updating the material in the test banks, updating and editing the PowerPoint presentations, and developing the online interactive quizzes. Jennifer Sawayda and Harper Baird deserve special thanks for their help in editing and updating the 9th edition of this book, the cases, and the online minicases.

We want to do our best to provide teaching materials that enhance the study of business ethics. Your suggestions will be sincerely appreciated. Please feel free to contact the authors to discuss teaching business ethics, the material in the text, or the Instructor’s Resource Manual.

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SYLLABUS

Business Ethics

SYLLABUS GUIDE
Instructor:
Office Location:
Phone:
Office Hours:

TEXT

READINGS FROM BUSINESS ETHICS JOURNALS

INTERNET RESOURCES
1. Ferrell/Fraedrich/Ferrell *Business Ethics* Companion Site
   - Go to http://www.cengage.com
   - Select “Management” and then “Ethics”
   - Select Ferrell/Fraedrich/Ferrell BUSINESS ETHICS from the textbook sites menus
2. Links to current resources, additional centers, articles, training materials and more are available at www.e-businessethics.com
4. AACSB Ethics Education Resource Center: www.aacsb.edu

READING FROM THE POPULAR PRESS

OBJECTIVES
1. Study the business ethics issues and definitions, theories, and frameworks important to organizational ethical decision making.
2. Identify the role of stakeholder interests and recognize ethical issues in business.
3. Understand the interrelationship of ethics and social responsibility.
4. Relate the significant issues of an ethical controversy in business to moral philosophy, work group influence, corporate culture, and social responsibility.
5. Choose and defend a theory or principle for resolving an ethical dispute in business.
7. Examine the consequences of unethical and ethical business decisions.
8. Expose students to the individual reasoning processes of others when resolving ethical dilemmas.
9. Understand the role of corporate governance and corporate culture in ethical decision making.
10. Evaluate the role of organizational ethics programs and understand the importance of implementing and auditing ethics and compliance programs.
12. Understand the role of ethical leadership in developing an ethical organizational climate.
13. Understand the benefits of strong ethics and compliance initiatives in terms of customer satisfaction, employee retention, and public relations.
14. Allow students to experience current ethical dilemmas through cases and role-play exercises.

CLASS SYLLABUS
To view alternative approaches to teaching this class, please access the Instructor’s website for class syllabi.
CHAPTER 1

The Importance of Business Ethics

SUMMARY
This chapter provides an overview of the field of business ethics. It develops a definition of business ethics and discusses why it has become an important topic in business education. It also examines the evolution of business ethics in North America and explores the benefits of ethical decision making in business. Finally, the chapter provides a framework for examining business ethics in this text.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
This Ethical Dilemma focuses on financial trading and its often-murky rules. Bull Steins (BS) hired John Peters because of his stellar record of getting good results, not because of his strong ethical standards. John’s investment strategies worked well every time, to the point where other investment brokers began to imitate his approach. Initially, none of John’s actions were outright illegal because he had years of experience and knew where to draw the line. However, his lifestyle grew out of control with continued success. John’s expense account for wooing his clients, which he paid for out of his own pocket, began to get very expensive. He also had new family responsibilities and a new house to worry about. On top of all of these outside issues, John was supposed to be training new hires at his job. It was John’s responsibility to oversee and train these new hires, but because other issues distracted him, he let those new hires trade as they saw fit. Since they had limited experience and poor training in the code of ethics and conduct of the company, these new hires made some trades that looked to the SEC like insider trading. Since John was supposed to be supervising their actions, he fears that the SEC will find him liable. Furthermore, John’s personal successes had gotten to his head, causing him to make some risky and potentially illegal trades.

LECTURE OUTLINE
I. Business Ethics Defined
   A. Business ethics is a complicated and controversial topic. Highly visible business ethics issues influence the public’s attitudes toward business and can destroy trust.
      1. The field of business ethics concerns questions about whether specific business practices are acceptable.
      2. Business ethics is controversial and there is no universally accepted approach for resolving ethical issues.
      3. Values and judgments play a critical role in the making of ethical decisions.
   B. Some special aspects must be considered when applying ethics to business.
      1. Businesses must earn a profit to survive, but these profits should not come from misconduct.
      2. Businesses must balance their desires for profits against the needs and desires of society.
      3. Maintaining a balance in business often requires compromises or tradeoffs.
   C. Business ethics comprises the principles, values, and standards that guide behavior in the world of business.
   D. Principles are specific and pervasive boundaries for behavior that are universal and absolute.
   E. Values are used to develop norms that are socially enforced.
Chapter 1: The Importance of Business Ethics

1. Investors, employees, customers, interest groups, the legal system, and the community often determine whether a specific action is right or wrong and ethical or unethical.

II. Why Study Business Ethics?
   A. A Crisis in Business Ethics
      1. Ethical misconduct is a major business concern, and organizations are under greater scrutiny than ever by stakeholders.
      2. Misuse of company resources, abusive behavior, harassment, accounting fraud, conflicts of interest, defective products, bribery, and employee theft are all problems cited as evidence of declining ethical standards in business and in other areas like government or sports. Misconduct can occur in any organization.
      3. Regardless of what an individual believes about a particular action, if society judges it to be unethical or wrong, whether correctly or not, that judgment directly affects the organization’s ability to achieve its business goals.
   B. Reasons for Studying Business Ethics
      1. Studying business ethics is valuable for several reasons.
         a. Business ethics is not merely an extension of an individual’s own personal ethics—an individual’s personal values and moral philosophies are only one factor in the ethical decision-making process.
         b. Being a good person with sound personal ethics is not sufficient to handle the ethical issues that arise in a business organization.
         c. Business strategy decisions involve complex and detailed discussions. A high level of personal moral development may not prevent an individual from violating the law in an organizational context.
         d. The values people learn from family, religion, and school may not provide specific guidelines for complex business decisions.
      2. Studying business ethics helps businesspeople begin to identify ethical issues, recognize the approaches available to resolve them, learn about the ethical decision-making process and ways to promote ethical behavior, and begin to understand how to cope with conflicts between personal values and organizational values.

III. The Development of Business Ethics
   A. Before 1960: Ethics in Business
      1. Prior to 1960, the United States went through several phases questioning the concept of capitalism.
         a. In the 1920s, the progressive movement sought to provide citizens with a “living wage,” or income sufficient for education, recreation, health, and retirement.
         b. In the 1930s, the New Deal specifically blamed business for the country’s economic woes. Businesses were asked to work more closely with the government to raise family income.
         c. By the 1950s, the New Deal had evolved into the Fair Deal, defining such matters as civil rights and environmental responsibility as ethical issues that businesses had to address.
      2. Until 1960, ethical issues related to business were discussed within the domain of theology or philosophy.
         a. Catholic social ethics included concern for morality in business, workers’ rights, and living wages, for humanistic values, and for improving the conditions of the poor.
         b. Protestants and other religions developed ethics courses in schools of theology and addressed issues concerning morality and ethics in business.
         c. Religious traditions provided a foundation for the future field of business ethics, with each religion applying its moral concepts not only to business but also to government, politics, family, personal life, and all other aspects of life.
1. American society turned to causes such as consumerism. An antibusiness attitude developed as critics attacked the perceived vested interests that controlled both the economic and political sides of society—the so-called military-industrial complex.

2. The 1960s saw the decay of inner cities and the growth of ecological problems.

3. The rise of consumerism—activities undertaken by independent individuals, groups, and organizations to protect their rights as consumers—began, and President John F. Kennedy outlined a Consumers’ Bill of Rights (the right to safety, the right to be informed, the right to choose, and the right to be heard).

4. The modern consumer movement has roots in 1965 and Ralph Nader’s Unsafe at Any Speed. His group fought successfully for consumer-protection legislation.

5. President Johnson’s Great Society told the business community that the U.S. government’s responsibility was to provide the citizen with some degree of economic stability, equality, and social justice. Activities that could destabilize the economy or discriminate against any class of citizens began to be viewed as unethical and unlawful.

C. The 1970s: Business Ethics as an Emerging Field

1. Business professors began to teach and write about corporate social responsibility: an organization’s obligation to maximize its positive impact on stakeholders and to minimize its negative impact.

2. Philosophers applied ethical theory and philosophical analysis to structure the discipline of business ethics.

3. As social demands grew, many businesses realized that they had to address ethical issues more directly.


5. Major business ethics issues emerged by the late 1970s, such as bribery, deceptive advertising, price collusion, product safety, and the environment.

6. Academic researchers sought to identify ethical issues and to describe how businesspeople might choose to act in particular situations.

D. The 1980s: Consolidation

1. Business ethics became a legitimate field of study. Membership in business ethics organizations increased, while centers of business ethics provided publications, courses, conferences, and seminars.

   a. Many firms established ethics and social policy committees to address ethical issues.

2. The Defense Industry Initiative on Business Ethics and Conduct (DII) was developed to guide corporate support for ethical conduct. The DII includes six principles:

   a. Development and distribution of understandable, detailed codes of conduct.

   b. Provision of ethics training and development of communication tools to support the periods between training.

   c. Creation of an open atmosphere in which employees feel comfortable reporting violations, without fear of retribution.

   d. Performance of extensive internal audits and development of effective internal reporting and voluntary disclosure plans.

   e. Preservation of the integrity of the defense industry.

   f. Adoption of a philosophy of public accountability.

3. The Reagan/Bush era ushered in the belief that self-regulation, rather than regulation by government, was in the public’s best interest.

E. The 1990s: Institutionalization of Business Ethics

1. The Clinton administration continued to support self-regulation and free trade, although it strengthened regulation in some areas like health-related social issues.

2. The Federal Sentencing Guidelines for Organizations, which were based on the six principles of the Defense Industry Initiative, codified into law incentives to reward
organizations for taking action, such as developing effective internal legal and ethical compliance programs, in order to prevent misconduct.

a. The guidelines mitigate penalties for businesses that strive to minimize misconduct and establish high ethical and legal standards.

b. Under the FSGO, if a company lacks an effective ethical compliance program and its employees violate the law, it can incur severe penalties.

c. The guidelines focus on firms taking action to prevent and detect business misconduct in cooperation with government regulation.

d. Chapters 4 and 8 will provide more detail on the FSGO’s role in business ethics programs.

F. The Twenty-First Century: A New Focus on Business Ethics

1. New evidence emerged in the early 2000s that more than a few business executives and managers had not fully embraced the public’s desire for high ethical standards.

2. To address a loss of confidence in financial reporting and corporate ethics, Congress passed the Sarbanes-Oxley Act in 2002, the most far-reaching change in organizational control and accounting regulations since the Securities and Exchange Act of 1934. The law:

   a. made securities fraud a criminal offense and stiffened penalties for corporate fraud.

   b. created an accounting oversight board that requires corporations to establish codes of ethics for financial reporting and to develop greater transparency in financial reports to investors and other interested parties.

   c. requires top executives to sign off on their firms’ financial reports, risking fines and jail if they misrepresent their companies’ financial position.

   d. requires company executives to disclose stock sales immediately and prohibits companies from giving loans to top managers.

3. The 2004 and 2008 amendments to the FSGO require that a business’s governing authority be well informed about its ethics program with respect to content, implementation, and effectiveness.

4. President Obama has led the passage of legislation to stimulate an economic recovery from the greatest recession the world has experienced since the 1930s. The legislation focused on social concerns.

5. To address lingering issues related to the financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act represents the most sweeping financial legislation since the Sarbanes-Oxley Act and possibly since the Great Depression.

6. Around the world, the basic assumptions of capitalism are under debate in the wake of the most recent financial industry meltdown and global recession. Widespread government intervention is worrisome to free-market capitalists.

IV. Developing an Organizational and Global Ethical Culture

A. Legally based compliance initiatives in organizations are usually designed to help establish cultural initiatives that make ethics a part of organizational values.

1. To develop more ethical corporate cultures many businesses communicate core values to their employees via ethics programs and appointing ethics officers to oversee them.

2. The ethical component of a corporate culture relates to the values, beliefs, and established and enforced patterns of conduct that employees use to identify and respond to ethical issues.

B. The term ethical culture can be viewed as the character or decision-making process that employees use to determine whether their responses to ethical issues are right or wrong. The goal of an ethical culture is to minimize the need for enforced compliance of rules and maximize the use of principles that contribute to ethical reasoning in difficult or new situations.
Chapter 1: The Importance of Business Ethics

C. Globally, businesses are working more closely together to establish standards of acceptable behavior. Many companies demonstrate their commitment to acceptable conduct by adopting globally recognized principles, such as the Global Sullivan Principles (GSP), the Coalition for Environmentally Responsible Economies (CERES) Principles, or the United Nations’ Global Compact.

V. The Benefits of Business Ethics

A. The field of business ethics is rapidly changing as more firms recognize the benefits of improving ethical conduct and the link between business ethics and financial performance.

B. Among the rewards for being more ethical and socially responsible in business are increased efficiency in daily operations, greater employee commitment, increased investor willingness to entrust funds, improved customer trust and satisfaction, and better financial performance.

C. Ethics Contributes to Employee Commitment

1. Employee commitment comes from employees who believe their future is tied to that of the organization and their willingness to make personal sacrifices for that organization.
   a. The more a company is dedicated to taking care of its employees, the more likely it is that the employees will take care of the organization.
   b. Issues that may foster the development of an ethical climate for employees include the absence of abusive behavior, a safe work environment, competitive salaries, and the fulfillment of all contractual obligations toward employees, as well as social programs such as stock ownership plans and community service.

2. Employees’ perception of their firm as having an ethical environment leads to performance-enhancing outcomes within the organization.
   a. An organization with a strong, ethical corporate culture helps to increase group creativity, decrease turnover, and increase job satisfaction.
   b. Trusting relationships within an organization between both managers and their subordinates and upper management contribute to greater decision-making efficiencies.
   c. When companies are viewed as highly ethical by their employees, they were six times more likely to keep their workers.

3. Research indicates that the ethical climate of a company matters to employees.

D. Ethics Contributes to Investor Loyalty

1. Investors today are increasingly concerned about the ethics, social responsibility, and the reputation of companies in which they invest.
   a. Investors recognize that an ethical climate provides a foundation for efficiency, productivity, and profits; while negative publicity, lawsuits, and fines can lower stock prices, diminish customer loyalty, and threaten a company’s long-term viability.
   b. Investors look at the bottom line for profits or the potential for increased stock prices or dividends, and for any potential flaws in the company’s performance, conduct, and financial reports.
   c. Gaining investors’ trust and confidence is vital to sustaining the financial stability of the firm.

E. Ethics Contributes to Customer Satisfaction

1. Customer satisfaction is one of the most important factors in successful business strategy.
   a. By focusing on customer satisfaction, a company continually deepens the customer’s dependence on the company, and as the customer’s confidence grows, the firm gains a better understanding of how to serve the customer.
   b. Successful businesses provide an opportunity for customer feedback, which can engage the customer in cooperative problem solving.

2. Research indicates that a majority of consumers place social responsibility ahead of brand reputation or financial factors when forming impressions of companies.
3. A strong organizational ethical environment usually focuses on the core value of placing customers’ interests first.
   a. An ethical climate that focuses on customers incorporates the interests of all employees, suppliers, and other interested parties in decisions and actions.
   b. Ethical conduct toward customers builds a strong competitive position that has been shown to affect both business performance and product innovation positively.

F. Ethics Contributes to Profits
   1. A company cannot nurture and develop an ethical organizational climate unless it has achieved adequate financial performance in terms of profits.
      a. Evidence shows a positive relationship between corporate social responsibility and better business performance.
      b. Research has shown that the world’s most ethical companies tend to have higher returns than those listed on the S&P 500 and the FTSE 100 indexes.
      c. Companies convicted of misconduct experience significantly lower average returns and sales than firms that have not faced such charges.
   2. Ethics is becoming one of the management issues within the effort to achieve competitive advantage.

VI. Our Framework for Studying Business Ethics
   A. Part One provides an overview of business ethics and explores the development and importance of this critical business area, as well as the role of various stakeholder groups in social responsibility and corporate governance.
   B. Part Two focuses on ethical issues and the institutionalization of business ethics, such as business issues that create ethical decision making in organizations and the institutionalization of business ethics and includes both mandatory and voluntary societal concerns.
   C. Part Three explores the ethical decision-making process and then at both individual and organizational factors that influence decisions.
   D. Part Four explores systems and processes associated with implementing business ethics into global strategic planning.
      1. The more you know about how individuals make decisions, the better prepared you will be to cope with difficult ethical decisions.
      2. It is your job to make the final decision in an ethical situation that affects you:
         Sometimes that decision may be right; sometimes it may be wrong.

DEBATE ISSUE: TAKE A STAND

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This issue deals with whether ethical companies are more profitable. Those who argue that ethical businesses are more profitable could point to the different studies showing a positive correlation between ethics and profitability, the goodwill gained from ethical conduct, and the additional customer confidence associated with an ethical company. The opposition might point out that some dishonest companies have gotten away with only small penalties for misconduct and that companies must be more concerned with obtaining profits than spending time worrying about ethics.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES

This is a classic case of conflicting values. The instructor may wish to ask why some students may believe there is an ethical component while others do not. The instructor may also find that there is a significant difference of opinion between business and nonbusiness-major students on this case. Additional pressure can be added by the instructor through providing different scenarios, such as
assuming that Frank is married, has financial difficulties, is operating in a weak economy, is likely to be fired, etc.

The instructor may also wish to discuss where the line is between developing client relationships and losing one’s values to the corporation. Given the hierarchical nature of the company, Frank’s superior, Amber, is urging Frank to do something she feels is correct. However, the situation is such that the instructor can point out that Amber seems to be making decisions contrary to the firm’s culture.

Note the following interchange: Frank had never been in a situation like this before, so he excused himself and called Amber about what he was thinking about doing. “Are you kidding!” responded Amber. “Why are you even calling me on this? I’ll find the money somewhere to pay for this.” Frank asked, “Is this OK with Acme?” “You let me worry about that,” was Amber’s reply. The situation was developed to demonstrate that even though a superior may ask an employee to do something, it might not be in accordance with company policies. These situations can be extraordinarily difficult for employees, particularly ones who have limited experience upon which to draw. It is in a situation like this that a clear code of conduct and a strong ethics and compliance program will minimize the opportunity for misconduct.
CHAPTER 2

Stakeholder Relationships, Social Responsibility, and Corporate Governance

SUMMARY
In this chapter, first we identify stakeholders’ different roles in business ethics. We examine the relationships between businesses and various stakeholder groups and examine how a stakeholder framework can help us understand organizational ethics. Then we define social responsibility and examine the relationships between having a stakeholder orientation and social responsibility. Next, we delineate how a stakeholder orientation helps to create corporate social responsibility. We then examine corporate governance as a dimension of social responsibility and its role in structuring ethics and social responsibility in business. The ethical decision making process is covered in order to provide an understanding of the importance of oversight in responding to stakeholders. Finally, we provide the steps for implementing a stakeholder perspective in creating both social responsibility and ethical decisions in business.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
Carla’s dilemma is whether to report her superior’s “moonlighting” to higher authorities. Jack had begun taking on additional work as a means of retaliating against his superiors after being denied a partner’s position. Jack’s outside consulting work may be taking away business from Aker & Aker Accounting (A&A), even though he claims that his outside clients are not within A&A’s market area. Students may want to discuss the implied threat to Carla, as well as her own minor infractions of the rules. Most will agree that Jack’s behavior is in flagrant disregard to the overall integrity of A&A’s business practices. Students should also discuss Jack’s rationalization of his behavior. It is common for people to make bad choices when they feel economic, family, or on-the-job pressures. Students may want to explore the ramifications of Carla exposing Jack and the potential problems that could occur if A&A decided to let her go. The instructor may wish to point out that some whistle-blowers have discouraged others from becoming whistleblowers themselves because of the tremendous physical and psychological pressures that it invokes; yet, when asked if they would do it again, the response is invariably yes. Carla may be correct in assuming that she would be retaliated against for bringing up the situation with Jack without having ample evidence first.

LECTURE OUTLINE
I. Stakeholders Define Ethical Issues in Business
   A. Building effective relationships is considered one of the more important areas of business today. A stakeholder framework helps identify the internal stakeholders such as employees, boards of directors, and managers and external stakeholders such as customers, special interest groups, regulators, and others who agree, collaborate, and have confrontations on ethical issues.
   B. In a business context, customers, investors and shareholders, employees, suppliers, government agencies, communities, and others who have a “stake” or claim in some aspect of a company’s products, operations, markets, industry, and outcomes are known as stakeholders.
1. The relationship between companies and their stakeholders is a two-way street. Stakeholders are influenced by business, but they also have the ability to affect businesses.
   a. Stakeholders apply their values and standards to many diverse issues—working conditions, consumer rights, environmental conservation, product safety, and proper information disclosure—that may or may not directly affect an individual stakeholder’s own welfare.
   b. Stakeholders provide both tangible and intangible resources that can be critical to a firm’s long-term success.
2. When individual stakeholders share similar expectations about desirable business conduct, they may choose to organize into communities.
3. Ethical misconduct can damage a firm’s reputation, causing stakeholders to withdraw valuable resources. This gives stakeholders power over businesses.

C. Identifying Stakeholders
1. Stakeholders can be divided into two categories.
   a. **Primary stakeholders** are those whose continued association is necessary for a firm’s survival (employees, customers, investors, and stockholders, governments and communities that provide necessary infrastructure).
   b. **Secondary stakeholders** do not typically engage in transactions and are not essential for its survival (the media, trade associations, and special-interest groups).
   c. Although primary groups may present more day-to-day concerns, secondary groups cannot be ignored or given less consideration in the ethical decision-making process.
2. The **stakeholder interaction model** indicates that there are two-way relationships between the firm and a host of stakeholders.

D. A Stakeholder Orientation
1. The degree to which a firm understands and addresses stakeholder demands can be expressed as a stakeholder orientation.
2. A stakeholder orientation comprises three sets of activities.
   a. The organization-wide generation of data about stakeholder groups and assessment of the firm’s effects on these groups.
   b. The distribution of this information throughout the firm.
   c. The organization’s responsiveness as a whole to this intelligence.
3. A stakeholder orientation is not complete unless it includes activities that address stakeholder issues.
4. Responsiveness processes may involve the participation of the concerned stakeholder groups. It can be viewed as a continuum as firms adopt a stakeholder orientation to varying degrees.

II. Social Responsibility and the Importance of a Stakeholder Orientation
A. From the perspective of social responsibility, business ethics embodies values, norms, and expectations that reflect concerns of major stakeholders, including consumers, employees, shareholders, suppliers, competitors, and the community.
B. Many businesspeople and scholars have questioned the role of ethics and social responsibility in business because legal and economic responsibilities are accepted as the most important determinants of performance.
   1. Adam Smith’s original form of capitalism, which reemphasizes stakeholder concerns and issues, is regaining popularity in the 21st century.
   2. Ethics and social responsibility cannot be just a reactive approach to issues as they arise.
   3. A description of corporate social responsibility should include rights and duties, consequences and values.
III. Social Responsibility and Ethics
   A. The concepts of ethics and social responsibility are often used interchangeably, although each
      has a distinct meaning.
      1. Social responsibility is an organization’s obligation to maximize its positive impact on
         stakeholders and minimize negative impacts. It can be viewed as a contract with society
      2. Business ethics involves carefully thought out rules or heuristics of business conduct that
         guide decision making.
   B. Employee satisfaction, consumer loyalty, and other stakeholder concerns can be quantified to a
      limited degree.
      1. The International Organization for Standardization (ISO) has tried to establish a corporate
         responsibility guideline, the ISO 26000, which is meant to promote a common
         understanding of social responsibility.
      2. ISO 14000 is an environmental regulation standard businesses can adopt to help them
         reduce their carbon footprints, pollution, and waste.
   C. There are four levels of social responsibility—economic, legal, ethical, and philanthropic—and
      they can be viewed as steps.
   D. The term corporate citizenship is often used to express the extent to which businesses
      strategically meet the economic, legal, ethical, and philanthropic responsibilities placed on
      them by their various stakeholders.
      1. Corporate citizenship has four interrelated dimensions:
         a. Strong sustained economic performance
         b. Rigorous compliance
         c. Ethical actions beyond what the law requires
         d. Voluntary contributions that advance the reputation and stakeholder commitment of
            the organization.
      2. Reputation is one of an organization’s greatest intangible assets with tangible value. The
         value of a positive reputation is difficult to quantify, but it is very important.

IV. Corporate Governance Provides Formalized Responsibility to Stakeholders
   A. Today, the failure to balance stakeholder interests can result in a failure to maximize
      shareholders’ wealth. Directors and corporate officers have a duty of care, or duty of diligence,
      to make informed and prudent decisions on behalf of their stakeholders and the organization.
   B. To remove the opportunity for employees to make unethical decisions, most companies have
      developed formal systems of accountability, oversight, and control—known as corporate
governance.
      1. Accountability refers to how closely workplace decisions are aligned with a firm’s stated
         strategic direction and its compliance with ethical and legal considerations. Oversight
         provides a system of checks and balances that limit employees’ and managers’
         opportunities to deviate from policies and strategies and that prevent unethical and illegal
         activities. Control is the process of auditing and improving organizational decisions and
         actions.
      2. A clear delineation of accountability helps employees, customers, investors, government
         regulators, and other stakeholders understand why and how the organization chooses and
         achieves its goals.
      3. Corporate governance establishes fundamental systems and processes for preventing and
         detecting misconduct, for investigating and disciplining, and for recovery and continuous
         improvement. It should interface with the corporation’s governance structure.
   C. Views of Corporate Governance
      1. The shareholder model of corporate governance is founded in classic economic
         precepts, including the goal of maximizing wealth for investors and owners.
         a. Focuses on developing and improving the formal system for maintaining
            performance accountability between top management and the firms’ shareholders.
b. A shareholder orientation should drive a firm’s decisions toward serving the best interests of investors.

2. The **stakeholder model of corporate governance** adopts a broader view of the purpose of business because it must answer to other stakeholders, including employees, suppliers, government regulators, communities, and special-interest groups.
   1. Because of limited resources, companies must determine which of their stakeholders are primary.

D. The Role of Boards of Directors

1. For public corporations, boards of directors hold the ultimate responsibility for their firms’ success or failure, as well as for the ethics of their actions. Board members have a fiduciary duty to act in the best interests of those they serve.

2. Traditionally, boards of directors rarely perform the management function. Are concerned with monitoring the decisions made by executives on behalf of the company.

3. Compensation, both of organizational executives and board members themselves, is a difficult ethical area because board members may place self-interest above those of shareholders.

4. Greater Demands for Accountability and Transparency
   a. Directors are chosen for their expertise, competence, and ability to bring diverse perspectives to strategic discussions.
   b. Outside directors are thought to bring more independence to the monitoring function.
   c. Many of the corporate scandals uncovered in recent years might have been prevented if each of the companies’ boards of directors had been better qualified, more knowledgeable, and less biased.
   d. The concept of board members being linked to more than one company is known as **interlocking directorate**. The practice is legal unless it involves a direct competitor.

5. Executive Compensation
   a. Many boards spend more time discussing compensation than they do ensuring the integrity of the firm’s financial reporting systems.
   b. The most recent financial meltdown and high bonuses for executives of failed firms re-ignited the public debate over compensation issues.
   c. The topic of executive compensation is important to boards because it receives much attention in the media, sparks shareholder concern, and is hotly debated in discussions of corporate governance.
   d. One area for board members to consider is the extent to which executive compensation is linked to company performance.
   e. Issues related to high compensation are excessive risk-taking, a focus on short-term financial performance, and reduced transparency at the expense of long-term growth.

V. Implementing a Stakeholder Perspective

A. An organization that develops effective corporate governance and understands the importance of business ethics and social responsibility in achieving success should develop processes for managing these important concerns. Although there are many different approaches, there are some steps to follow that are effective in utilizing the stakeholder framework in managing responsibility and business ethics.

1. Step 1: Assessing the Corporate Culture
   a. To enhance organizational fit, a social responsibility program must align with the corporate culture of the organization.
   b. The purpose of this step is to identify the organizational mission, values, and norms that are likely to have implications for social responsibility.

2. Step 2: Identifying Stakeholder Groups
a. In managing this stage, it is important to recognize stakeholder needs, wants, and desires.
b. Stakeholders have some level of power over a business because they are in the position to withhold, or at least threaten to withhold, organizational resources.

3. Step 3: Identifying Stakeholder Issues
   a. This step involves understanding the nature of the main issues of concern to primary stakeholders.

4. Step 4: Assessing Organizational Commitment to Social Responsibility
   a. Step 4 brings the previous three steps together to arrive at an understanding of social responsibility that specifically matches the organization of interest.

5. Step 5: Identifying Resources and Determining Urgency
   a. The prioritization of stakeholders and issues, along with the assessment of past performance, provides guidance for allocating resources.
   b. Two main criteria should be considered:
      i) the level of financial and organizational investments required by different actions.
      ii) the urgency when prioritizing social responsibility challenges.

6. Step 6: Gaining Stakeholder Feedback
   a. Stakeholder feedback can be generated through a variety of means.
      i) Satisfaction or reputation surveys
      ii) Assessment of stakeholder-generated media (blogs, websites, podcasts, and newsletters)
      iii) Formal research using focus groups, observation, and surveys

VI. Contributions of a Stakeholder Perspective
   A. Balancing stakeholder interests requires good judgment because broader societal interests can create conflicts.
   B. This chapter provides a good overview of the issues, conflicts, and opportunities of understanding more about stakeholder relationships. The stakeholder framework helps recognize issues, identify stakeholders, and examine the role of boards of directors and managers in promoting ethics and social responsibility.

DEBATE ISSUE: TAKE A STAND

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This particular issue deals with whether a socially irresponsible product—in this case, a product that promotes adultery—should be sold if it is legal. Students on the first team could argue that as long as the product is legal and allows for freedom of choice, there should be no barriers to selling it. Students on the other team could argue that the product causes emotional harm to people. Since it is a detriment to society, it should be banned.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES

In this case, Karl is being pressured by his boss, parents, and wife about the marketing campaign for Bounce Corporation’s new Web browser-based game called “Breakaway.” He has been at Bounce for two years and Breakaway was his first big project. The reader first goes through a brief overview of the fierce competition that is present in the gaming industry. Karl’s previous work at Bounce was conducting market research on the gaming industry and what consumers want. He finds that consumers want more violence, distinct character roles, multiple levels of difficulty, and in-game rewards. Instructors may want to pause to ask students whether these are characteristics of games they also
desire. Karl also found that regular gamers exhibit the same characteristics as compulsive gamblers and are willing to pay as they go to purchase credits that allow them to play longer. Karl also noticed that social networking games that gave positive reinforcements to the consumer, such as encouraging messages after a completed task, were played much more frequently than others were.

The Breakaway game fits the criteria for games that consumers will find attractive, according to Karl’s previous research. The game is made even more appealing by 3-D technology and a female character who removes articles of her clothing as the player advances through the game. At this point, many students will determine that this is the ethical issue; however, the pivotal issue of this case is promoting a product that may be detrimental to the consumer. Some students may consider this video game a form of gambling. Other students may find the nudity objectionable, as Karl does in the case. Students should discuss the acceptability of gambling, nudity, and violence in products for the U.S. culture, relative to other cultures. Finally, students should think about the family and community pressures influencing Karl’s decision.

In this case, Karl weighed his father’s comments against the potentially detrimental effects of a game that promotes nudity and violence, and he concluded that the nudity is a bad idea. Will, the company’s president, agrees, and has arranged to sell the game on the Internet as a standalone adult product. Karl and Will also consider toning down the more offensive aspects and selling the game in Mexico. However, Will states that the Taiwanese market wants an even more graphic game.

The Internet is now rife with “adult” content software. Students could discuss how these behaviors (gambling, sexual exploitation, and violence) affect a society. In this situation, all of the items marketed are legal, yet studies have shown that promotion of such activities can harm the fabric of a society. The issue for students is whether or not to market products and services that are legal but personally objectionable.

Care should be taken to allow students to explain their reasoning. Students will attempt to disassociate themselves from these situations, so the instructor should prompt them to discuss the situation as if they were Karl. Discussion can also revolve around whether the student has any reservations about marketing such products in their own culture versus other cultures.
CHAPTER 3

Emerging Business Ethics Issues

SUMMARY
In this chapter, we consider some of the ethical issues that are emerging in business today in the context of organizational ethics. We look at how these issues arise from the demands of specific stakeholder groups. In the first part of the chapter, we explain certain universal ethical concepts that pervade business ethics, such as honesty, fairness, and integrity. The latter part of the chapter explores a number of emerging ethical issues, including misuse of company resources, abusive and intimidating behavior, lying, conflicts of interest, bribery, corporate intelligence, discrimination, sexual harassment, environmental issues, fraud, insider trading, intellectual property rights, and privacy. We then examine the challenge of determining an ethical issue in business.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
At the close of the case, the ethical issue for Jackie is whether and how to bring up sexual harassment allegations against Curtis to the upper management at Song & Dance Records (SDR). This case features multiple aspects of sexual harassment, and should help students to see how complicated these matters can be. Jackie was hopeful that a contract with SDR would help jump-start her music career, but she became romantically involved with her manager, Curtis. When things soured with him, he started harassing and threatening Jackie. Jackie also discovered that Curtis had had a sexual relationship with Leslie, from the Legal department. Leslie is disinclined to believe Jackie’s claims and even less inclined to help. Because Jackie had a relationship with her manager and did not immediately report it, Leslie states that it will be more difficult to prove her harassment claims. It will be her word against Curtis’. Students may try to argue that Jackie’s crucial mistake was in becoming intimate at all, but instructors should remind students that this scenario does happen in real life. The instructor should ask students to ponder Jackie’s options. What should she say to upper management? How can she extricate herself from this difficult situation after inadvertently violating the organization’s code of conduct?

The probable cost to Jackie if she officially reports the sexual harassment case is a protracted legal and political struggle and possible loss of recording contracts at SDR and at other labels. Curtis has threatened to ruin her future music career anywhere she goes if she does not comply with his wishes. Jackie does not have the support of the Legal department no matter what avenue she decides to pursue, and it is her word against Curtis. He is an established employee at SDR and presumably has a strong influence.

The different factors will affect the students in different ways. Try to encourage the students to put themselves in Jackie’s shoes when contemplating this case.

LECTURE OUTLINE
I. Recognizing an Ethical Issue
   A. The first step in understanding business ethics is to develop ethical issue awareness.
      Awareness arises because of conflicts among individuals’ personal moral philosophies and values, the values and culture of the organizations in which they work, and those of the society in which they live.
B. Failure to acknowledge ethical issues puts corporations at great risk, particularly in industries where business is perceived as a game that must be won at all costs.

C. An ethical issue is a situation or a problem that requires thought, discussion, or investigation in order to make a decision.
   1. **Honesty** refers to truthfulness or trustworthiness. Issues related to honesty also arise because business is sometimes regarded as a “game,” governed by its own rules rather than by those of society.
      a. **Dishonesty** is a lack of integrity, incomplete disclosure, and an unwillingness to tell the truth. Lying, cheating, and stealing are actions usually associated with dishonest conduct.
   2. **Fairness** is the quality of being just, equitable, and impartial.
      a. In business, **equality** is about how wealth or income is distributed between employees within a company, a country, or across the globe.
      b. **Reciprocity** is an interchange of giving and receiving in a social relationship. It is the return of small favors of approximately equal value.
      c. **Optimization** is the tradeoff between equity (that is, equality or fairness) and efficiency (that is, maximum productivity).
   3. **Integrity** refers to being whole, sound, and in an unimpaired condition. In an organization, it means uncompromising adherence to ethical values.
   4. Honesty, fairness and integrity are the glue that holds businesses together.

II. **Ethical Issues and Dilemmas in Business**

An **ethical issue** is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several actions that must be evaluated as right or wrong, ethical or unethical. An **ethical dilemma** is a problem, situation, or opportunity that requires an individual, group, or organization to choose among several wrong or unethical actions.

A. Misuse of company resources is the leading form of observed misconduct in organizations.
   1. Using company computers for personal business is one of the most common ways employees misuse company resources.
   2. Many companies, like Boeing, have implemented official policies delineating acceptable use of company resources.

B. **Abusive or intimidating behavior** is a common ethical problem for employees. The concepts of abusive or intimidating behavior can mean anything from physical threats, false accusations, annoying behavior, profanity, insults, yelling, harshness, ignoring someone, or even unreasonableness. The meaning of these words can differ from person to person.
   1. Intent is an important factor in determining whether a situation is abusive.
   2. Bullying is associated with a hostile workplace where a person or group is threatened, harassed or overly criticized. The concept of bullying is now considered a legal issue, with millions of Americans reporting having experienced or witnessed bullying at work.

C. **Lying** relates to distorting the truth. There are three types of lies:
   1. Joking without malice
   2. **Commission lying** is creating a false perception by choosing words that intentionally deceive the receiver of the message.
      a. Commission lying involves using words or creating noise that intentionally confuse the receiver of a message. Noise can be the intentional use of modes of communication that the sender knows the receiver does not fully understand.
   3. **Omission lying** is intentionally not informing others of any differences, problems, safety warnings, or negative issues related to the product, service, or company that significantly affects awareness, intention, or behavior.
   4. When a lie becomes unethical in business is based on the context and an intent to distort the truth. A lie becomes illegal if it is determined by the judgment of courts to damage others.
D. A **conflict of interest** exists when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group. To avoid conflicts of interest, employees must be able to separate their private interests from business dealings.

E. **Bribery** is the practice of offering something (usually money) in order to gain an illicit advantage. Bribery can be defined a number of different ways.
   1. **Active bribery** means that the person who promises or gives the bribe commits the offense.
   2. **Passive bribery** is an offense committed by the receiver of the bribe.
   3. **Facilitation payments** to obtain or retain business do not constitute bribery payments in the United States, as long as they are small. However, the legality of this practice varies in other countries.

F. **Corporate intelligence** is the collection and analysis of information on markets, technologies, customers and competitors, as well as on socioeconomic and external political trends. CI involves in-depth discovery of information from corporate and court documents, regulatory filings, and press releases. CI is not an ethical issue if the information is obtained legally. However, there are a number of questionable or illegal techniques used to collect information.
   1. **Hacking** is one of the top methods for obtaining trade secrets.
      a. **System hacking** assumes that the attacker already has access to a user account
      b. **Remote hacking** involves remotely trying to penetrate a computer system via the Internet
      c. **Physical hacking** requires that an agent personally enter a facility
   2. **Social Engineering** is another popular method of obtaining valuable corporate information. Social Engineering is tricking or fooling individuals into revealing their passwords or other valuable corporate information.
      a. **Shoulder surfing** is when someone looks over an employee’s shoulder to obtain a password
      b. **Password guessing** is self-explanatory
   3. **Dumpster diving** is a messy but very successful way to acquire trade secrets. Once trash is discarded onto a public street or alley, it is considered fair game.
   4. **Whacking** is wireless hacking.
   5. **Phone Eavesdropping** is yet another tool in the game of corporate intelligence. A person with a digital recording device can monitor and record a fax line.

G. **Discrimination** on the basis of race, color, religion, sex, marital status, sexual orientation, public assistance status, disability, age, national origin, or veteran status is illegal in the United States. A company in the United States can be sued for discrimination if it:
   a. Refuses to hire an individual for discriminatory reasons
   b. Maintains a system of employment that unreasonably excludes an individual from employment
   c. Unreasonably discharges an individual
   d. Discriminates against an individual with respect to hiring, employment terms, promotion, or privileges of employment as it relates to discrimination
   2. The **Age Discrimination in Employment Act** specifically outlaws hiring practices that discriminate against people between the ages of 49-69. However, charges of age discrimination persist in the workplace.
   3. Many companies have **affirmative action programs** that seek to recruit, hire, train and promote qualified individuals from groups that have endured the most of discrimination. These programs may be mandated from the federal level, but many companies opt to implement them voluntarily. Discrimination can be a major ethical
issue in business when companies use race or other factors to discriminate against their customers.

H. Sexual harassment is a form of sex discrimination that violates Title VII of the Civil Rights Act of 1964. It is defined as a repeated, unwanted behavior of a sexual nature perpetrated upon one individual by another.

1. To establish sexual harassment, an employee must understand the definition of a hostile work environment, for which three criteria must be met:
   a. The conduct was unwelcome
   b. The conduct was severe, pervasive, and regarded by the claimant as so hostile or offensive as to alter his or her conditions of employment
   c. The conduct was such that a reasonable person would find it hostile or offensive

2. The key ethical issue within sexual harassment is called dual relationship, which is defined as a personal, loving, and/or sexual relationship with someone with whom you share professional responsibilities. An unethical dual relationship is one where the relationship causes a conflict of interest or risk of impairment to professional judgment. Consent is created if any sexual relationship is considered mutual.

I. Environmental issues such as air and water pollution and waste are becoming significant issues within the business community. Environmental concerns are creating ethical issues for individuals, organizations, and public policy decision-makers.

1. Air pollution refers to gases or particulates in the air. Three sources: stationary, mobile and natural.

2. The Kyoto Protocol is an international treaty on climate change that commits signatory nations to reducing emissions of greenhouse gases.

3. Water pollution results from dumping sewage and toxic chemicals into waterways; from oil spills and fertilizer runoff; or from burying industrial waste in a location where it can filter into water supplies.

4. Alternative energy sources are perceived to have lower emissions and waste than traditional sources. Wind power, solar power, geothermal power, hydropower, biofuels, and nuclear power are all forms of alternative energy.

J. In general, fraud is any purposeful communication that deceives, manipulates, or conceals facts in order to create a false impression. Fraud is a crime that can result in fines and/or imprisonment.

1. Accounting fraud usually involves falsifying information about a corporation’s financial reports, which would otherwise provide important information about the financial health of the company to investors and other stakeholder groups. Accountants today feel increased pressure to perform, to keep fees low, and must follow complicated regulations—all of which can contribute to the pressure to commit fraud.
   a. Regulators passed the Sarbanes-Oxley Act in 2002 in an effort to address problems created by lack of both transparency and ethics in financial accounting.

2. Marketing fraud is the process of dishonestly creating, distributing, promoting, and pricing products. Serious ethical issues can occur in this area. False or misleading marketing communications can destroy stakeholder trust in a corporation. False or deceptive advertising is a key issue in marketing communications.
   a. Sometimes, it can be difficult to draw the line between outright marketing fraud and puffery, which is exaggerated advertising claims, blustering and boasting, upon which no reasonable buyer would rely. Puffery is not considered fraud.
      i) Implied falsity means that an advertising message has a tendency to mislead, confuse, or deceive the public.
      ii) Literally false claims can be divided into tests prove and bald assertions (non-establishment claims).
b. Advertising can also make ambiguous statements or weak claims from which viewers must infer a message. These are often called “weasel words”
c. Labeling issues also create an ethical gray area.

3. **Consumer fraud** is when consumers attempt to deceive businesses for personal gain. There are many different ways of engaging in consumer fraud, from stealing from stores, to price tag switching, to lying to obtain discounts.
   a. Collusion involves an employee who helps a consumer commit fraud.
   b. Duplicity involves a consumer duping a store. For example, a customer who stages an accident and then sues the store for damages is engaging in duplicity.
   c. Guile is associated with a person who knows right from wrong but uses tricks to obtain an unfair advantage.

K. **Financial Misconduct**
   1. The failure to understand and manage ethical risks played a key part in the financial meltdown and recession of 2008-2009. The global recession was caused in part by the financial industry refusing to take responsibility for its decision to make excessively risky decisions, often without the knowledge of investors and other stakeholders.
   2. Corporate cultures in many firms were built on giving rewards for taking risks.
   3. Subprime lending and executive compensation in poorly performing or failed firms are two areas of ethical concern that emerged out of the most recent recession. Such concerns led to the call for additional legislation such as the Dodd-Frank Act.
   4. Remember that top executives are ultimately responsible for decisions made by the employees of their companies. Regulatory systems in place failed to catch the systemic risks that were at play during the financial industry meltdown.

L. **Insider Trading.** An insider is any officer, director, or owner of ten percent or more of a class of a company’s securities.
   1. There are two types of insider trading: legal and illegal
      a. Illegal insider trading is the buying or selling of stocks by insiders who possess material that is still not public.
      b. Legal insider trading involves legally buying and selling stock in an insider’s company, but not all of the time. Insiders are required to report their trades within two days of the transaction.

M. **Intellectual property rights** involve the legal protection of intellectual properties, such as music, books, and movies
   1. A decision by the Federal Copyright Office (FCO) helped lay the groundwork for IP in the digital world.
   2. IP continues to grow as an issue because of nations like China, which have thriving industries for cheap, pirated goods.

N. Many **privacy issues** come into play in the business world. Some issues that managers should consider involve monitoring employee use of technology and consumer privacy. It can be a challenge for businesses today to meet the needs of consumers while at the same time protecting their privacy.
   1. There are few legal protections of an employee’s right to privacy while at work, which allows employers a great deal of leeway in monitoring employees.
   2. Electronic monitoring allows a company to determine whether productivity is lower than it could be because employees are spending too much time on personal activities.
   3. Practices that respect employee privacy but do not abdicate the employer’s responsibility help create a climate of trust that promotes opportunities for resolving employee–employer disputes without lawsuits.
   4. There are two dimensions to consumer privacy:
      a. Consumer awareness of information collection
b. Growing lack of control over how companies use consumers’ personal information

III. The Challenge of Determining an Ethical Issue in Business

A. Most ethical issues will become visible through stakeholder concerns about an event, activity, or the results of a business decision.
B. Determining ethical issues is a constant challenge. With changing societal standards, what are considered merely problems today can become ethical issues over time.
C. Once ethical issue awareness occurs and individuals begin open discussion, the ethical decision-making process can begin.

DEBATE ISSUE: TAKE A STAND

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This particular issue deals with whether Google is violating users’ privacy. One team might argue that Google is violating users’ privacy because the company could misuse users’ search query information or use it to identify people. The opposing team could argue that Google is using this information to improve its systems and that it has clear privacy disclosures on its website.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES

The ethical issue for Joseph is whether he should tolerate kickbacks within his sales force. If Joseph allows the three to continue the practice, in all likelihood, the behavior will increase. The vignette is purposefully vague on stated company policy because many companies allow such behavior during periods of bad sales. This gives many salespeople mixed signals as to right/wrong behavior.

Students may also want to discuss the consequences of Ellen’s spending patterns and how they may affect Joseph’s options. Students should consider the ramifications of Kathryn being a client of Ellen’s as well as Carl’s link to upper management. Notice that Carl said he had tacit approval from upper management; he did not say actual approval.

Finally, the case is vague on whether we can trust Carl and his statement. What if Carl is lying and Joseph goes ahead and allows the questionable activities? He certainly cannot defend his actions based on what Carl said to him. This is an excellent opportunity to bring out the point that, in business, decisions are often made with less-than-perfect information.
CHAPTER 4
The Institutionalization of Business Ethics

SUMMARY
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 consider the requirements of the Sarbanes–Oxley legislation, its implementation by the Securities and Exchange Commission (SEC), and how its implementation has affected companies. We also discuss the 2010 passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act and examine some of its major provisions. Additionally, we provide an overview of the FSGO for organizations and give recommendations and incentives for developing an ethical corporate culture. The FSGO, the Sarbanes–Oxley Act, the Dodd-Frank Act, industry trade associations, and societal expectations support core practices. Finally, we examine voluntary responsibilities and cause-related marketing, along with how strategic philanthropy can be an important core competency to manage stakeholder relationships.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
Students may wish to debate the controversy surrounding the marketing of products that have psychological as well as physical dependencies associated with them. The products in this example are marketing betel nuts in India and Khat around Asia. Myron is a recent graduate who just started working for Producto International (PI). He is excited to work on discovering and marketing medical products around the world. Myron’s dilemma is that if he agrees to help market the two products, he will become an active participant in promoting products that may result in addiction. However, he and his wife will be generously compensated for his endeavors. Both products are grown legally around the world and have no distribution restrictions in the countries in which PI wishes to market them (although they do face restrictions in the United States). His other option is to reject the position, which may not be enthusiastically received by his wife. It would also hurt his chances for future projects and promotions within PI. Also, by choosing to reject the marketing opportunity, Myron may be “labeled” in the industry, making it difficult to get hired by another company if he chooses to leave PI. In addition, students may wish to discuss the similarities of these products to tobacco and cigarettes and the marketing of such items to children/teenagers in countries where no restrictions exist.

LECTURE OUTLINE

I. Managing Ethical Risk Through Mandated and Voluntary Programs
   A. Voluntary practices include beliefs, values, and voluntary contractual obligations. All businesses engage in some level of commitment to voluntary activities in order to benefit both internal and external stakeholders.
   B. Most firms engage in philanthropy—giving back to communities and causes.
   C. Core practices are documented best practices, often encouraged by legal and regulatory forces as well as trade associations.
   D. The Better Business Bureau (BBB) is a leading self-regulatory body that provides directions for managing customer disputes and reviews advertising cases.
E. **Mandated boundaries** are the externally imposed boundaries of conduct, such as laws, rules, regulations, and other requirements.
   1. Corporate governance, compliance, risk management, and voluntary activities all help to maintain an ethical culture and to manage stakeholder expectations for appropriate conduct in an organization.
   2. Compliance represents areas that must conform to existing legal and regulatory requirements.
   3. Corporate governance is structured by a governing authority providing oversight and checks and balances to make sure that the organization meets its goals and objectives for ethical performance.
   4. Risk management analyzes the probability or chance that misconduct could occur based on the nature of the business and the exposure to risky events.
   5. Voluntary activities often represent the values and responsibilities that firms accept in contributing to stakeholder needs and expectations.

II. **Mandated Requirements for Legal Compliance**

A. Laws and regulations are established by governments to set minimum standards for responsible behavior—society’s codification of what is right and wrong.

B. 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.
   1. **Civil law** defines the rights and duties of individuals and organizations (including businesses).
   2. **Criminal law** prohibits specific actions—such as fraud, theft, or securities trading violations—and imposes fines or imprisonment as punishment for breaking the law.
   3. The state or nation enforces criminal laws, while individuals enforce civil laws.
      a. 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).
      b. The Consumer Financial Protection Agency was established after the latest financial crisis, which resulted in many consumers losing their homes.
      c. 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. Lawsuits are expensive and many organizations seek to avoid them.
      d. Laws establish the basic ground rules for responsible business activities.

C. **Laws Regulating Competition**
   1. The issues surrounding the impact of competition on a business’s social responsibility arise from the rivalry among businesses for customers and profits.
   2. **Procompetitive legislation** involves laws that have been passed to prevent the establishment of monopolies, inequitable pricing practices, and other practices that reduce or restrict competition among businesses.
      a. They were enacted to encourage competition and prevent activities that restrain trade.

D. **Laws Protecting Consumers**
   1. Laws that protect consumers require businesses to provide accurate information about products and services and to follow safety standards. The first consumer
protection law was passed in 1906.
2. Large groups of people with specific vulnerabilities have been granted special protections under the law (the elderly, children, etc.)
3. The FTC’s Bureau of Consumer Protection was created to protect consumers against unfair, deceptive, or fraudulent practices. It is divided into five divisions.
4. The Food and Drug Administration regulates food safety, human drugs, tobacco, dietary supplements, vaccines, veterinary drugs, medical devices, cosmetics, products that give off radiation, and biological products.

E. Laws Promoting Equity and Safety
1. 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.
   a. 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.
   b. The Occupational Safety and Health Administration (OSHA) makes regular inspections to ensure that employees have a safe working environment.
   c. Many employees still work in unhealthy or dangerous environments, in spite of the passage of laws to protect them.
   d. Competitive pressures can lead to workplace safety problems, such as manufacturing injuries or careless accidents by overworked employees.

F. Laws Protecting the Environment
1. 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.
2. Sustainability has recently become an important concept to businesses. It means “meeting the present needs without compromising future generations’ abilities to meet their own needs.”
   a. Many consumers are interested in environmental issues and expect companies to be environmentally responsible.
   b. Being green is even a competitive issue for some firms.
3. The Environmental Protection Agency (EPA) was created in 1970 to coordinate environmental agencies involved in enforcing the nation’s environmental laws.
4. While pollution can be harmful to people, animals, and industries, trying to pinpoint who is responsible for environmental degradation is not always easy, especially when it involves different countries.

III. Gatekeepers and Stakeholders
A. Trust is the glue that holds businesses together. It creates confidence and helps build long-lasting business relationships. Ethics help to create the foundational trust between two business parties.
1. There are many people who must trust and be trusted to make business work properly. Sometimes these parties are called gatekeepers (accountants, regulators, lawyers, financial rating corporations, auditors)
2. They are critical in providing information that allows stakeholders to gauge the true health of a corporation

B. Accountants
1. Measure and disclose financial information to the public
2. Some accountants have not adhered to their duties as stakeholders and have allowed profits or conflicts of interest to interfere with their objectivity

C. Risk Assessment
1. Assessors of financial products failed in their duties to stakeholders during the most recent recession.
2. By not appropriately assessing the risks associated with various financial instruments, investors and stakeholders were misled.

3. Many are calling for more drastic oversight of credit-rating firms.

IV. The Sarbanes–Oxley (SOX) Act

A. Congress passed the Sarbanes–Oxley Act in 2002 to establish a system of federal oversight of corporate accounting practices.

1. 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.

2. The **Public Company Accounting Oversight Board** represents the heart of Sarbanes-Oxley.
   a. It oversees the audit of public companies in order to protect the interests of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports for companies.
   b. The Sarbanes–Oxley Act also seeks to ensure auditor and analyst independence, in order to reduce conflicts of interest and to ensure enhanced financial disclosures of public companies’ true condition. Registered public accounting firms can no longer provide both auditing and non-auditing services to public companies.
   c. The Sarbanes–Oxley Act is better able to ensure compliance with the enhanced financial disclosures of public companies’ true condition
   d. Sarbanes–Oxley offers whistle-blower protection to employees that would prohibit the employer from taking certain actions against employees who lawfully disclose private employer information. However, employees who witness wrongdoing are often still afraid to be whistle-blowers because of backlash and difficulties finding employment elsewhere.
   e. The national cost of compliance to the Sarbanes–Oxley Act was high, but studies show that the costs of compliance have gone down somewhat since the law’s implementation.
      i. Many companies benefit from compliance in spite of the costs.

V. The Dodd-Frank Wall Street Reform and Consumer Protection Act

A. The Dodd-Frank Act was passed to improve financial regulation, increase oversight of the industry, and prevent the type of risk-taking, deceptive practices, and lack of oversight that led to the 2008-2009 financial crisis.

B. One of the provisions of the Dodd-Frank Act instituted the creation of two new financial agencies.

1. The Office of Financial Research is charged with improving the quality of financial data available to government officials and creating a better system of analysis for the financial industry.
2. The Financial Stability Oversight Council (FSOC) is responsible for maintaining the stability of the financial system in the United States through monitoring the market, identifying threats, promoting market discipline among the public, and responding to major risks that threaten stability.

C. The Dodd-Frank Act created the **Consumer Financial Protection Bureau** (CFPB) to regulate consumer financial products and protect consumers from deceptive or toxic financial instruments.

1. The CFPB has the responsibility to curtail unfair lending and credit card practices, enforce consumer financial laws, and check the safety of financial products before their launch into the market.
2. Critics believe that the CFPB has too much power that could result in heavy sanctions for financial institutions.
D. The Dodd-Frank Act instituted a whistle-blower bounty program to reward whistle-blowers who report misconduct to the SEC. Whistle-blowers who report financial fraud to the Securities and Exchange Commission and Commodities Exchange Commission are eligible to receive 10 percent to 30 percent of fines and settlements if their report results in a conviction of more than $1 million in penalties.

VI. Laws That Encourage Ethical Conduct
A. Laws and regulations have been passed to discourage unethical decisions—and to foster programs designed to improve business ethics and social responsibility.
B. The most important of these are the FSGO, the Sarbanes–Oxley Act, and the Dodd-Frank Act.

VII. Federal Sentencing Guidelines for Organizations
A. The FSGO was passed in 1991 to create an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance.
   1. It applies to all felonies and class A misdemeanors committed by employees in association with their work.
B. A 2004 amendment to the FSGO requires that a business’s governing authority be informed about its ethics program with respect to content, implementation, and effectiveness.
C. 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.
D. The Guidelines had four new amendments in 2010. The guidelines recommend simplifying the complexity of reporting relationships; encourage companies to extend their internal ethical controls; add more specific language of the word “prompt” to help employees recognize what it means to report an ethical violation promptly; and amend the extent of operational responsibility to apply to all personnel within a company’s ethics and compliance program.

VIII. Highly Appropriate Core Practices
A. The concept of core practices is to focus more on developing structurally sound organizational practices and structural integrity for financial and nonfinancial performance measures than on an individual’s morals.
   1. Most ethical issues relate to non-financials such as marketing, human resource management, and customer relationships.
B. Voluntary responsibilities relate to business’s contributions to stakeholders. Voluntary responsibilities provide four major benefits to society:
   1. They improve the quality of life and help make communities places where people want to do business, raise families, and enjoy life.
   2. They reduce government involvement by providing assistance to stakeholders.
   3. They develop employee leadership skills.
   4. They help create an ethical culture and values that can act as a buffer to organizational misconduct.
C. Cause-related marketing ties an organization’s product(s) directly to a social concern through a marketing program.
   1. Cause-related marketing can affect buying patterns if consumers sympathize with the cause, the brand and cause are perceived as a good fit, and consumers are able to transfer feelings toward the cause to the brand.
   2. A potential problem is that consumers may perceive a company’s cause-related campaign as merely a publicity stunt, especially if they cannot understand the link between the campaign and the company’s business practices.
D. **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.

IX. The Importance of Institutionalization in Business Ethics

A. Institutionalization involves embedding values, norms, and artifacts in organizations, industries, and society.

B. It is important to recognize that institutionalization of business ethics has advanced rapidly over the last 20 years as stakeholders have recognized the need for improving business ethics.

**DEBATE ISSUE: TAKE A STAND**

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This issue involves the creation of the Consumer Financial Protection Bureau. While some believe the agency is necessary to protect consumers, others believe the agency may have too much power. The team in favor of the CFPB could argue about the necessity for consumer protection and the need to regulate the excessive risk-taking and questionable financial practices that led to the last recession. The team against the CFPB could argue that the agency will increase the costs of financing and put too many burdens on banks and other companies.

**“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES**

Students will probably feel that some of Albert’s business practices are unethical but may not recognize that Albert and his wife have also been involved in some illegal activities. Purchasing stock from Mary’s father’s company while conveying sensitive information to investors about activities within the company could be construed as insider trading. Insider trading has also occurred if Albert buys the stocks for his boss and friends and then receives the “bonus.” Also, Albert and Mary’s use of the information gleaned from Uncle Chen can be construed as corporate espionage. Albert is guilty of trading stocks within portfolios in order to gain the fees, even if the activity does not benefit the client. He is also guilty of allocating hot IPOs to the personal brokerage accounts of corporate or venture-capital executives. The shares are often sold, or “spun” for quick profits to get future business from these clients. Finally, Albert and Barry are involved in front-running, which is the exchange equivalent of waiting in line and having someone cut in front of you. In the stock market, an investor places an order to buy a large amount of shares and, knowing that the trade will likely boost the value of the shares, will first trade some stock for himself or a partner. After the second trade is completed, the broker can cash in, netting a profit with no risk involved. Several firms have pleaded no contest to allegations such as these and are now being scrutinized by the SEC. Students may also want to discuss Uncle Chen’s friends, especially those elderly clients who wanted low-risk investments.

Students can also discuss Mary’s feelings of depression and potential relocation to Taiwan in case the SEC discovers their activities. In reality, many of the things that Albert and Mary have done are usually settled out of court; however, insider trading such as what Albert’s superior is attempting could potentially result in jail time. Spinning, when detected, is usually handled internally before the SEC gets involved.

One fundamental point is that the stock exchange is based upon the trust between the broker and the client. Trust is defined as the perception that everyone who enters the market has an equal opportunity to make money. When activities such as spinning, churning, and insider trading come to the attention of exchange members, the matters are usually dealt with internally to avoid damaging the general public’s perception of trust.
CHAPTER 5
Ethical Decision Making and Ethical Leadership

SUMMARY
This chapter aims to provide a comprehensive framework for our current knowledge of ethical decision making in business. Chapter 5 provides insights into ethical decision making in organizations. Although it is impossible to describe exactly how any one individual or work group might make ethical decisions, we can offer generalizations about average or typical behavior patterns within organizations. We present a framework for understanding ethical decision making in the context of business organizations. In addition to business, this framework integrates concepts from philosophy, psychology, sociology, and organizational behavior.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
The ethical issue in this case has to do with whether or not Troy Buchanan should report all his hours at his job at Circa Communications, an online publishing company. By “eating the time,” Troy Buchanan will look more efficient in his work and therefore good to his superior. Customers will perceive that the company is highly efficient, and Troy hopes to be rewarded accordingly. Usually eating time is a significant issue only at the beginning of an employee’s career because as the employee learns the tasks and becomes more efficient, he/she usually can meet the prescribed time/task targets. Some firms purposefully underestimate certain tasks in the hopes of gaining more lucrative business contracts. This strategy will become a long-term nightmare if adopted.

Another consideration in this dilemma is Troy’s family. He has a wife and child and is financially overextended, as are many new graduates. Long work hours cause him to lose time with his family. Students may argue that fudging time sheets is the price for success. However, the instructor may wish to point out that “eating time” does not accurately reflect the learning curve effect. If the practice is not stopped, it will perpetuate, thus skewing the company’s billing data a great deal over time. This might also contribute to bigger problems, such as employee turnover as employees become disenchanted with their jobs and quit. These are teleological justifications for not “eating time.”

Some students may argue that Troy should be honest and accurately report the time it takes him to complete his assigned tasks no matter what the costs (deontological justification). The instructor may wish to point out that there is a probability that in doing so, Troy may be considered inefficient, and his career with the firm may be shortened.

LECTURE OUTLINE
I. A Framework for Ethical Decision Making in Business
   A. This model of the ethical decision-making process in business includes ethical issue intensity, individual factors, and organizational factors, such as corporate culture and opportunity. All of these interrelated factors influence the evaluations of and intentions behind the decisions that produce ethical or unethical behavior.
      1. **Ethical Issue Intensity**
         a. The first step in ethical decision making is to recognize that an ethical issue requires an individual or group to choose among actions that stakeholders will evaluate as right or wrong.
b. The intensity of an ethical issue relates to its perceived importance to the decision maker.

c. Ethical issue intensity is therefore defined as the relevance or importance of an ethical issue in the eyes of the individual, work group, and/or organization.

d. Individuals are subject to six “spheres of influence” when confronted with ethical choices—the workplace, family, religion, legal system, community, and profession—and the level of importance of each of these influences will vary depending on how important the decision maker perceives the issue to be.

e. **Moral intensity** relates to a person’s perception of social pressure and the harm the decision will have on others.

2. **Individual Factors**

a. People often base their decisions regarding ethical issues on their own values and principles of right or wrong. These values are subjective and can vary across cultures.

b. Research on gender and ethical decision making suggests that women are generally more ethical than males.

c. Education and work experience are both positively correlated with making ethical decisions.

d. **Nationality** is the legal relationship between a person and the country in which he/she is born. Culture differences may contribute to differing value systems.

e. Research on age and ethical decision making reveals a complicated relationship. Younger managers are far more influenced by organizational culture than are older managers.

f. **Locus of control** relates to individual differences in relation to a generalized belief about how one is affected by internal versus external events or reinforcements.

  i) Those who believe in *external control* (externals) see themselves as going with the flow because that is all they can do.

  ii) Those who believe in *internal control* (internals) believe that they control the events in their lives by their own effort and skill and trust in their capacity to influence their environment.

3. **Organizational Factors**

a. No one operates in a vacuum.

b. In the workplace, the organization’s values have the greatest influence on decisions. The alignment between a person’s own values and the values of the organization help to create positive work attitudes and organizational outcomes.

c. A **corporate culture** can be defined as a set of values, norms, and artifacts, including ways of solving problems that members (employees) of an organization share.

d. The **ethical culture** reflects whether the firm also has an ethical conscience. Ethical culture is a function of many factors, including corporate policies on ethics, top management’s leadership on ethical issues, the influence of coworkers, and the opportunity for unethical behavior. The more ethical a culture is perceived to be, the less likely employees are to make unethical decisions.

e. Those who have influence in a work group, including peers, managers, coworkers, and subordinates, are referred to as **significant others**.

f. **Obedience to authority** helps to explain why many employees resolve business ethics issues by simply following the directives of a superior. In organizations that emphasize respect for superiors, employees may feel that they are expected to carry out all orders from a supervisor.
4. **Opportunity**
   a. Opportunity describes the conditions in an organization that limit or permit ethical or unethical behavior.
   b. It results from conditions that either provide rewards or fail to erect barriers against unethical behavior.
   c. It also relates to individuals’ immediate job context—where they work, with whom they work, and the nature of the work.
   d. The opportunity that employees have for unethical behavior in an organization can be greatly reduced through formal codes, policies, and rules that are adequately enforced by management. These mechanisms for eliminating misconduct must be consistent and aggressive.

B. **Business Ethics Evaluations and Intentions**
   1. An individual’s intentions and the final decision regarding what action he or she will take are the last steps in the ethical decision-making process.
   2. Guilt or uneasiness is the first sign that an unethical decision has occurred. This feeling occurs when a person’s behaviors are inconsistent with ethical judgment.

II. **Using the Ethical Decision-Making Framework to Improve Ethical Decisions**
   A. The ethical decision making framework cannot tell you if a business decision is ethical or unethical, but it does provide you with insights and knowledge about typical ethical decision making processes in business organizations.
   B. It is unlikely that an organization’s ethical problems will be solved through a thorough knowledge about how ethical decisions are made.
   1. Business ethics involves value judgments and collective agreement about acceptable patterns of behavior.
   C. Ethical decision making within an organization does not rely strictly on the personal values and morals of individuals. Knowledge of moral philosophies or values must be balanced with business knowledge and understanding of the complexities of the dilemma requiring a decision.
   1. Organizations take on a culture of their own, which, when combined with corporate governance mechanisms, have a significant influence on business ethics.

III. **The Role of Leadership in a Corporate Culture**
   A. Top managers provide a blueprint for what a firm’s corporate culture should be.
   B. **Leadership**, the ability or authority to guide and direct others toward achievement of a goal, has a significant impact on ethical decision making because leaders have the power to motivate others and enforce the organization’s rules and policies as well as their own viewpoints.
   C. Leaders are important in influencing an organization’s corporate culture. Leaders are the organization’s board of directors, as well as its managers and top executives.

IV. **Leadership Styles Influence Ethical Decisions**
   A. Leadership styles influence many aspects of organizational behavior, including employees’ acceptance of and adherence to organizational norms and values.
   B. Ethical leaders need both knowledge and experience to make decisions. Strong ethical leaders must have the right kind of moral integrity.
   C. Six leadership styles are based on emotional intelligence:
      1. Coercive
      2. Authoritative
      3. Affiliative
      4. Democratic
      5. Pacesetting
      6. Coaching.
   D. They can also classify leaders as transactional or transformational.
1. **Transactional leaders** attempt to create employee satisfaction through negotiating, or “bartering,” for desired behaviors or levels of performance.

2. **Transformational leaders** strive to raise employees’ level of commitment and to foster trust and motivation.

V. Habits of Strong Ethical Leaders

1. The “7 Habits of Highly Moral Leaders” were developed by Archie Carroll and are based on *The Seven Habits of Highly Effective People* by Stephen Covey.

2. Ethical leadership is based on holistic thinking that embraces the complex and challenging issues companies face.

3. Leaders need both knowledge and experience to make the right decision.

4. They must have courage and the most complete information to make decisions that will be the best in the long run.

5. Leaders must stick to their principles and be ready to leave the organization if it is impossible to make the right choice.

A. Ethical Leaders Have Strong Personal Character

1. Ethical leadership is highly unlikely without a strong personal character.

B. Ethical Leaders Have a Passion to Do Right

1. Strong ethical leaders are “The glue that holds ethical concepts together.”

C. Ethical Leaders Are Proactive

1. They anticipate, plan, and act proactively to avoid potential ethical crises.

D. Ethical Leaders Consider Stakeholders’ Interests

1. Ethical leaders must consider the interests of and implications for all stakeholders, not just those that have an economic impact on the firm. Ethical leaders have the responsibility to balance stakeholder interests to ensure that the organization maximizes its role as a responsible corporate citizen.

E. Ethical Leaders Are Role Models for the Organization’s Values

F. Ethical Leaders Are Transparent and Actively Involved in Organizational Decision Making

1. Foster openness, freedom to express ideas, and the ability to question conduct

2. Encourages stakeholders to learn about and comment on what a firm is doing

3. Transparent leaders will not be effective unless they are personally involved in the key decisions that have ethical ramifications.

G. Ethical Leaders Are Competent Managers Who Take a Holistic View of the Firm’s Ethical Culture

1. They view ethics as a strategic component of decision making.

VI. Understanding Ethical Decision Making in Leadership

A. Ethical issue intensity, individual factors, organizational factors, and opportunity are all factors that result in business ethics evaluations and decisions.

B. An ethical organizational culture is shaped by effective leadership. Without top level support for ethical behavior, the opportunity for employees to engage in their own personal approach to ethical decision making will evolve.

C. The more you know about ethical decision making in business, the more likely you will be to make good decisions.

**DEBATE ISSUE: TAKE A STAND**

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This issue involves an integrity dilemma at Berkshire Hathaway and the management style of Warren Buffett. Those who argue that Buffett’s current management style is sufficient could emphasize the past success of Berkshire Hathaway as a profitable and ethical company. Those arguing
against Buffett’s current management style might point out that the misconduct happened with someone close to Buffett, showing that his trusting management style is insufficient to prevent unethical behavior on the part of his top executives.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES

This case deals with employee discrimination, legislation that protects employees, and the difficulty of organizational versus individual ethical decision making. Under the ADA, a rehabilitated alcoholic is protected on the grounds that a past record of driving while intoxicated may not be used to exclude a recovered alcoholic. First, if there was any legal basis for such an approach, it would apply to all alcoholics—rehabilitated and non-rehabilitated. The ADA protects all alcoholics. Second, if an essential element of a position entails driving and this essential element cannot be excluded from the job requirements through reasonable accommodation, then it is legally acceptable to exclude a disabled applicant on the basis of selection criteria that are job related and consistent with business necessity. In a position unequivocally requiring an employee to drive, a recent conviction for driving while intoxicated is job related and consistent with business necessity, especially when one considers the public safety implications, as well as the employer’s liability exposure due to hiring someone with a very negative driving record.

It is permissible to ask the candidate if he or she is legally able to live and work permanently in the United States. It is not legal to verify the documentation that establishes this prior to making an offer. Whether someone is or is not a citizen should not be any part of the decision-making process.

All you need to know is if they can work in the country legally, whether they are a citizen or not. If you don’t hire someone because they are a citizen of another country, not the United States, but authorized to work in the United States, you are breaking the law. If you reject on the basis of residency, it could be seen as a proxy for national origin discrimination.

While FMLA may not apply, pregnancy disability acts will. The fact is that you’re making an employment decision based on pregnancy, and that is illegal. It should be suggested that in this case students should consult with counsel to help figure out the best way to proceed. With respect to this issue, I would recommend reviewing UAW versus Johnson Controls, Inc., 499 U.S. 187 (1991). This U.S. Supreme Court case addressed an employer’s attempt to protect pregnant individuals, as well as those who were potentially able to bear children, from dangerous exposure to lead.

Asking the question, “Do you think Peter is too emotionally attached to the Martin case to make an objective decision?” will help students discuss the thin red line between an organizational ethical decision and a personal ethical decision. Peter must act as an agent for the company in this case and do what is ethically and legally appropriate under the circumstances.
CHAPTER 6

Individual Factors: Moral Philosophies and Values

SUMMARY
This chapter provides a description and analysis of how individuals’ background and philosophies influence their decisions. It is important to determine when one action is considered right and when another is viewed as wrong, as well as the individual moral philosophies that are often used to justify decisions or explain actions. To understand how people make ethical decisions, it is useful to have a grasp of the major types of moral philosophies. This chapter compares and contrasts the teleological, deontological, virtue, and justice perspectives of moral philosophy in order to give students a solid working basis of the different moral philosophies and to understand how they impact business. This chapter discusses the stages of cognitive development as it relates to these moral philosophies, along with their shortcomings. We then examine white-collar crime as it relates to moral philosophies and values.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
In this scenario, Lael Matthews is faced with a hiring challenge. She must choose between three candidates to fill a vacant position at her firm—all while keeping in mind that making a choice that appears discriminatory of gender or race could have serious repercussions on her own career. This case should help students understand the difficulties in hiring and the problems associated with being ethical and sensitive to diversity.

Each candidate has advantages and disadvantages and each seems to have a champion within the company. There is no “right” person to hire—which often happens in real-world hiring situations. The ethical issue revolves around the various pressures exerted upon Lael herself by upper management. Additionally, rewards may not have been given for qualified personnel in the past (Roy). A strong case can be made for each person, and there are ethical ramifications associated with not promoting each candidate. This vignette should help students to see that hiring decisions can be both complicated and important.

LECTURE OUTLINE
I. Moral Philosophy Defined
   A. Moral philosophy refers to the specific principles or rules that people use to decide what is right or wrong.
   B. Moral philosophies are person-specific, whereas business ethics is based on decisions made by groups or when carrying out tasks to meet business objectives.
   C. The concept of the economic value orientation is associated with values that can be quantified by monetary means. If an act produces more value than its effort costs, then it should be accepted as ethical.
   D. Idealism is a moral philosophy that places special value on ideas and ideals as products of the mind, in comparison with the world’s view. There is a positive correlation between idealistic thinking and ethical decision making.
E. **Realism** is the view that an external world exists independent of our perception of it. Realists assume that humankind is not naturally benevolent and kind but instead is inherently self-centered and competitive.

II. Moral Philosophies

A. Although there are many moral philosophies, the text focuses on those that are most applicable to the study of business ethics. There is no one “correct” way to resolve ethical issues.

1. **Instrumental and Intrinsic Goodness**
   a. Two basic concepts of goodness are monism and pluralism.
   b. **Monists** believe that only one thing is intrinsically good, and pluralists believe that two or more things are intrinsically good.
      i) Monists are often exemplified by **hedonism**—one’s pleasure is the ultimate intrinsic good or moral end.
      ii) **Quantitative hedonists** are those who believe that more pleasure is better
      iii) **Qualitative hedonists** are those who believe that it is possible to get too much of a good thing
   c. **Pluralists** (non-hedonists) take the position that no one thing is intrinsically good.
      i) All pluralists are non-hedonists, but not all monists are hedonists because an individual can believe in a single intrinsic good other than pleasure.
   d. Sometimes called pragmatists, **instrumentalists** reject the idea that
      i) ends can be separated from the means that produce them.
      ii) ends, purposes, or outcomes are intrinsically good in and of themselves.

B. **Goodness theories** typically focus on the end result of actions and the goodness or happiness created by them.

C. **Obligation theories** emphasize the means and motives by which actions are justified. These obligation theories are teleology and deontology, respectively.

1. **Teleology** refers to moral philosophies that assess the moral worth of a behavior by looking at its consequences, and thus moral philosophers today often refer to these theories as **consequentialism**.
   a. **Egoism** defines right or acceptable behavior in terms of the consequences for the individual. They believe in making decisions to maximize self-interest.
      i) **Enlightened egoists** take a long-range perspective and allow for the well-being of others, although their own self-interest remains paramount.
   b. **Utilitarianism** seeks the greatest good for the greatest number of people. Utilitarians look for the greatest total utility, or benefit, that can come of a decision using cost/benefit comparisons of all affected parties.
      i) Utilitarians use various criteria to judge the morality of an action.
         a) **Rule utilitarianism** determines behavior on the basis of principles, or rules, designed to promote the greatest utility.
         b) **Act utilitarianism** examines a specific action itself, rather than the general rules governing it.

2. **Deontology** refers to moral philosophies that focus on the rights of individuals and on the intentions associated with a particular behavior rather than on its consequences.
   a. They regard certain behaviors as inherently right, and the determination of this rightness focuses on the individual actor, not society. Thus, these perspectives are sometimes referred to as **nonconsequentialism**, an ethics of respect for persons.
   b. Deontology is greatly influenced by the philosopher Immanuel Kant’s **categorical imperative**: “Act as if the maxim of thy action were to become by thy will a universal law of nature.”
c. They regard the nature of moral principles as permanent and stable, and they believe that compliance with these principles defines ethicalness.
d. Deontologists believe that individuals have certain absolute rights, including
   i) freedom of conscience
   ii) freedom of consent
   iii) freedom of privacy
   iv) freedom of speech
   v) due process
e. Deontologists may be divided into those who focus on moral rules and those who focus on the nature of the acts themselves.
   i) Rule deontologists believe that conformity to general moral principles based on logic determines ethicalness.
   ii) Act deontologists hold that actions are the proper basis on which to judge morality or ethicalness.

3. From the relativist perspective, definitions of ethical behavior are derived subjectively from the experiences of individuals and groups.
   a. Descriptive relativism relates to observing cultures.
   b. Metaethical relativism proposes that people naturally see situations from their own perspectives and argue that there is no objective way of resolving ethical disputes between different value systems and individuals.
   c. Normative relativism assumes that one person’s opinion is as good as another’s.
   d. A problem with relativism is that it emphasizes peoples’ differences while ignoring their basic similarities. Research indicates that relativism is negatively related to a person’s sensitivity to ethical issues.

4. Virtue ethics argues that ethical behavior involves not only adhering to conventional moral standards but also considering what a mature person with a “good” moral character would deem appropriate.
   a. Individual virtue and integrity count, but good corporate ethics programs encourage individual virtue and integrity.
   b. By the employee’s role in the community (organization), these virtues are associated with appropriate conduct form a good person.
   c. The ultimate purpose is to serve society’s demands and the public good and to be rewarded in one’s career.
   d. The well-being of the community goes together with individual excellence because of the social consciousness and public spirit of every individual.

5. Justice is fair treatment and due reward in accordance with ethical or legal standards, including the disposition to deal with perceived injustices of others.
   a. Three types of justice provide a framework for evaluating fairness of different situations.
      i) Distributive justice is based on the evaluation of outcomes or results of the business relationship.
      ii) Procedural justice is based on the processes and activities that produce the outcome or results.
      iii) Interactional justice is based on the relationships between organizational members, including the way that employees and management treat one another.

III. Applying Moral Philosophy to Ethical Decision Making
   A. Individuals use different moral philosophies depending on whether they are making a personal or making a work-related decision.
   B. Two possible reasons may explain this behavior.
1. In the business arena, some goals and pressures for success differ from the goals and pressures in a person’s life outside of work.
2. The corporate culture where they work may cause employees to alter their moral philosophies.
C. The concept of a moral philosophy is inexact. Moral philosophies must be assessed on a continuum rather than as static entities.

IV. Cognitive Moral Development
A. Many people believe that individuals advance through stages of moral development as their knowledge and socialization continue over time. Some models attempt to explain, predict, and control individual’s ethical behavior.
B. According to Kohlberg's model of cognitive moral development, people pass through six cognitive moral development stages, divided into three different stages of ethical concern.
   (1. Punishment and obedience; 2. Individual instrumental purposes and exchange; 3. Mutual interpersonal expectations, relationships, and conformity; 4. Social system and conscience maintenance; 5. Prior rights, social contract, or utility; 6. Universal ethical principles)
1. The model suggests that people continue to change their decision-making priorities after their formative years, and as a result of time, education, and experience, they may change their values and ethical behavior.
2. An individual’s moral development can be influenced by corporate culture, especially ethics training. Some experts believe that experience in resolving moral conflicts accelerates an individual’s progress in moral development.

V. White-Collar Crime
A. White-collar crimes (WCCs), “crimes of the suite,” do more damage in monetary and emotional loss in one year than the crimes of the street over several years combined. A WCC is a “non-violent criminal act involving deceit, concealment, subterfuge and other fraudulent activity.”
1. White-collar criminals tend to be highly educated people who are in positions of power, trust, respectability, and responsibility within a business or organization.
2. Online WCC is a growing problem globally because technology allows people to hack into systems and access sensitive information.
   a. WCCs that previously originated at the top of organizations are now able to be committed at lower levels.
   b. Advocates of the organizational deviance perspective argue that a corporation is a living, breathing organism that can collectively become deviant. When companies have lives that are separate and distinct from biological persons, the corporate culture of the company transcends the individuals who occupy these positions.
   c. Peer influence is a cause of WCC.
   d. White-collar crime tends to increase in the years following an economic recession.
   e. Some businesspeople may have personalities that are inherently criminal.
   f. The focus of the Federal Sentencing Guidelines for Organizations is that all organizations should develop effective ethics and compliance programs to prevent WCC.

VI. Individual Factors in Business Ethics
A. Not everyone agrees on the roles of traditional moral philosophies in ethical decision making in an organization.
B. Although a personal moral compass is important, it is not sufficient to prevent ethical misconduct in an organizational context.
C. Both the rewards for meeting performance goals and the corporate culture, especially for coworkers and managers, have been found to be the most important drivers of ethical decision making.

D. Equipping employees with intellectual skills that will allow them to understand and resolve the complex ethical dilemmas they encounter in complex corporate cultures will help them make the right decisions.

DEBATE ISSUE: TAKE A STAND

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This debate asks students to speculate on the causes behind white-collar crime cases. The team who argues that white-collar criminals tend to have psychological disorders might point to the narcissistic nature of many white-collar criminals, their tendency to blame the victims, and the fact that many continue to commit fraud despite their knowledge of the consequences (e.g. Barry Minkow). Those who argue that white-collar crime results more from the organizational culture could give examples of white-collar criminals who were coerced by managers and co-workers to commit a crime.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES

From this case, students should be able to identify the ethical issues for Elaine and Dennis as the marketing and sale of products harmful to humans. In addition, they should see that UBC is looking more toward the financial bottom line as opposed to what is beneficial for Elaine and Dennis. Students should also realize, after some discussion, that the ABCO loan can be considered illegal under a Federal standard.


INTRODUCTION—The Foreign Assets Control Regulations (the “Regulations”), authorized under the Trading with the Enemy Act, established economic sanctions against the Democratic People’s Republic of Korea (“North Korea”) in 1950. They have been modified on several occasions, most recently on June 19, 2000, as a result of President Clinton’s September 17, 1999 decision to ease economic sanctions against North Korea in order to improve relations, to support the Agreed Framework, and to encourage North Korea to continue to refrain from testing long-range missiles. As a result of that decision, the Office of Foreign Assets Control ("OFAC") amended the Regulations to authorize transactions concerning certain North Korean property. On April 6, 2006, OFAC added a provision to the Regulations prohibiting U.S. persons from owning, leasing, operating or insuring any vessel flagged by North Korea. This provision is effective on May 8, 2006. Except for this provision, which does not apply to foreign subsidiaries of U.S. companies, the Regulations affect all U.S. citizens and permanent residents wherever they are located, all people and organizations physically in the United States, and all branches, subsidiaries and controlled affiliates of U.S. organization throughout the world. Criminal penalties for violating the sanctions range up to 10 years in prison, $1,000,000 in corporate fines, and $250,000 in individual fines.

SELLING TO NORTH KOREA—The June 19, 2000 amendments to the Foreign Assets Control Regulations ended the ban on exports to North Korea, provided that any exports or re-exports to North Korea are licensed or otherwise authorized by the Department of Commerce or other appropriate agencies. Source: Foreign Assets Control Regulations for the Financial Economy, http://www.complianceforbankers.com/ifs_cd_regulations_files/treasury_regulation/ofac_2006.pdf (accessed May 26, 2011).
CHAPTER 7

Organizational Factors: The Role of Ethical Culture and Relationships

SUMMARY
This chapter takes a look at corporate culture and the way a company’s values and traditions can affect employees’ ethical behavior. It also covers the role of leadership in influencing ethical behavior within the organization, looks at two organizational structures, and examines how they may influence ethical decisions. Additionally, this chapter examines the potential impact of groups within organizations and the implications of organizational relationships for ethical decisions.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
This case covers the ethical difficulties inherent in trying to balance quality service and profits in a sensitive area like healthcare. The list of ideas Dawn presents to Nancy include some ethical and legal issues:

- Trimming some prescription-drug benefits (ethical)
- Reducing redundant tests for terminal patients (ethical)
- Hiring physician assistants to see patients but billing the patient at the physician rate (ethical—possibly a legal pricing issue)
- Allowing physicians to buy shares in PCA, thus providing an incentive for bringing in more patients (illegal)
- Increasing the number of nurse practitioners to reduce the need for registered nurses (ethical)
- Sterilizing and reusing cardiac catheters (ethical)
- Having one-vendor policy on hospital products to gain quantity discounts (ethical)
- Prescreening “insurance” patients for probability of payment (ethical/legal)

Additionally, this case covers the issue of “breaking” the nurses’ union. The more basic issue is whether or not for-profit health care facilities are good for patients.

With increasing numbers of elderly straining the social security systems in the United States and in Europe, the debate over how to handle healthcare costs has been heating up. As a result, pressure has increased to reduce certain types of care or treatments to specific patients.

LECTURE OUTLINE
I. Defining Corporate Culture
   A. Culture is a broad term that can mean many different things. Corporate culture includes values, norms, artifacts, rituals, history, and unwritten rules that are specific to an organization.
      1. Culture gives the members of the organization meaning as well as the internal rules of behavior.
2. All organizations, not just corporations, have a culture.

B. The Sarbanes-Oxley 404 compliance section codified into law that leaders are responsible for the actions of subordinates, and corporations should have ethical corporate cultures.
   1. Section 404 forces firms to adopt a set of values that must make up a portion of the company’s culture.
   2. Compliance with Sarbanes-Oxley 404 requires cultural change, not merely accounting changes.

II. The Role of Corporate Culture in Ethical Decision Making
   A. The culture of an organization may be explicitly articulated or left unspoken. Explicit statements of values, beliefs, and customs usually come from upper management.
      1. Memos, written codes of conduct, handbooks, manuals, forms, and ceremonies are all formal expressions of an organization’s culture.
      2. Corporate culture is often expressed informally—for example, through comments, both direct and indirect, that communicate the wishes of management.
      3. The “tone at the top” is often cited as a determining factor in creating a high-integrity organization.

   B. Ethical Frameworks and Evaluations of Corporate Cultures
      1. There are two basic dimensions to describe an organization’s culture
         a. concern for people.
         b. concern for performance.
      2. The four organizational cultures can be classified as
         a. Apathetic: shows minimal concern for either people or performance
         b. Caring: exhibits high concern for people but minimal concern for performance issues
         c. Exacting: shows little concern for people but a high concern for performance
         d. Integrative: combines high concern for people and for performance. An organization becomes integrative when superiors recognize that employees are more than interchangeable parts
      3. A cultural audit is an assessment of the organization’s values. It is usually conducted by outside consultants but may be performed internally as well.

   C. Ethics as a Component of Corporate Culture
      1. If a firm’s culture encourages unethical behavior, its employees may act unethically, and vice versa.
      2. It is important for top managers to determine what the organization’s culture is and to monitor its values, traditions, and beliefs to ensure that they represent the desired culture.

   D. Compliance versus Values-based Ethical Cultures
      1. A compliance culture is organized around risk. Compliance-based cultures use a legalistic approach to ethics.
      2. A values-based ethics culture approach to ethical corporate cultures relies upon an explicit mission statement that defines the firm as well as how customers and employees should be treated.

   E. Differential association refers to the idea that people learn ethical or unethical behavior while interacting with others who are part of their role-sets or other intimate personal groups.
      1. A variety of studies have supported the notion that such differential association influences ethical decision making.
      2. Superiors have a strong influence on the ethics of their subordinates.
F. **Whistle-blowing** means exposing an employer’s wrongdoing to outsiders (external to the company), such as the media or government regulatory agencies.
   1. Interpersonal conflict ensues when employees think they know the right course of action in a situation, yet their work group or company promotes or requires a different, unethical decision.
   2. The Sarbanes–Oxley Act and the Federal Sentencing Guidelines for Organizations (FSGO) have institutionalized internal whistle-blowing to encourage discovery of misconduct.
   3. The 2010 passage of the Dodd-Frank Act proposed additional incentives for whistle-blowers.
   4. If an employee provides information to the government about the company’s wrongdoing, under the Federal False Claims Act, the whistle-blower is known as a *qui tam relator*.
   5. Retaliation is still a concern for whistle-blowers and they often have a difficult time winning their cases.

II. **Leaders Influence Corporate Culture**
   A. Organizational leaders use their power and influence to shape corporate culture. Leaders should be both effective and ethical.
   1. *Power* refers to the influence that leaders and managers have over the behavior and decisions of subordinates. An individual has power over others when his or her presence causes them to behave differently.
   2. There are five power bases from which one person may influence another
      a. *Reward power* refers to a person’s ability to influence the behavior of others by offering them something desirable
      b. *Coercive power* is essentially the opposite of reward power. Instead of rewarding a person for doing something, coercive power penalizes actions or behavior
      c. *Legitimate power* stems from the belief that a certain person has the right to exert influence and that certain others have an obligation to accept it. The titles and positions of authority that organizations bestow on individuals appeal to this traditional view of power
      d. *Expert power* is derived from a person’s knowledge (or the perception that the person possesses knowledge).
      e. *Referent power* may exist when one person perceives that his or her goals or objectives are similar to another’s. The second person may attempt to influence the first to take actions that will lead both to achieve their objectives. For this power relationship to be effective, some sort of empathy must exist between the individuals.

III. **Motivating Ethical Behavior**
   A. **Motivation** is a force within the individual that focuses his or her behavior toward achieving a goal.
   1. *Job performance* is considered to be a function of ability and motivation, thus $\text{Job performance} = \text{ability} \times \text{motivation}$, meaning that employees can be motivated, but resources and know-how are also needed to get the job done.
   2. To create motivation, an organization offers incentives to encourage employees to work toward organizational objectives
   3. An individual’s hierarchy of needs may influence his or her motivation and ethical behavior.
   4. After basic needs such as food, working conditions (existence needs), and survival are satisfied, relatedness needs and growth needs become important.
      a. *Relatedness needs* are satisfied by social and interpersonal relationships
b. **Growth needs** are satisfied by creative or productive activities.

c. Needs or goals may change as a person progresses through the ranks of the company.

IV. Organizational Structure and Business Ethics

A. The two broad structures for organizations are centralized and decentralized. Note that these are not mutually exclusive structures.

1. In a **centralized organization**, decision-making authority is concentrated in the hands of top-level managers, and little authority is delegated to lower levels.

2. In a **decentralized organization**, decision-making authority is delegated as far down the chain of command as possible.

3. Unethical behavior is possible in either centralized or decentralized structures when specific corporate cultures permit or encourage workers to deviate from accepted standards or ignore corporate legal and ethical responsibilities. Centralized firms may have a more difficult time uprooting unethical activity than decentralized organizations.

V. Group Dimensions of Corporate Structure and Culture

A. Two main categories of groups affect ethical behavior in business.

1. A **formal group** is defined as an assembly of individuals that has an organized structure accepted explicitly by the group.
   
   a. Can be divided into committees, work groups, and teams
   
   i) A **committee** is a formal group of individuals assigned to a specific task.
   
   ii) **Work groups** are used to subdivide duties within specific functional areas of a company.
   
   iii) **Teams** bring together the functional expertise of employees from several different areas of the organization—for example, finance, marketing, and production—on a single project, such as developing a new product.

2. An **informal group** is defined as two or more individuals with a common interest but without an explicit organizational structure.

   a. Most organizations have a number of informal groups, usually composed of individuals, often from the same department.

   b. **Group norms** are standards of behavior that groups expect of their members. They help define acceptable and unacceptable behavior within a group.

VI. Variation in Employee Conduct. A substantial amount of research indicates that significant differences exist in the values and philosophies that influence how the individuals that comprise corporations make ethical decisions.

VII. Can People Control Their Own Actions Within a Corporate Culture?

A. A popular way of viewing business ethics is to see it as a reflection of the alternative moral philosophies that individuals use to resolve their personal moral dilemmas.

B. Ethical decisions within organizations are often made by committees and formal and informal groups, not by individuals.

C. Both individual ethics and organizational ethics have an impact on an employee’s ethical intention. If there is ethical congruence between individual ethics and the organizational ethical culture, there is an increase in the potential for making ethical choices in organizational decision-making.

DEBATE ISSUE: TAKE A STAND

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This debate involves whether government support for whistle-blowers in
the form of monetary rewards will be effective. Students who argue for this point might say that these financial incentives are necessary to convince whistle-blowers to step up. Financial incentives might also help to compensate whistle-blowers for the negative repercussions they might face from employers or peers if they report externally. Those opposed could argue that financial incentives might encourage people to choose external rather than internal channels of reporting, which will inundate the SEC with reports that could have been settled in other ways.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES
Gerard works for Trawlers Accounting and has for several years, but pressures from his wife’s high-risk pregnancy and changes in the accounting industry have placed him in a difficult situation. Students should be asked to identify the financial, emotional, and organizational pressures to which Gerard is exposed. The issue of accounting firms going into the financial services industry has become prevalent. We saw such conflicts of interest arise in the fallout after the most recent Wall Street meltdown in 2008. However, many of the large accounting firms have purposefully stayed away from this practice because of the potential conflict of interest, as brought up in the scenario.

Another issue in this case involves the question of what is Gerard going to do to pacify existing clients? The instructor may wish to discuss the ramifications of unwittingly engaging in illegal activities because of either misinformation or lack of experience.
CHAPTER 8
Developing an Effective Ethics Program

SUMMARY
This chapter first provides an assessment of the corporation as an entity in society, and then gives an overview of why businesses need to develop an organizational ethics program. It covers the factors that are requisite parts of an ethics program: a code of conduct, the role of ethics officers and the appropriate delegation of authority, effective ethics training, systems for monitoring and supporting ethical compliance, and the importance of continual efforts to improve the ethics program. Finally, the chapter discusses the common mistakes made in designing and implementing ethics programs.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
This situation revolves around whether the attempt at a partial monopoly is ethical, unethical, or illegal. It involves Koke International (KI) and the ethical implications of the manager’s actions, which may result in making KI a monopoly. Students should be aware that there are many antitrust laws in the United States that are not enforced. While the United States has antitrust laws in place, many other countries do not.

The case of Wendy and KI illustrates the business-as-war mentality that can occur when companies face fierce competition. Students may believe that what KI is doing is illegal, yet, depending upon whether its actions substantially lessen or reduce competition as defined by the courts, its strategy may accomplish its objectives. Students may wish to discuss the ramifications of smaller firms using the court system to obtain redress. In many cases, litigation can go on for years with the final outcome being a pyrrhic victory—meaning the costs to the victor are devastatingly high.

Another issue relates specifically to the employee, Victoria. It can be argued that when Wendy suggests that Victoria develop a predatory pricing strategy, this constitutes illegal behavior by substantially reducing competition within the targeted area. Students should discuss the issue of hiring away employees from competitors for the purpose of weakening competition. Students should think about the ethical implications of doing this when KI knows before they are even hired that most will be eliminated.

LECTURE OUTLINE
I. The Responsibility of the Corporation as a Moral Agent
   A. Corporations are increasingly viewed as moral agents that are accountable for their conduct to stakeholders.
      1. Through legislation and court precedents, society holds companies accountable for the conduct of their employees as well as for their decisions and the consequences of those decisions.
      2. Viewed as moral agents, companies are required to obey the laws and regulations that define acceptable business conduct. However, because companies are not human, laws and regulations are necessary to provide formal structural restraints and guidance on ethical issues.
II. The Need for Organizational Ethics Programs
A. Understanding the factors that influence the ethical decision-making process can help companies encourage ethical behavior and discourage undesirable conduct.

B. To promote legal and ethical conduct, an organization should develop an organizational ethics program by establishing, communicating, and monitoring the ethical values and legal requirements that characterize its history, culture, industry, and operating environment.

C. Without uniform standards and policies of conduct, it is difficult for employees to determine what behaviors are acceptable within a company, and they may make decisions based on how their coworkers and superiors behave.
   1. A strong ethics program includes a written code of conduct, an ethics officer to oversee the program, care in the delegation of authority, formal ethics training, and auditing, monitoring, enforcement, and revision of program standards.
   2. There are no universal standards for organizational ethics programs.
   3. Ethics is not something to be delegated to lower-level employees.

III. An Effective Ethics Program
   A. The more misconduct occurs at a company, the less trust employees feel toward the organization—and the greater the turnover will likely be.
   B. A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical culture.
   C. Managers cannot assume that employees will automatically know how to behave when entering a new organization.
   D. An Ethics Program Can Help Avoid Legal Problems.
      1. Some corporate cultures provide opportunities for unethical conduct because their management lacks concern or the company has failed to comply with the minimum requirements of the FSGO, which can result in fines or probation.
      2. An ethics program can help a firm avoid civil liability, but the company bears the burden of proving that it has an effective program.
         a. A program developed in the absence of misconduct will be more effective than one imposed as a reaction to scandal or prosecution.
         b. A legal test of a company’s ethics program is possible when an individual employee is charged with misconduct.
   E. Values versus Compliance Programs
      1. No matter what their goals, ethics programs are developed as organizational control systems to create predictability in employee behavior.
      2. Two types of control systems can be created.
         a. A **compliance orientation** creates order by requiring that employees identify with, and commit to, specific required conduct.
         b. A **values orientation** strives to develop shared values, with a focus on core ideals such as respect and responsibility.
            i) Research has shown that a values orientation creates ethical reasoning among employees. Values-based programs increase employees’ awareness of ethics at work, their integrity, their willingness to deliver information to supervisors, their use of reporting mechanisms, and the perception that better ethical decisions are made.

IV. Codes of Conduct
   A. Today, society expects to see organizational members adhere to ethical principles and standards specified through company ethics programs. Most companies begin the process of establishing organizational ethics programs by developing codes of conduct.
   B. Such statements may take three different forms:
      1. A **code of conduct** is a formal statement that describes what an organization expects of its employees.
2. **A code of ethics** is the most comprehensive and consists of general statements, sometimes altruistic or inspirational, that serve as principles and the basis for rules of conduct.

3. **A statement of values** is conceived by management and fully developed with input from all stakeholders.

C. Codes require continuous reinforcement to be effective.

D. Research has found that corporate codes of ethics often contain six core values or principles
   1. Trustworthiness
   2. Respect
   3. Responsibility
   4. Fairness
   5. Caring

E. These values will not be effective without distribution, training, and the support of top management in making these values a part of the corporate culture. Codes of conduct will not resolve every ethical issue encountered in daily operations, but they help employees and managers deal with ethical dilemmas by prescribing or limiting specific activities.

V. Ethics Officers
   A. Organizational ethics programs also must have oversight by high-ranking persons known to respect legal and ethical standards called **ethics officers**.
      1. Ethics officers are responsible for managing their organizations’ ethics and legal compliance programs.
      2. Although recommended as best practice, it is not common for ethics officers to report directly to the board of directors. Ethics officers often report directly to the chief executive officer and may have some access to the board.

VI. Ethics Training and Communication
   A. A major step in developing an effective ethics program is implementing a training program and communication system to educate employees about the firm’s ethical standards.
      1. It can educate employees about the firm’s policies and expectations, relevant laws and regulations, and general social standards.
      2. It can make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice.
      3. It can empower employees to ask tough questions and make ethical decisions.
   B. Ethics training must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees.
      1. Training and communication initiatives should reflect the unique characteristics of an organization.
      2. There are many different training methods that organizations can use, such as hands on experience or behavioral simulations.

VII. Systems to Monitor and Enforce Ethical Standards
   A. An effective ethics program employs a variety of resources to monitor ethical conduct and measure the program’s effectiveness.
      1. Observing employees, internal audits, surveys, reporting systems, and investigations can assess compliance with the company’s ethical code and standards.
      2. An external audit and review of company activities may sometimes be helpful in developing benchmarks.
      3. Consistent enforcement and necessary disciplinary action are essential to a functional ethics or compliance program.
   B. Continuous Improvement of the Ethics Program
1. Implementation requires designing activities to achieve organizational objectives using available resources and given existing constraints.

2. Implementation translates a plan for action into operational terms and establishes a means by which an organization’s ethical performance will be monitored, controlled, and improved.
   a. A firm’s ability to plan and implement ethical business standards depends in part on how it structures resources and activities to achieve its ethical objectives.
   b. If a company determines that its ethical performance has been less than satisfactory, executives may want to change how certain kinds of decisions are made.

C. Common Mistakes in Designing and Implementing an Ethics Program
   1. Many business leaders recognize that they need to have an ethics program, but few take the time to answer fundamental questions about the goals of such programs.
   2. Not setting realistic and measurable program objectives.
   3. Senior management’s failure to take ownership of the ethics program. Maintaining an ethical culture may be impossible if CEOs do not support an ethical culture.
   4. Developing program materials that do not address the needs of the average employee.
   5. Transferring an “American” program to a firm’s international operations.
      a. In multinational firms, executives should involve overseas personnel as early as possible in the process.
   6. Designing an ethics program that is little more than a series of lectures. In such cases, participants typically recall less than 15 percent the day after the lecture.

DEBATE ISSUE: TAKE A STAND
Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This debate asks students to examine whether they feel codes of conduct can explain the level of misconduct in an organization. In this case, banks and financial institutions are examined because of the widespread misconduct that occurred in these industries. Students who argue that the code of conduct does reflect why misconduct has run rampant in the banking and finance industries could point out the seeming correlation between these companies’ badly constructed ethical codes and instances of misconduct. They can also argue that since codes of conduct set forth ethics and compliance procedures for employees, a bad code of conduct could leave employees without guidance in ethical decision-making. Those who argue that codes of conduct do not affect behavior in the industry might point to the fact that other companies had great codes of conduct, such as BP and Enron. This seemed to have no effect in preventing their disasters. Therefore, corporate culture may be a more suitable measure.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES
This case examines Cinco Corporation, which owns paper pulp processing plants that use fast-growing genetically-altered tress. Cinco is located near a river and uses old and outdated equipment. Jim has been placed at one of these older plants to see if he can manage a workforce and a mill. Jim learns that his mill is violating EPA waste disposal standards.

Instructors may wish to have the students discuss the issue of EPA guidelines and the utilitarian arguments surrounding their implementation. Jobs versus clean water versus Jim’s career are topics that
could be explored. It should also be brought up that there is a very high probability that many of the people at Cinco’s Headquarters probably know of the EPA situation because of Cinco’s duplicity in handling the matter. Taking different moral philosophical views and discussing how people may react to this situation will help students understand why people make the choices they do.
CHAPTER 9

Managing and Controlling Ethics Programs

SUMMARY
This chapter examines the concept of an ethics audit as a way to help implement an effective ethics program. The chapter begins by discussing the implementation of ethics programs. We define the term ethics audit and explore its relationship to a social audit. Next, we examine the benefits and limitations of this implementation tool. The challenges of measuring nonfinancial ethical performance are examined, and evolving standards are reviewed from AA1000, the Global Reporting Initiative, and the Open Compliance Ethics Group. We then detail a framework for an ethics audit, including securing the commitment of directors and top managers; establishing a committee to oversee the audit; defining the scope of the audit process; reviewing the firm’s mission, values, goals, and policies and defining ethical priorities; collecting and analyzing relevant information; verifying the results; and reporting them. Finally, this chapter considers the strategic importance of ethics auditing.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”
In this vignette, Chantal—who has been a loyal employee of Butterfly Industries for 13 years—has been asked to head up a committee to create a corporate ethics program. The company had recently experienced dramatic global growth. Among the tasks Chantal faces in her new role is prioritizing the ethical and legal issues and risks faced by the company. Students may prioritize these issues in many ways, but they should recognize issues such as the potential for legal violations in the area of international marketing; treatment of workers, especially women; product labeling; shareholder interaction; and the natural environment. Students should also be able to identify ethical issues such as the challenge of balancing profits with the desires of various stakeholders and improving communication among facilities within an organization. An ethics program should address these issues with a code of conduct and/or specific regulations, as well as consistently-applied and appropriate penalties for violations of the rules. Students should recognize that without such a program, Butterfly could face significant penalties or lawsuits should one of its employees be found in violation of the law. They should also be able to offer some recommendations as to the composition of Chantal’s ethics committee and describe how the steps outlined in Chapter 8 for creating an ethics program can be applied to Butterfly. As part of the process of creating an ethics program, Chantal may wish to commission an ethics audit by an experienced outside consultant in order to define the issues and specific priorities to be addressed and to establish baseline measures against which future performance can be compared. This move would demonstrate a concerted effort to improve ethics and legal compliance at Butterfly Industries.

LECTURE OUTLINE
I. Implementing Ethics Programs
   A. In order to implement a successful ethics program, an organization must have ways of managing, evaluating, and controlling business ethics programs.
   B. Viewing a business ethics program as a part of strategic planning and management activities is critical to the success of any firm.
1. Shared values among employees are the “glue” of successful management and control of business ethics programs. When the business ethics program helps to align and direct activities toward an ethical culture, there will be a commitment to the long-term ethical progress of the firm.

C. Three types of controls are involved with implementing and managing an ethics program.
   1. Formal controls for business ethics include input controls that provide the proper tools and resources (proper selection of employees, ethics training, and structural systems, including communication systems).
   2. Process controls include management commitment to the ethics program and the methods or system for evaluation.
   3. Output controls involve setting standards against actual behavior. One of the most popular methods of evaluating ethical performance is an ethics audit.

II. The Ethics Audit
A. An ethics audit is a systematic evaluation of an organization’s ethics program and performance to determine whether it is effective.
B. It includes regular, complete, and documented measurements of compliance, measuring conformity to the firm’s desired ethical standards.
C. Can be a precursor to setting up an ethics program. It identifies the firm’s current ethical standards, policies, and risk areas so that an ethics program can effectively address problem areas.
D. A social audit is the process of assessing and reporting a business’s performance in fulfilling the economic, legal, ethical, and philanthropic responsibilities expected of it by its stakeholders.
   1. Social reports often discuss issues related to a firm’s performance in the four dimensions of social responsibility as well as to specific social responsibility and ethical issues such as staff issues, community economic development, volunteerism, and environmental impact.
   2. In contrast, ethics audits focus on more narrow issues related to assessing and reporting on a firm’s performance in terms of ethical and legal conduct.
   3. An ethics audit can be a component of a social audit. Ethics auditing is similar to financial auditing in that it employs similar procedures and processes to create a system of integrity that includes objective reporting.

III. Benefits of Ethics Auditing
A. There are many reasons why companies choose to understand, report on, and improve their ethical conduct.
   1. One reason is to detect ethical misconduct before it becomes a major problem.
   2. Accounting scandals and legal and ethical transgressions have encouraged companies to better account for their actions in a wide range of areas including corporate governance, ethics programs, customer relationships, employee relations, environmental policies, and community involvement.
   3. Measuring the ethical work climate is one way to learn about the ethical culture of an organization. The auditing process can highlight trends, improve organizational learning, and facilitate communication and working relationships.
B. One of the greatest benefits of the auditing process is improved relationships with stakeholders.
C. Ethical Crisis Management and Recovery
   1. Just as companies develop crisis management plans to prepare to, respond to, and recover from natural disasters, they should also prepare for ethical disasters, which can
result in substantial legal and financial costs, disrupt operations, reduce productivity, 
destroy organizational reputation, and erode stakeholder confidence.

a. Despite the high costs of misconduct, U.S. companies are failing to identify and 
   manage ethical, social, economic, and environmental concerns.

b. Ethical disasters follow recognizable phases of escalation, from ethical-issue 
   recognition and the decision to act unethically to the organization’s discovery of 
   and response to the act.

   i) Anticipation of and intervention during these situations can stave off 
      organizational disaster. Contingency planning assesses risks, plans for these 
      potential occurrences, and provides ready tools for responding to ethical 
      crises.

   ii) The process of ethical disaster recovery planning involves assessing the 
       organization’s values, developing an ethics program, performing an ethics 
       audit, and developing contingency plans for potential ethical disasters.

D. Measuring Nonfinancial Ethical Performance

1. Although much of the regulatory focus of corporate ethics and compliance is driven by 
   financial measures, the integrity of an organization also has to focus on nonfinancial 
   areas of performance.

2. The word *integrity* implies a balanced organization that not only makes ethical 
   financial decisions but also is ethical in the more subjective aspects of its corporate 
   culture.

   a. The Sarbanes–Oxley Act has focused on questionable accounting and the metrics 
      that destroy shareholder value. On the other hand, models exist (Six Sigma, the 
      Balanced Scorecard, and the Triple Bottom Line) to capture structural and 
      behavioral organizational ethical performance.

   b. Six Sigma is a methodology to manage process variations that cause defects, 
      defined as unacceptable deviation from the mean or target, and to systematically 
      work toward managing variation to eliminate those defects.

   c. Balanced Scorecard is a method for measuring a company’s activities in terms of 
      its vision and strategies.

   d. The Triple Bottom Line captures an expanded spectrum of values and criteria for 
      measuring organizational (and societal) success—economic, environmental, and 
      social.

3. The purpose of nonfinancial measures is to determine the wholeness and soundness of 
   the many aspects of a business that enhance ethics and profits without increasing risk.

4. The Global Reporting Initiative (GRI), which advances sustainability reporting, has 
   become a prominent framework that companies have adopted to report their social and 
   sustainability progress.

   a. Businesses can use the GRI to come up with a more standardized method of 
      reporting nonfinancial results in a way that users of the reports can understand.

   b. Companies benefit because the GRI provides tools for improving their 
      implementation of the triple bottom line, the disclosure of their progress in this 
      area, the ability to compare their sustainability efforts to those of other 
      companies, and the chance to enhance their reputation in the eyes of stakeholders.

   c. Users benefit because this standardized sustainability reporting provides them 
      with a benchmark to compare companies’ sustainability initiatives.

5. AccountAbility is an international membership organization committed to enhancing 
   the performance of organizations and to developing the competencies of individuals in 
   social and ethical accountability and sustainable development.
Chapter 9: Implementing and Auditing Ethics Programs

a. The AA1000 process standards link the definition and embedding of an organization’s values to the development of performance targets and to the assessment and communication of organizational performance.

b. AA1000 ties social and ethical issues into the organization’s strategic management and operations.

6. Open Compliance Ethics Group created a universal framework for compliance and ethics management.
   a. Focus on non-financial compliance and qualitative elements of internal controls.
   b. Guidelines that companies can utilize as they see fit.
   c. Offers tools and certification procedures.

E. Risks and Requirements in Ethics Auditing

1. Although ethics audits provide many benefits for individual companies and their stakeholders, they do have the potential to create risks.
   a. A firm may uncover a serious ethical problem that it would prefer not to disclose until it can remedy the situation.
   b. It may find that one or more of its stakeholders’ criticisms cannot be dismissed or easily addressed.
   c. The process of conducting an ethics audit may foster stakeholder dissatisfaction.
   d. The auditing process imposes burdens (especially with regard to record keeping) and costs for firms that undertake it.
   e. The process of auditing and reporting a firm’s ethics programs is no guarantee that it will avoid challenges related to its efforts.
   f. Because this type of auditing is relatively new, there are few common standards to judge disclosure and effectiveness or to make comparisons.

2. Being viewed by the public as needing an audit can motivate companies to conduct one in order to signal their intention to respond to concerns.

3. Although ethics and social responsibility are defined and perceived differently by various stakeholders, a core of minimum standards for ethical performance is evolving.
   a. Specific, measurable, achievable, and meaningful measurements in terms of business impact on communities, employees, consumers, the environment, and economic systems
   b. The FSGO’s seven steps for effective ethical compliance, the Sarbanes–Oxley Act, and the Dodd-Frank Act provide standards that organizations can use in ethics auditing.

IV. The Auditing Process

A. Questions to be addressed during an audit:
   1. How broad the audit should be?
   2. What standards of performance should be applied?
   3. How often the audit should be conducted?
   4. Whether and how the audit’s results should be reported to stakeholders
   5. What actions should be taken in response to audit results?

B. An ethics audit should be unique to each company, reflecting its size, industry, corporate culture, and identified risks as well as the regulatory environment in which it operates.

C. The framework in this text encompasses a wide range of business responsibilities and relationships. There is no generic approach that will satisfy every firm’s circumstances.

D. Secure Commitment of Top Managers and Board of Directors
   1. The first step in conducting the audit is to secure the commitment of the firm’s top management and, if it is a public corporation, its board of directors.
      a. Pressure for an ethics audit may come from the board of directors in response to stakeholder concerns or legally mandated corporate governance reforms related
to the Sarbanes–Oxley Act, which suggests that boards of directors should provide oversight for all auditing activities.

b. Court decisions related to the FSGO hold board members responsible for the ethical and legal compliance programs of the firms they oversee.

2. Pressure for an audit may come from top managers looking for ways to track and improve ethical performance, and to give their firm an advantage over competitors that are facing questions about their ethical conduct.

3. CEOs and CFOs may face prosecution if they knowingly certify misleading financial statements.
   a. Some companies have established an ethics officer in conjunction with an ethics program, and the ethics officer may campaign for an ethics audit as a way to measure the effectiveness of the firm’s ethics program.
   b. Regardless of where the impetus for an audit comes from, its success hinges on the support of top management.

E. Establish a Committee to Oversee the Ethics Audit
   1. The next step is to establish a committee or team to oversee the audit process.
      a. Ideally, the board of directors’ financial audit committee should oversee the ethics audit.
      b. In most firms, managers or ethics officers conduct social and ethics auditing.
      c. This team should include members who are knowledgeable about the nature and role of ethics audits and come from various departments within the firm.
      d. Outside consultants may be hired to coordinate the audit and report the results directly to the board of directors.
         i) An external auditor should not have other consulting or conflict-of-interest relationships with top managers or board members.

F. Define the Scope of the Audit Process
   1. The ethics audit committee should establish the scope of the audit and monitor its progress to ensure that it stays on track.
      a. The scope depends on the type of business, the risks faced by the firm, and available opportunities to manage ethics.
      b. This step includes defining the key subject matter or risk areas that are important to the ethics audit as well as the bases on which they should be assessed.

G. Review Organizational Mission, Values, Goals, and Policies, and Define Ethical Priorities
   1. The audit process should include a review of the current mission statement and strategic objectives. The company’s overall mission may incorporate ethics objectives, but these may also be found in separate documents, including those that focus on social responsibility.
   2. This step should examine all formal documents that make explicit commitments with regard to ethical, legal, or social responsibility, as well as less formal documents, including marketing materials, workplace policies, and ethics policies and standards for suppliers or vendors.
   3. It is important to examine all of the firm’s policies and practices for the specific areas covered by the audit.
      a. Should look at how managers are rewarded for meeting their goals and the systems available for employees to give and receive feedback.
      b. An effective ethics audit should review all systems and assess their strengths and weaknesses.
   4. Concurrent with this step in the auditing process, the firm should define its ethical priorities.
a. Because there may be no legal requirements for ethical priorities, it is up to management’s strategic planning processes to determine appropriate standards, principles, duties, and required action to deal with ethics issues.

H. Collect and Analyze Relevant Information
1. The next step is to identify the tools or methods for measuring the firm’s progress in improving employees’ ethical decisions and conduct. The firm should collect relevant information for each designated subject-matter area.
   a. A thorough audit will include a review of all relevant reports, including external documents sent to government agencies and other parties. The information collected will help determine baseline levels of compliance as well as the internal and external expectations of the company. This step identifies where the company has met its commitments.
   b. Some techniques for collecting evidence might involve examining both internal and external documents, observing the data-collection process (such as by consulting with stakeholders), and confirming information in the organization’s accounting records. Auditors may also employ ratio analysis of relevant indicators to identify any inconsistencies or unexpected patterns.
2. Because stakeholder integration is so crucial to the ethics audit, a company’s stakeholders need to be defined and interviewed during the data-collection stage
   a. Understanding employee issues is vital to a successful audit.
   b. Customers are a primary stakeholder group because their patronage and loyalty determines the company’s financial success. Providing meaningful feedback is critical for creating and maintaining customer satisfaction.
3. Some investors seek to include in their investment portfolios the stocks of companies that conduct ethics and social audits. They are becoming more aware of the financial benefits that can stem from socially responsible management systems.
4. Organizations can obtain feedback from stakeholders through standardized surveys, interviews, and focus groups. Companies can also encourage stakeholder exchanges by inviting specific groups together for discussions.
   a. The primary objective is to generate a variety of opinions about how the company is perceived and whether it is fulfilling stakeholders’ expectations.
5. Once these data have been collected, the firm should then compare its internal perceptions to those discovered during the stakeholder assessment stage, and then summarize findings and draw preliminary conclusions.
   a. May involve descriptive assessments of the findings (the costs and benefits of the company’s ethics program, the strengths and weaknesses of the firm’s policies and practices, feedback from stakeholders, and issues that should be addressed in future audits).
   b. It may be appropriate to weigh the findings against standards identified earlier, both quantitatively and qualitatively.
   c. Data analysis should also include an examination of how other organizations in the industry are performing in the designated subject-matter areas.

I. Verify the Results
1. The next step is to have an independent party (social/ethics audit consultant, a financial accounting firm that offers social auditing services, or a nonprofit special-interest group with auditing experience) verify the results of the data analysis.
   a. Independent verification offers a measure of assurance that the company has reported its audit fairly and honestly, as well as providing an assessment of its social and environmental reporting systems.
b. Verification by an independent party gives stakeholders confidence in a company’s ethics or social audit and lends the audit report credibility and objectivity.

3. An increasing number of companies are opting for independent verification of ethics audits.
   a. The process of verifying the results of an audit should involve standard procedures that control the reliability and validity of the information.
   b. Auditors can apply substantive tests to detect material misstatements in the audit data and analysis.
   c. A financial auditor may be asked to provide a letter to the company’s board of directors and senior managers that highlights any inconsistencies in the reporting process.

J. Report the Findings
   1. The final step is to issue the ethics audit report.
      a. Reporting the audit findings to the relevant internal parties and, if approved, to external stakeholders in a formal report.
   2. The report should spell out the purpose and scope of the audit, the methods used in the audit process (evidence gathering and evaluation), the role of the (preferably independent) auditor, any auditing guidelines followed by the auditor, and any reporting guidelines followed by the company.
   3. Although the ethics audit may be similar to a financial audit, their forms are quite different. In a financial audit, the Statement of Auditing Standards dictates the content and placement of every word of a financial audit report.
      a. The report issued can be an unqualified opinion, a qualified opinion, an adverse opinion, or a disclaimer of opinion.

V. The Strategic Importance of Ethics Auditing
   A. Although the concept of auditing implies an official examination of ethical performance, many organizations audit their performance informally.
   B. Any attempt to verify outcomes and to compare them with standards can be considered an auditing activity.
   C. Organizations such as the Better Business Bureau (BBB) provide awards and assessment tools to help any organization evaluate their ethical performance. Companies with fewer resources may wish to use the judging criteria from the BBB’s Torch Award Criteria for Ethical Companies as benchmarks for their informal self-audits.
   D. The ethics audit should be conducted regularly rather than in response to problems or questions about a firm’s priorities and conduct.
   E. An audit may be comprehensive and encompass all of the ethics and social responsibility areas of a business, or it can focus on one or two specific areas.
   F. Ethics audits can present several problems.
      1. They can be expensive and time consuming
      2. Selecting the auditors may be difficult if objective, qualified personnel are not available
      3. Employees sometimes fear comprehensive evaluations, and in such cases, ethics audits can be disruptive
   G. Auditing ethical performance can also generate many benefits.
      1. Provides an assessment of a company’s ethical performance as compared to its core values, ethics policy, internal operating practices, management systems, and the expectations of key stakeholders
      2. The assessment can be used to reallocate resources and activities as well as focus on new opportunities.
3. The process can also help companies fulfill their mission statements in ways that boost profits and reduce risks.
4. Can pinpoint areas where improving operating practices can improve both bottom-line profits and stakeholder relationships.
5. Can demonstrate the positive impact of ethical conduct and social responsibility initiatives on the firm’s bottom line, convincing managers—and other primary stakeholders—of the value of more ethical and socially responsible business practices.

DEBATE ISSUE: TAKE A STAND

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This debate asks students to choose which ethical auditing guidelines to use for a small company’s situation. Those arguing for the Better Business Bureau auditing criteria might point out that this audit provides a practical approach and allows the organization to examine itself from a multitude of stakeholder’s perspectives. Those arguing for the audit guidelines provided in Table 9-4 could argue that it is easier and more helpful to use a checklist of items that address specific areas of the company.

“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES

In this vignette, Jerry, a member of the board of directors for Soumey Corporation, is concerned that the company is not responding properly to a number of troubling legal and ethical issues. Instructors may wish to have students discuss Jerry’s responsibilities as a director of the corporation, including whether he has a legal, if not ethical, obligation to report to authorities—such as OSHA, EPA, and the EEOC—what he has learned about employee safety issues, unfair treatment of employees, possible sexual harassment, and the toxic spill. Students should recognize that under Sarbanes-Oxley and other laws and regulations, Jerry could be legally liable for the corporation’s misconduct in these areas. They should also be able to identify issues associated with the composition of Soumey’s board of directors, such as whether there are sufficient outside directors and whether any of them may have conflicts of interest that may influence their roles as members of the firm’s ethics committee. Instructors may wish to ask students to discuss what actions, given the facts presented in the vignette, Jerry should insist be taken at Soumey to address these issues.
CHAPTER 10

Globalization of Ethical Decision Making

SUMMARY
Advances in communication, technology, and transportation have further minimized the world’s borders, creating an ever more interconnected global economy. This chapter discusses how transactions across international boundaries define global business, and how the variety of cultures and expectations around the globe complicates the topic of business ethics. International businesspeople must understand the values, cultures, and ethical standards of his or her home country, as well as every country in which his or her firm conducts business. Formal codes of conduct are less common internationally, and the topics of principle concern shift between countries and across time. Major concerns today involve global risks, legal approaches to business ethics, and compliance measures. Insufficient understanding of the complexity of global business can destroy trust and do lasting damage to a firm. This chapter examines these topics, as well as the role of international organizations like the IMF, the UN, and the WTO in shaping international business. It will help students to learn about the cultural differences between nations and how they can affect common business practices, as well as to gain a general awareness of global ethical issues. This chapter aims to help students understand, and possibly avoid, the ethical quagmires that exist in the global business environment.

INSTRUCTOR NOTES FOR “AN ETHICAL DILEMMA”

Students may wish to discuss the issue of companies doing business in other cultures and the argument that an activity is acceptable and ethical as long as it is legal. This case examines the Dun & Ready Company (D&R) and its stockbroker, Sid. Sid’s job was to monitor the Japanese stock market, a job for which he was suited given his understanding of the culture. However, Sid’s performance was not satisfactory, and he was not producing good enough results relative to his expenses. As a way of staying afloat, Sid started to “churn” some accounts, which is buying and selling stocks for the express purpose of increasing his own revenues. Churning and spending funds on government officials are both prohibited under U.S. law, but are rarely enforced when outside the country. The rationale, “when in Rome,” is a classic act reasoning style, which students may recall is also known as cultural relativism. The instructor may also want to discuss the issue of employee loyalty as well as obtaining critical information and providing such to hostile organizations. Betraying trust issues are prevalent in the finance sector of business and should be explored. The situation closes with the problem of trust from the standpoint of Sid versus his fellow confidants.

LECTURE OUTLINE
I. Global Culture, Values, and Practices
   A. Global business is a practice that brings together people from countries that have different cultures, values, laws, and ethical standards.
   B. Country cultural values are specific to groups, sects, regions, or countries that express actions, behavior, and intent.
   C. National culture consists of everything in our surroundings that is made by people—both tangible items and intangible things such as concepts and values.
      1. Each nation has a distinctive culture and distinctive beliefs about what business activities are acceptable or unethical.
2. Many nations also have distinct subcultures.
3. Geert Hofstede identified four cultural dimensions that can have a profound impact on the business environment.
   a. Individualism/collectivism refers to how self-oriented cultural members are in their behavior
   b. Power distance refers to the “power inequality” between superiors and subordinates
   c. Uncertainty avoidance refers to how members of a society respond to uncertainty or ambiguity.
4. The self-reference criterion is the unconscious reference to one’s own cultural values, experiences, and knowledge.
5. Businesspeople tend to fall into the thinking of cultural relativism, or “When in Rome, do what the Romans do.”
6. Global common values are shared across most cultures.
   a. Although divergent religious values and other aspects of culture can create ethical issues in international business, many cultures share desirable common values such as integrity, equality, family and community unity, and honesty.

II. Economic Foundations of Business Ethics
A. The last economic recession highlighted the fact that firms were taking extreme risks, bending rules, and engaging in unethical activity. A major part of the problem was an excessive focus on rewards and the bottom line that pervaded the global financial industry.
   1. Risk compartmentalization occurs when various profit centers within corporations are unaware of the consequences of their decisions on the organization as a whole. No one person can be blamed, as problems were systemic.
   2. National disasters can also destabilize economies and affect the economic system.
   3. The world is still coping with the after effects of the last global recession, which caused massive distrust in the stability of governmental institutions as well as the responsibility of those who manage the money of individuals, corporations, and countries.
B. Economic Systems. To understand capitalism and what people are beginning to perceive as its shortcomings, one needs a historical review of key figures and concepts.
   1. Adam Smith was a 19th century professor of logic and moral philosophy and is considered the father of modern free market (laissez-faire) capitalism and economics. Smith believed that the market has its own internal set of checks and balances that help the system to self-regulate.
   2. John Maynard Keynes is the father of the second incarnation of capitalism that gained traction in the 1930s. Keynes believed that the private sector, in order to stimulate growth and improve stability, occasionally needs help from government intervention. Keynesian economic policies were widely employed during the 1930s and into the 1940s.
   3. Milton Friedman represents the most recent form of capitalism, which represented a swing to the right politically. Friedman stood for a return to the self-regulating free-market capitalism espoused by Smith. Friedman called for widespread deregulation. His ideas took off during the 1980 Reagan years in the United States.
      a. Both Keynes and Friedman believed that
         i) People have rational preferences among outcomes that can be identified and associated with value
         ii) Individuals seek to maximize utility, and firms seek to maximize profits
         iii) People act independently on the basis of full and relevant information
C. **Socialism** refers to economic theories advocating the creation of a society in which wealth and power are shared and distributed evenly based on the amount of work expended in production.
   1. Modern socialism was a working-class political movement that emerged in the 19th century
   2. Karl Marx was one of socialism’s most famous advocates
   3. **Social democracy** formed in the 1940s as an offshoot of socialism. It allows for private ownership of property, but also has a large government that provides a wide range of services to citizens.

D. Large multinational corporations have created unprecedented concentrations of wealth and power that lie, not with states, but with private corporations. This has led to **bimodal wealth distribution**, which occurs when the middle class shrinks, resulting in highly concentrated wealth amongst the rich and large numbers of poor people with very few resources.

E. There are two main schools of economic thought
   1. **Rational economics** is based on the idea that people are rational and will base their decisions on maximizing their utility based on the amount of resources available to them. It also assumes that people act independently on the basis of full and relevant information.
   2. **Behavioral economics** assumes that humans may not act rationally because of a variety of influences such as genetics, learned behaviors, and heuristics (rules of thumb).

F. Capitalism is one of the United States’ many cultural exports.
   1. The United States practices one kind of capitalism, but there are many forms.
   2. The last recession, combined with the collapse of some of the world’s largest financial firms has dampened global enthusiasm for capitalism in general.
   3. There is a general consensus that corporations should practice social responsibility as a means of improving performance and reputation along with avoiding some of the pitfalls of capitalism.

III. Multinational Corporations (MNCs)
A. **Multinational Corporations** (MNCs) are public companies that operate on a global scale without significant ties to any one nation or region.
B. They represent the highest level of international business commitment and are characterized by a global strategy of focusing on opportunities throughout the world.
C. Because of their size and financial power, MNCs have been the subject of much ethical criticism, and their impact on the countries in which they do business has been hotly debated.
   1. Critics believe that the size and power of MNCs create ethical issues related to the exploitation of both natural and human resources. Critics also accuse MNCs of exploiting the labor markets of host countries.
   2. Sometimes, countries refuse outright to allow MNCs in.
   3. The activities of MNCs may also raise issues of unfair competition.
   4. Some MNCs strive to be good global citizens with strong ethical values.
   5. Because of increased stakeholder scrutiny and growing pressures to be sustainable and socially responsible, many corporations belong to **Business for Social Responsibility**, which is a globally based research system that tracks trends and issues and provides resources for corporations.
   6. Although MNCs are not inherently unethical, their size and power often seem threatening to less-developed countries.
   7. The U.S. model of the MNC is fading over time as countries such as China, India, Brazil, and South Korea continue to grow.
8. Regardless of the MNC model, ethics and social responsibility are always important—particularly in MNCs because of their strong international presences.

IV. Global Cooperation to Support Responsible Business

A. International Monetary Fund

1. The IMF emerged from the Bretton Woods agreement of 1944, where a group of leaders decided that the responsibilities for the regulation of monetary relationships among nations should be carried out by an extra-national body. Member states provide funds for IMF through quotas that are proportional to the size of their economies.
   a. The IMF makes short-term loans to member countries that have deficits and provides foreign currencies for its members.
   b. Its main function is to regulate monetary relationships between national economies. The organization has also taken steps to promote responsible global business conduct.
      i) The concept of risk and IMF bailouts took on significant importance during the last global recession. Because of a massive amount of debt, the European countries of Greece and Ireland required major bailout packages from the IMF.

B. United Nations Global Compact

1. It is a set of 10 principles that promote human rights, sustainability, and the eradication of corruption.
2. The purpose is to create a collaborative arrangement between businesses, governments, nongovernmental organizations, societies, and the United Nations to overcome challenges and advocate for positive economic, social, and political change.
3. Businesses that make a commitment to the UN Global Compact are required to annually post the organization’s progress toward Global Compact goals, show commitment to UN guiding principles, and cooperate with the UN on social projects within developing nations in which they do business.

C. The Association to Advance Collegiate Schools of Business (AACSB) joined with groups such as the UN Global Compact to inspire a set of six principles for business schools.

D. The World Trade Organization

1. The WTO was established in 1995 at the Uruguay round of negotiations of the General Agreement on Tariffs and Trade (GATT).
   a. It has 153 member and observer nations.
2. The WTO administers its own trade agreements, facilitates future trade negotiations, settles trade disputes, and monitors the trade policies of member nations.
3. It addresses economic and social issues involving agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards, food sanitation regulations, services, and intellectual property.
4. It provides legally binding ground rules for international commerce and trade policy. The organization attempts to reduce barriers to trade between and within nations, and settle trade disputes.
5. The WTO rules on trade issues, such as dumping, which is the practice of charging high prices for products in domestic markets while selling the same products in foreign markets at low prices, often at below cost.
6. The WTO has not been able to increase global commitment to free trade.

III. Global Ethics Issues

A. Global risks are becoming an increasingly important ethics issue. Four major risks include
   1. “G-Zero” risks
   2. Internet security and privacy
   3. Relations with China
   4. Emerging markets
B. Bribery
1. The U.S. Foreign Corrupt Practices Act prohibits American companies from making corrupt payments to foreign officials for the purpose of obtaining or keeping business. Small facilitation payments are allowed to facilitate or expedite routine governmental transactions.
2. The U.K. Anti-Bribery Act goes further by holding businesspeople more accountable for bribery. It does not have provisions for facilitation payments.

C. Anti-trust
1. In 1890, the United States passed the Sherman Antitrust Act to prohibit antitrust activities.
2. The European Union has more stringent antitrust laws than many other countries.
3. A vertical system is where a channel member (manufacturer, wholesaler, distributor, or retailer) has control of the entire business system, via ownership, contract, or through its purchasing ability. Vertical systems create inertia, which causes channel members to stay with their various retailers and distributors even though competitors may have better products and prices. Sometimes MNCs use their size to coerce other companies to do business exclusively with them.

D. Internet Security and Privacy
1. Today’s computer hackers can use tools like the Internet and computer viruses to commit corporate espionage, launch cyber terrorism attacks against government infrastructures, steal confidential information, and more.
2. Many companies use questionable Internet practices such as cookies, which may not be illegal but could be construed as unethical.
3. Another ethical issue is the personal information collected by companies such as Facebook. Some countries are debating legislation to limit the amount of information companies can collect or track.

E. Human rights have been codified in the United Nations Human Rights Declaration. They are defined as an inherent dignity that should be afforded to all people with equal and inalienable rights as the foundation of freedom, justice, and peace in the world.

F. Health is a major global human rights issue, with millions of people dying of preventable diseases each year. Particularly with multinational corporations, the issue of health care availability and affordability for workers in all nations is becoming a major source of concern. Many businesses have run into ethical trouble over the question of whether access to health care is a right or a privilege.

G. Labor and Right to Work
1. More people than ever work in nations other than their homeland, and multinationals are larger than ever.
2. One example of a global labor issue involves gender pay inequality. Women worldwide tend to be paid less than their male counterparts are.
3. Many countries outlaw or limit workers’ rights to join trade unions.
4. Rights for pregnant workers vary from country to country.

H. Compensation
1. A living wage refers to the minimum wages that workers require to meet basic needs. Many countries have passed minimum wage laws to try to provide employees with a living wage.
   a) While many multinationals choose to do business in other countries because of the low cost labor, this becomes an ethical issue when workers do not make enough to support themselves or their families.
2. Recently, many executives of bailed-out financial firms found themselves facing criticism over their high compensation, which many stakeholders felt was tantamount to rewarding failure.
I. **Consumerism** is the belief that consumers, not the interests of corporations, should dictate the economic structure of society. Part of this theory is that the consumption of goods relates to increased well-being. However, strains on resources around the world have caused many to begin to question the idea that greater consumption is always better.

1. **Made-to-break** or planned obsolescence is part of the consumerist mindset that many people are finding increasingly difficult to accept. Made-to-break items encourage consumers to return regularly to buy more items.

IV. The Importance of Ethical Decision Making in Global Business

A. Ethical decision-making is essential to operate successfully within a global business context. Without a clear comprehension of global ethics issues, companies will face a variety of legal and political snares that could result in disaster.

B. Many companies choose to adopt global business codes of ethics to provide guidelines for its international operations. Some organizations create ethics and social responsibility frameworks that businesses can adopt in formulating their own global ethics codes.

C. For multinational corporations, risk management and global ethics are so integral to the stability of their overseas operations that they have created special officers or committees to oversee global compliance issues.

**DEBATE ISSUE: TAKE A STAND**

Have your students split into two teams. One team will argue for the first point, and the other will argue for the opposing view. The purpose is to get students to realize that there are no easy answers to many of these issues. This debate revolves around an increasingly important question: Is health care a universal right that should be provided by governments. Students who argue that health care is a right could point out the sanctity of human life and the government’s responsibility to protect its citizens’ rights. Those in opposition could argue that government health care will increase costs and add inefficiencies to the system.

**“RESOLVING ETHICAL BUSINESS CHALLENGES” NOTES**

George Wilson of CornCo has a problem—corn prices are on the rise at the same time that a competitor is introducing a competitive product. George must figure out a way to keep CornCo’s products competitive in order to maintain market share. George finds some cheap corn, but it is tainted with a difficult-to-detect poison. There are laws in place to prevent this practice, but no one has been convicted and there are no laws preventing the products from being shipped abroad. Without selling the tainted corn, CornCo’s prices will be too high.

The instructor can divide the students into multiple groups representing differing perspectives such as U.S. versus foreign workers or George and Jake. They may have an interesting discussion on the cost/benefit comparison between selling tainted corn but keeping profit margins and market share high while risking a fine versus selling a more expensive but non-tainted product and risk dropping market share. Students may discuss the concept of law and political action committees (PACs). They may also discuss how the law is not necessarily a static concept within business and how laws vary across nations. The issue of exporting contaminated products into other countries where laws are less stringent can be equated to many established policies in many companies around the world.
CASE NOTES

The following pages provide notes and suggestions for handling the twenty cases contained in *Business Ethics*, Ninth Edition. The cases are meant to help students realize that ethics can be applied to specific business situations, as well as to aid them in recognizing the ethical issues that arise from the “real world” of business.

The instructor can treat the questions at the end of each case a number of ways: as essay topics for use on examinations, as a means of directing class discussions of the cases, or as issues that groups of students may debate in class. There are no “correct” answers to the questions. Their function is to help students detect and acknowledge ethical issues and grasp the factors that may influence a businessperson’s decisions in ethical situations. The questions can also guide students through the ethical decision making process. Thus, instructors should ask students to defend and justify their answers and should evaluate students on their ability to apply what they have learned about business ethics to the cases.

Class discussions of the cases are particularly useful because they encourage a sharing of views and expose students to a variety of personal moral philosophies. In fact, the instructor might encourage students to explore their own personal moral philosophy and to apply that philosophy to some of the events described in the cases.

The more students can be exposed to different moral philosophies, the better they will be able to understand why people may make unethical decisions. Such exposure may also prompt them to be more respectful of and open-minded about the values and personal moral philosophies of others when they enter the business world. Recognition that different values and philosophies guide different people and that different variables affect them may help students respond more ethically in the business world.
CASE 1

Monsanto Attempts to Balance Stakeholder Interests

CASE NOTES FOR INSTRUCTORS

This deals with the themes of management and marketing. A major issue in the Monsanto case is whether genetically modified products (GM) are safe both for the environment and for human consumption. Monsanto faces two other issues: patent protection and seed sterility. The following are some major points discussed in the Monsanto case:

1. Monsanto is a monopoly, or at best an oligopoly, within the GM market for soybeans, cotton, corn, and canola. Monsanto must manage its market power advantage so that it avoids abusing market practices and leveraging its position to engage in anti-competitive practices.
2. Proponents of Monsanto claim that its seeds increase crop yields and that its chemicals—for example, Roundup Ready—decrease labor cost and crop damage.
3. Critics accuse Monsanto of attempting to control the world’s food supply, destroying biodiversity, and inserting genetically modified seeds into the environment that could potentially damage the world’s eco-system and create negative long-term effects on the human race.

Monsanto’s stated business mission is to create solutions to world hunger by generating higher crop yields and hardier plants. A big part of the company’s means of addressing hunger problems is its line of GM products. Monsanto reaps 60 percent of its revenues from GM corn, cotton, soybeans, and canola. Students should be urged to look over the firm’s website http://www.monsanto.com/. From there they may discover that the company has experienced a dramatic drop in stock prices in recent years, just as the debate over GM crops began to heat up. The January to May 2009 drop was the overall market adjustment related to the global financial crisis; however stock prices have stayed markedly lower than their 2004-2005 levels.

Students should be encouraged to review other information on Monsanto’s website. After their review, the instructor may like to start a discussion of what kinds of information the website provides on the company’s ethical stance, including what is missing. The instructor may point out that such websites are theoretically designed for all stakeholders. If this is the case, students should think about what is missing or hard to locate. Missing information can clue in stakeholders as to how the company seeks to mold its image.

The information on Monsanto’s ethics is located under the heading: Public Policy and Corporate Responsibility (http://www.monsanto.com/responsibility/corp_gov/committees/public_policy.asp). Instructors can develop a discussion around Monsanto’s Public Policy and Corporate Responsibility Committee’s stated duties and ask how Monsanto measures the following objectives:
The Public Policy and Corporate Responsibility Committee shall:
1. Review and monitor the performance of the Company as it affects communities, customers, other key stakeholders and the environment. Hold periodic meetings with stakeholders to understand external perspectives.
2. Review issues affecting the acceptance of Company products in the marketplace, including issues of agricultural biotechnology.
3. Identify and investigate significant emerging issues.
4. Receive periodic reports on the state and effectiveness of the Business Conduct Program from the Company's Director of Business Conduct.
5. Receive periodic reports regarding the Company's political contributions.
6. Receive periodic reports regarding the Company's charitable contributions.
7. Perform such other duties and responsibilities as may be assigned to the Public Policy and Corporate Responsibility Committee by the Board of Directors and/or the Chairman of the Board.
8. Make delegations of authority and responsibilities of the Public Policy and Corporate Responsibility Committee as the Public Policy and Corporate Responsibility Committee deems appropriate and periodically review such delegations.

Instructors can have students read and discuss the firm’s charitable giving history (Students can access Monsanto’s contributions reports here: http://www.monsantofund.org/programs/contributions-reports/). Students may note that, while Monsanto donates tens of millions of dollars a year, its donations still generally only amount to less than 1 percent of its annual profits. Instructors may wish to note to students that individual donations, as a proportion of disposable income, generally amount to over 2% a year.\(^1\) Small businesses are even more generous, with those earning between $250,000 and $1 million contributing an average of 6 percent of their profits to charity.\(^2\)

As this case underscores, Monsanto has faced many legal battles over the years. An important one for the company was in 2003, when the Anniston, Alabama PCB verdict awarded $700 million to 20,000 residents for decades of ground water contamination. To counter nervous investors after this ruling, the company brought in Hugh Grant as CEO. He split up Monsanto into various SBUs such as Pharmacia, Seminis, and Solutia, possibly to diffuse stakeholder concerns with the Monsanto name. Discussion and research about Grant and Monsanto’s Board of Directors before and after 2003 may lead students to a better understanding of corporate politics.

The issue of sterile seed technology as well as the firm’s “seed police” can lead students into a discussion of whether patents on food are ethical or legal from a global perspective. Within the United States, patent infringement lawsuits have become more common, especially within pharmaceuticals and gene therapy.

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Starting in the 1990s, profitability in the farming industry began to decline with increased costs for inputs, more unpredictable weather, and rising wages. Large commercial farms expose farmers to a greater degree of market volatility. Farming a large quantity of one or two crops leaves farmers more vulnerable to price fluctuations than farming smaller quantities of many crops. Monsanto seeds, which claim to require less water and are more pest resistant, can be attractive to farmers; for instance, the genetically modified seed Bt was marketed in India and was endorsed by the local government. Monsanto said it was resistant to boll weevil—the main cotton pest—and required just two sprays of insecticide for every crop, instead of the usual eight. However, the GM seed sold for about four and a half times the cost of normal seed. Nevertheless, many farmers opted to buy it because they believed it was indestructible and would provide a higher yield. They were devastated when many of the Bt cotton plants were afflicted with another disease that destroyed much of the crop and left the farmers with unusually high debts. Monsanto’s decision to market its products in the developing world to farmers with fewer resources should yield a fruitful debate over ethics.

A marketing strategy that has increasing cache around the world is claiming that products are “green.” Even Monsanto has tried this strategy. The Monsanto “green” strategy for the past couple of decades has been to promote that its products allow farmers to grow more productive crops on the same amount of land. The negative aspect for farmers is that they become dependent upon Monsanto and other manufacturers for seed, fertilizers, and chemicals. Opponents argue that farmers can grow their operations, but the increased costs of inputs means that they do not necessarily become more profitable. Organic farming generally takes more thought than switching seed. Farmers must take into account the natural advantages and disadvantages of crop rotation, soil chemical make-up, and taking care of the land instead of maximizing output.

QUESTIONS AND DISCUSSION

1. Does Monsanto maintain an ethical culture that can effectively respond to various stakeholders?

Monsanto remains controversial because of the strong feelings that many stakeholders have about the biogenetic engineering of agricultural products. This is a very debatable area because in many developing countries, food crops such as rice, corn, and soybeans have been able to increase yields to help feed hungry people. With populations increasing in less developed countries (LDCs), food demands are growing rapidly. If GM seeds can increase crop yields with few negative effects, then Monsanto will be able to meet stakeholders’ needs. On the other hand, many question Monsanto’s true intentions. Is Monsanto operating from a desire to help others, or does it only care about its own profits? Monsanto explains that its products can achieve both ends: positive development for farmers as well as profits. Critics are not convinced. They are concerned with the unknown effects of GM seeds, including the potential danger they might pose to biodiversity and to human health, and Monsanto’s power in the seed industry. Monsanto’s past ethical lapses and its seed investigators might also conflict with an ethical corporate culture.

Students should realize that there are no easy answers to this question. As with many large companies, Monsanto’s history and operations have both ethical and unethical areas. Students will need to carefully examine Monsanto’s current culture and weigh the tradeoffs before developing their responses.
2. Compare the benefits of growing GM seeds for crops with the potential negative consequences of using them.

The benefits of GM seeds include the potential to grow crops that survive in hostile conditions and on degraded land and generate higher yields. An issue that Monsanto constantly addresses is the need to increase crop yield. While the global demand for food continues to increase, land suitable for farming has been decreasing. If GM seeds can create higher yields, then farmers are making better use of their resources.

At the same time, these benefits must be weighed against potential negative consequences. Long-term research on the health effects of GM food is inconclusive. Europe has banned many GM products and mandates labels identifying accepted ones. GM plants might contaminate wild or traditional plants and create unforeseen genetic mutations. Critics believe that GM seeds pose a threat to the agricultural practices that farmers have been using for thousands of years. Another consequence that students might want to explore involves the risk of relying solely on GM seeds. Many crops in the United States are now genetically modified. Such reliance on genetically modified seeds—or on any form of technology—always comes with a degree of risk. If the supply of genetically modified plants was contaminated in some way, this could have serious repercussions on the nation’s—and the world’s—food supply.

3. How should Monsanto manage the potential harm to plant and animal life from using products such as Roundup?

The Roundup issue is a difficult topic. Genetics suggest that Roundup resistant weed strains will necessitate increasing the strength of or changing Roundup’s formula. While Monsanto will likely not have difficulty developing new chemicals, it will always only be a matter of time before pests form a resistance to these new products. Monsanto might want to offer additional incentives and training on the proper use of Roundup products to encourage farmers to engage in activities that will reduce the build-up of resistance in pests. Be aware that student discussion may deteriorate into a debate about nature/humanity. Instructors should bring the class back to the business issue of cost/benefit and corporate responsibility.

The following are other issues that can be explored with the Monsanto case:

1. The seed police, farmer rights, and patents.
2. Terminator seeds and farmers in developing countries.
3. Monsanto and bribes.
4. Glyphosate and potential hazards.
5. Monsanto seed monopolies
ADDITIONAL RESOURCES

- Have students click to the following NPR discussion about organic farming in India:
  http://www.npr.org/templates/story/story.php?storyId=104708731. This article demonstrates that
  the popularity of organic farming is not limited to the United States. The rise in organic farming
  can constitute a significant threat to Monsanto.

- Monsanto has experienced much antagonism in Europe. The following article link from the BBC
  discusses a fine that France levied against Monsanto regarding advertising for its Roundup

- The 2004 documentary “The World According to Monsanto” was filmed to showcase the
  problems of Monsanto’s Roundup herbicide. Instructors may wish to show parts of this
  documentary to students.

- The following link helps present both sides of the controversy regarding Monsanto:

- Read the following discussion of Monsanto’s Feed the Future Initiative:
  discussion portrays Monsanto in a more positive light and discusses its efforts to combat hunger.
CASE 2

Starbucks’ Mission: Social Responsibility and Brand Strength

CASE NOTES FOR INSTRUCTORS:

Students will likely have strong opinions regarding Starbucks. Many may be committed patrons who view Starbucks as a socially responsible company committed to green practices and free-trade coffee. Others might dislike Starbucks because it is a large chain that pushes out smaller local competitors. Another possible reason students may be opposed to Starbucks are its prices, which are higher than many of its competitors. Starbucks seems to be able to justify its higher prices because the company sells more than just coffee—it sells an experience. Starbucks patrons can order specialty drinks and hang out in what founder Howard Schultz envisioned to be the “third place” to be after home and work. Love it or hate it, Starbucks has been very successful at branding.

Starbucks has had a profound influence on the U.S. coffee market. Before Starbucks came onto the scene, coffee was perceived as an uninteresting product largely consumed by older people in the United States. It did not have the “cool” factor or the cache that it does today. Starbucks’ entry in the market largely changed how Americans consumed coffee—and what they thought about coffee shops. It all started in the cold, gray climate of Seattle—the perfect setting for launching a warm beverage with international appeal. Starbucks emphasized quality and service and location became a critical issue.

In spite of its popularity, Starbucks faltered during the most recent recession, when many customers cut back on discretionary purchases. This prompted the return of founder Howard Schultz as CEO. Schultz implemented a restructuring process at Starbucks and closed hundreds of stores. He sought a return to the value that had initially made Starbucks a great company: quality. Today Starbucks is once again thriving, and is even expanding into the consumer packaged goods market.

No matter what one thinks of Starbucks, it is more involved in social causes and the care of its workers than many comparable chains. Starbucks is committed to employee well-being, as one can see in its employee health care system. Howard Schultz made employee health care a priority after watching his father struggle with injuries because he had no access to employee health care or worker’s compensation. In large part because of its commitment to providing good wages and health care, Starbucks ranked No. 98 on Fortune’s “Best Companies to Work For” list in 2011.

The company also has a history of giving to charities that affect its primary stakeholders. As part of its commitment to ethics and sustainability, the company launched its Shared Planet website, which communicates to interested stakeholders all of the company’s ethics and sustainability initiatives. The company also is a large purchaser of Fair Trade Certified coffee and has partnered with Project Red to raise money for HIV/AIDS research in Africa.

In spite of its professed commitment to caring for workers and for social causes, such a large company always will be subject to criticism. From complaints that Starbucks pushes smaller competitors out of markets, to criticisms that some of its coffee drinks are excessively fatty and caloric, Starbucks is facing many challenges. For instance, disposable cups pose a problem as the company strives to become more eco-friendly. An estimated 3 billion Starbucks cups are thrown into landfills each year. In light of some
of its weaknesses, instructors may ask students whether they feel that Starbucks deserves its image as a socially responsible brand.

QUESTIONS AND DISCUSSION

1. Why do you think Starbucks has been so concerned with social responsibility in its overall corporate strategy?

It should be obvious from examining Starbucks’ history that Schultz, the founder, was concerned with social responsibility from the very beginning. Because he made it an original core value of the company, it has remained a deeply ingrained part of the Starbucks culture. Starbucks also recognizes the benefits of being perceived as a socially responsible company. Employees who receive health care are likely more satisfied because they feel that the company truly cares for them in a time when many organizations are scaling back on employee benefits. Consumers may be inclined to like Starbucks because of its many community and environmental initiatives. Thus, social responsibility for Starbucks is translating into good business.

2. Is Starbucks unique in being able to provide a high level of benefits to its employees?

Students should understand that, while Starbucks does provide very good benefits to most of its workers, this is not exactly unique. However, it is true that many comparably-sized chains do not treat their workers as well as Starbucks, and for this Starbucks should be lauded. For instance, many chains do not provide any benefits to part-time workers. However, other companies also have a mission of providing for their workers. Some examples students may cite are Green Mountain Coffee, Wegmans, Whole Foods, Timberland, and the Gap, as well as other retailers on the Business Ethics “100 Best Corporate Citizens” list.

3. Do you think that Starbucks has grown rapidly because of its ethical and socially responsible activities, or because it provides products and an environment that customers want?

Students’ answers to this question could provoke serious debate in class. If Starbucks had a poor record in its activities, its reputation might be diminished, which could lead to lower profits and reduced customer loyalty. However, many customers likely go to Starbucks, not because of its social mission, but because they like the coffee or the coffee shop atmosphere. Many customers likely began frequenting Starbucks because the locations are convenient and continue to go as long as Starbucks remains a readily available option. On the other hand, its record in responsibility has been a major selling point for consumers who care where products come from and under what conditions they were produced. These people may choose Starbucks because they offer Fair Trade coffee and organic snack products when other local coffee shops do not. Most people probably will agree that, at least to a point, Starbucks’ responsible activities have become a part of the total Starbucks product—a product for which many are willing to pay a premium price. In other words, both answers could be considered correct.
ADDITIONAL RESOURCES

- Starbucks 2010 charitable contributions were $22.4 million: $17 million in corporate giving and $5.4 million from the Starbucks Foundation. Within the corporate portion $6.7 million was largely the result of employee donations of hours to community activities. It also gave more than 100 grants to nonprofit organizations, including $1.6 million for Starbucks Youth Action Grants and $1 million to the American Red Cross for its Haiti earthquake relief efforts. Instructors may wish to compare this figure to the company’s annual profits.

- It is interesting to note that in Starbucks’ 2010 Annual Report (http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NzkzODl8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1), the only mention of something related to corporate social responsibility was on the very last page, which is included in its entirety below:

  Starbucks is committed to being a deeply responsible company in the communities where it does business around the world. The Company’s focus is on ethically sourcing high-quality coffee, reducing its environmental impacts and contributing positively to communities. Starbucks Global Responsibility strategy and commitments are integral to the Company’s overall business strategy. As a result, Starbucks believes it delivers benefits to the Company and its stakeholders, including employees, business partners, customers, suppliers, shareholders, community members and others.

- For an overview of Starbucks Global Responsibility strategy and commitments, instructors may want to direct students to Starbucks’ Global Responsibility Report, available online at: http://www.starbucks.com/responsibility/learn-more/goals-and-progress/community.
CASE 3

Walmart: The Future Is Sustainability

CASE NOTES FOR INSTRUCTORS

The Walmart case was written to give students another perspective on one of the largest employers in the world. Over the years, Walmart has faced a large number of lawsuits and allegations of unethical behavior. Students likely will have heard stories of unethical and illegal activities involving Walmart, and they should be encouraged to share their stories in class. However, Walmart has taken significant strides in recent years to repair its damaged reputation and improve its image as an ethical and environmentally-conscious business. The company has been a leader in adopting energy-efficient and renewable energy technology, and it has greatly improved its employee rights record. Nevertheless, many people remain hesitant to accept that Walmart can be truly socially responsible—they have a hard time believing that Walmart does anything that is not motivated by profits. After having students read this case, instructors may want to ask students whether they believe Walmart is inherently unethical or whether they are convinced the corporate giant has changed its ways.

As Walmart has grown, its strategy has changed. In the 1970s, Walmart’s strategy was to focus on secondary markets, meaning communities with fewer than 10,000 residents. The company’s strategy was to start in Bentonville, Arkansas, and grow into these smaller towns to such a degree as to gain channel economies of scale. In these secondary markets, the competition, normally small independent retailers, could not compete with Walmart on price and closed down. This, along with Walmart’s Everyday Low Price strategy, helped Walmart grow rapidly. It was then able to enter primary markets (communities with populations of more than 10,000). During the 1980s, outsourcing to less-developed countries became the norm because Walmart could obtain goods for even less.

Despite its success, Walmart continues to adapt in order to compete effectively against rivals such as Target, Costco, and discount retailers. Recently, Walmart has tried to create a new socially responsible brand image. It has also begun to focus on opening smaller stores so that it can break into urban markets like Chicago. Although its efforts have contributed to a more favorable perception, some of its initiatives have backfired. For instance, Walmart’s foray into higher priced items and organic food alienated its original customer base. Interestingly, although Walmart is still growing internationally, sales in the domestic market are down. This is convincing Walmart to go back to the basics regarding its merchandise.

Another issue to consider is Walmart’s channel structure. Vertically integrated channel structures and their effects on competition is another issue that instructors could address in conjunction with this case. In the 21st century, one sees more training in eliminating conflict within the channel structure, so that companies can deliver the right products at the right time and place at the lowest costs. Implicit in this concept is the potential for collusion, not with competitors across an industry, but collusion within the channel. It becomes imperative to have a free flow of information to be able to implement total quality management and just-in-time inventory systems that reduce safety stock while increasing profitability. Many countries adhere to a managed competition model, but within the United States any form of collusion that substantially reduces competition can be considered illegal. Students may wish to discuss whether Walmart’s form of negotiating the best prices for products, combined with its sales strength, crosses the boundary from ethical and legal to unethical and illegal.
QUESTIONS AND DISCUSSION

1. Do you think Walmart is doing enough to become more sustainable?

Students are often suspicious of Walmart’s intentions. This is understandable given Walmart’s history of managing and mismanaging stakeholders. Previously, Walmart’s strategic maneuvers had been carefully calculated to increase market share, grow the company, and satisfy investors—without much regard for human rights or the natural environment. However, Walmart has taken great strides to improve its image, its social responsibility record, and its environmental track record. These steps should not be discounted or downplayed. Given Walmart’s size, it has enormous power to enact change throughout the supply chain. Its increased demand for organic food and locally grown produce has made such items more accessible to potentially millions of consumers. Walmart is also in a tremendous position to educate consumers about important issues. The company has made a sustained effort to make its stores more eco-friendly, reduce emissions, improve employee benefits, and better track the carbon footprint of its supply chain. It will be up to students to decide whether they think what Walmart has done is sufficient, or whether they think Walmart should do more—given its status as the world’s largest retailer and its huge revenues.

2. What are the problems that Walmart has faced, and what has the company done to address them?

Walmart has been the focus of many major news stories of an ethical nature. Given its status as largest retailer in the world, Walmart receives a huge amount of scrutiny from many different stakeholder groups. Students can discuss any number of issues from the case, including employee benefit issues, Walmart’s stance on unions, workplace conditions and discrimination, illegal immigration issues, problems with sustainability, and past unethical leadership. Walmart has responded in a number of ways, such as increasing health care benefits for its employees. One recent victory for Walmart involved the class-action lawsuit filed against it by millions of female employees. The employees claimed they had been discriminated against because of their gender. In this case, Walmart decided to appeal to the Supreme Court. The Supreme Court ruled that the women did not have enough in common to qualify for class-action status.1 This decision was a victory for many organizations that fear gender discrimination lawsuits. In the future, individual women will be able to pursue lawsuits, but it will be harder for them to secure a victory than if they had been able to pursue lawsuits as a group. Although Walmart benefited from this ruling, it is important for students to realize that these allegations still constitute a significant ethical issue for Walmart. It would be a good idea for students to discuss whether they believe most of the numerous criticisms against Walmart are justified, or whether they feel Walmart is being unjustly targeted due to its huge size.

3. Why has Walmart tended to improve performance while other retail outlets have been suffering financially?

Simply put, Walmart is everywhere and it has a reputation of selling goods cheaper than nearly anyone else. Because most Americans (and many people around the world) live or work near a Walmart, and because the goods are cheaply priced, when an economic recession hits and consumers cut back on expenditures, a larger percentage of their spending money goes to stores such as Walmart. Even when many people would prefer to spend their money elsewhere, in tough economic times, Walmart is able to fill a need that other stores do not.

1 Joan Biskupic, “Supreme Court limits Wal-Mart sex bias case,” USA Today, June 21, 2011, 2A.
Another possible part of the answer to this question has ethical implications. Because it can dictate manufacturing standards and prices and can deliver products less expensively than other retailers, Walmart can undercut other stores on prices in order to build up its market share (it has used this strategy on everything from books to coffins). Walmart occasionally is willing to take a loss on a certain product category at first in order to draw in customers, who then hopefully will make up for the loss by purchasing goods in other categories. Part of why Walmart is able to sell goods so cheaply is because it dictates to suppliers how much it is going to pay for items. This means that the onus is on suppliers to cut costs or lose Walmart as a client, which is not a desirable scenario for most manufacturers. Suppliers may seek lower-cost workers or cut corners in other ways to fill Walmart’s desire for cheap goods. This leads many people to wonder: What is the true cost of cheap goods? It will be interesting to see whether Walmart’s new sustainability initiatives affect the costs of the products they sell.

During the recession, Walmart also began to offer services to help cash-strapped consumers. This got many consumers into their stores. Walmart decreased the fees for its Walmart Moneycard to three dollars, rather than the nine dollars it cost originally. It also began to cash government, payroll, or tax checks for $3 for checks up to $1,000 and $6 for checks over $1000.

Students might also want to point out that, although Walmart profited during the recession, it also lost customers to discount chains. Walmart made the common mistake of trying to be all things to all consumers and began selling higher priced items and cutting back on some of its more basic goods. Yet despite the loss of some of its domestic customers, Walmart is still expanding and making a good profit internationally. This most likely has to do with Walmart’s ability to adapt to different markets. Although it has failed in certain countries such as Germany and South Korea, Walmart’s skillful ability to adapt has made it successful in other large markets such as China and Mexico.

ADDITIONAL RESOURCES


2 Some of the items on this list include links to articles and reports concerning Walmart that may be construed as negative. Please note that it is not the intention of the authors to portray Walmart in a negative light, but rather to show some of the controversy regarding the world’s largest retailer.
Walmart contractor accused of wage theft:

Crains study on Walmart’s impact on minority contractors:


Walmart and the gender discrimination lawsuit:
http://www.businessweek.com/magazine/content/10_48/b4205039091060.htm.

Walmart seeks to force disclosure of opponents’ funders:

CASE RELATED ACTIVITIES

To enhance case discussion, instructors may use the following questions from Walmart’s Statement of Ethics Manual (http://cdn.walmartstores.com/statementofethics/pdf/U.S_SOE.pdf) to help students better understand some of the potential issues facing Walmart employees every day. Remember to explain to students that these are the answers for such issues within Walmart and not necessarily the opinions of other companies.

1. If an associate reports a Statement of Ethics violation to the Global Ethics Helpline, is that associate exempt from disciplinary actions for unrelated misconduct?

   Answer: Not necessarily. The report made by the associate, and the associate’s own misconduct are two separate issues that should be dealt with independent of each other. We are all expected to perform our duties with integrity, respect, and are accountable for our own actions when conducting business for Walmart.

2. I’m attending a Walmart–sponsored group/supplier meeting. Alcohol will be served. May I have alcohol while there?

   Answer: With executive vice president approval, Walmart–sponsored events may provide alcohol. Associates of legal age may consume alcohol at these events as long as they do not allow it to impair their judgment.

3. One of my associates called the Helpline and made a false claim against me this past year. I think they did it to hurt my career. Can I score them lower on the “Integrity” section of their evaluation since they’re obviously trying to spread lies about me?

   Answer: We should believe that associates who report concerns do so in good faith. Therefore, taking action against an associate for reporting a concern would be viewed as retaliation, and could result in disciplinary action for you as a manager. Retaliation will not be tolerated at Walmart. It prevents an open reporting environment, and encourages a culture of fear.
4. After an associate reported an ethics violation concerning their assistant manager to the Human Resources manager, their assistant manager began tracking all their mistakes. Is this retaliation?

Answer: Any variations from how the assistant manager previously treated the associate, and variations from how they treat other associates could be perceived as retaliation.

5. My manager has reduced my hours recently because she says we need to cut expenses. Is this a violation of the Wage and Hour section?

Answer: If you want to raise concerns about your hours being reduced, you should exercise the Open Door process by contacting your store, market, or Human Resources manager.

6. My next-door neighbor is one of my suppliers. They invited my family and me to a neighborhood party. Would it be a violation of the Personal Relationships with Suppliers policy if we went to the party?

Answer: It would be OK to attend as long as the party is open to the entire neighborhood and you’re invited because you’re a neighbor, not because of your position with Walmart. Remember to ask yourself, if another supplier or other associates knew of this situation, would it appear you are giving preferential treatment to your neighbor as a supplier?

7. A supplier I work with has offered me two tickets to the World Cup if I pay face value for them. Can I buy the tickets?

Answer: You should decline the offer. Although you may be paying face value for the tickets, it may not necessarily reflect the market value of the item. Some areas allow you to resell tickets, and you might be able to make a profit if you sold them. Also, there could be a gift of prestige in receiving the ability to attend a coveted event, such as the World Cup.

8. I have to travel often for my job. Can I use my company laptop to check my bank account online while I am traveling?

Answer: Yes, as long as it does not interfere with work performance.

9. My manager told me when I travel with my laptop I should carry it on the plane with me. Is this really necessary?

Answer: Yes. When traveling with a company-issued laptop, you must carry it on the plane with you. It may not be checked with your baggage. This is necessary to protect the laptop and the information contained on it from theft, loss, misuse, or damage.

10. A store is seeking a permit from the local Transport Authority. The store usually gives holiday baskets to various local officials. This year, the store manager suggested including a $300 gift card in the basket for the head of the Transport Authority. Is this acceptable?

Answer: The policy does not allow the gift because it’s something of value and is apparently intended to influence the Transport Authority. The policy does permit certain customary gifts, such as holiday baskets that are of relatively low value and are not intended to influence anyone.

11. A customer asked me if I could split a $5000 transaction into two transactions of $2500 so they did not have to bother with the paperwork that may otherwise be involved. Should I process the transaction this way?
Answer: No. If it’s truly the same transaction, it should be processed as one transaction and the proper paperwork should be completely filled out and turned in to the Home Office for reporting to the government. If the customer refuses to comply, contact a member of management to assist you.

12. My manager told all my peers about my medical condition when I called in sick yesterday. Is that a violation of the Privacy policy?

Answer: It could be. Your peers do not have a business need for knowing your medical condition. Many times the information is shared out of genuine care and concern for you as an important and valued member of the team. Talk to your manager and tell them your concern. If you don’t feel comfortable talking to them, contact your Human Resources manager or the Global Ethics Office.
CASE 4

BP Struggles to Resolve Sustainability Disaster

CASE NOTES FOR INSTRUCTORS

Students should be able to identify with this case as it has happened so recently. The interesting aspect of the BP oil spill case is that, for a number of years, BP tried to portray itself as a more eco-friendly energy company—not just a dirty oil company. Students should carefully examine the first part of this case detailing BP’s environmental initiatives. Before the Deepwater Horizon oil spill, BP received praise for its code of conduct and investments in alternative energy. However, in a matter of months the oil spill disaster quickly unraveled BP’s efforts at re-branding. This case demonstrates to students how easily a misconduct disaster, poor planning, or lack of oversight can tarnish a company’s reputation.

After a 2005 explosion at a Texas refinery and oil leaks in Alaska, BP decided to change its image. The company changed its name from British Petroleum to BP and began to invest significant resources in alternative energy through its Alternative Energy division. BP was the first oil company to officially recognize the threat of climate change and created the Carbon Toolkit for students to help them measure their schools’ carbon footprint. In 2010, however, BP was drilling for oil in the Gulf of Mexico using a Transocean oil rig called Deepwater Horizon when there was an explosion on the rig. The explosion killed 11 workers and caused a massive oil leak. It would take three months before BP closed the pipe and stopped the leak. The incident went down as the worst oil leak in U.S. history. The leak killed many animals, damaged the ocean, and negatively impacted the fisherman and tourism-based industries in the region, as well as many other stakeholders.

Investigations revealed that BP cut corners in safety to ensure it would meet deadlines. Its contingency plan in case of an oil leak in the Gulf of Mexico contained several inaccuracies. BP also took many risks in areas such as the well design that were not necessarily illegal but likely made the disaster harder to contain. BP reacted quickly with public relations efforts to try to mitigate damage to the brand. It went beyond what the law requires in terms of the cleanup, which some estimate will ultimately cost the company as much as $40 billion. However, the company sustained numerous damages to its reputation, leading to the resignation of CEO Tony Hayward.

A question lingers over whether BP can be charged with negligence. The Justice Department has launched a civil lawsuit against BP and eight other companies. To successfully prosecute, the government must show that the disaster resulted from a deliberate flouting of the law, or from demonstrable negligence.

Instructors should emphasize how this disaster will impact multiple stakeholder groups and industries. The most commonly recognized stakeholders in this situation are the environment and workers in the region, but other stakeholders have also been harmed. For instance, the oil industry was negatively impacted after President Obama issued a six-month moratorium on deep sea drilling in the Gulf. Even with the moratorium lifted, oil companies are finding it harder to obtain
the necessary permits. This case should teach students that ethical crises never just impact one particular stakeholder, but many at once.

**QUESTIONS AND DISCUSSION**

1. What aspects of BP’s ethical culture could have contributed to the Gulf Coast oil spill disaster?

The oil spill disaster was an unfortunate occurrence for BP, as it seemed to be successfully revamping its image after a long history of misconduct. Yet there were disturbing instances that occurred both before and after the disaster which indicated that BP frequently experienced safety lapses. In early 2010, U.S. regulators fined the oil giant $3 million for safety problems at an Ohio factory. The Occupational Safety and Health Administration (OSHA) found that workers might be exposed to injury or death should explosive or flammable chemicals be released at the factory. This violation was not an isolated event. Just four months earlier, OSHA had fined BP a record $87 million for not correcting safety problems that were identified after the 2005 explosion at its Texas refinery. Less than a year after the Gulf oil spill, it was revealed that BP had been reprimanded by a U.K. safety regulator regarding safety issues on three of its North Sea rigs. This implies that BP’s culture probably does not take safety issues as seriously as it should.

BP’s culture also does not appear to have enough of a planning or compliance focus, suggesting that the organization takes an excessively short-term perspective. For instance, it did not have an accurate or adequate contingency plan in place to deal with the Deepwater Horizon disaster. Although it touted its code of conduct, the disaster revealed that the code was not enforced in regard to safety violations. All of these weaknesses seem to reveal a corporate culture that was so focused on making deadlines and making profits that it ignored critical ethical concerns until they became disasters.

2. Did BP engage in purposeful avoidance of risk management? Why or why not?

Most students will likely respond that BP did fail in managing potential risks. Students might argue, and rightly so, that BP is not the only entity to blame. Transocean, Halliburton, and even the U.S. government have been cited for ignoring risks and thereby contributing to the disaster. Some students might believe that Transocean and Halliburton are more to blame, or that BP is being treated as a scapegoat by stakeholders such as the government. However, BP did ignore risks, failed to adequately prepare for a potential emergency, and likely cut some ethical corners to keep to its schedule. The previous safety lapses by BP, such as the 2005 explosion at a Texas refinery, indicates that BP does not sufficiently manage potential risks.

3. What should BP do in the future to rebuild its reputation and manage the risks associated with offshore drilling activities?

Some obvious answers would be to update its contingency and emergency response plans. The corporate culture needs to be changed so that safety and quality are more emphasized. BP might want to perform periodic safety audits of its rigs, even those it does not own directly, to ensure compliance. Since BP is in a high-risk industry, the company should demonstrate that it is willing to go above and beyond the law to prevent disasters. As this case demonstrates, just because something is legal does not mean that it is risk-free. BP should ensure that its equipment and all of
its contractors’ equipment adheres to the highest safety standards. The company should perform tests to make sure that equipment parts (such as the blowout preventer) are working effectively.

Building BP’s reputation will take many years because of the negative publicity that continues from the Deepwater Horizon oil spill disaster. It is interesting that we had a BP case in the 8th edition of our book that reviewed some of the accidents and misconduct that had occurred in the company, but that case indicated that BP had corrected its problems and was focused on sustainability. As it turns out, the Gulf Coast oil spill disaster eroded most of the positive publicity and goodwill that BP had built up in previous years. As Warren Buffett said, “It takes 20 years to build a reputation, and five minutes to destroy it.” That’s exactly what BP did, and it may take another 20 years to restore its image.

All companies in the petroleum exploration business have to manage their risks. This requires specific knowledge about drilling and best practices for this business activity. The purpose of the case is not to explore specific compliance issues, but the case does point out that apparently BP was either lax or not in compliance with some best practice drilling activities. There seems to be plenty of evidence that the Deepwater Horizon crew took risks that caused the disaster. BP cannot afford to engage in high-risk activities in the future because another accident of this magnitude could result in even more damage, possibly the destruction of the company.

Table

Instructors may want to show students the following table. It is interesting to note that 2010 has the lowest number of oil spills, and yet the oil spill that occurred during this year was more damaging than the others.

<table>
<thead>
<tr>
<th>Safety</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Safety</td>
<td>2006</td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
<td>2010</td>
</tr>
<tr>
<td>Fatalities – employees</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Fatalities - contractors</td>
<td>7</td>
<td>4</td>
<td>3</td>
<td>18</td>
<td>14</td>
</tr>
<tr>
<td>Day away from work cases - workforce</td>
<td>188</td>
<td>167</td>
<td>175</td>
<td>134</td>
<td>408</td>
</tr>
<tr>
<td>Day away from work case frequency (DAFWCF) - workforce</td>
<td>0.085</td>
<td>0.075</td>
<td>0.080</td>
<td>0.069</td>
<td>0.193</td>
</tr>
<tr>
<td>Recordable injuries - workforce</td>
<td>1,067</td>
<td>1,060</td>
<td>951</td>
<td>665</td>
<td>1,284</td>
</tr>
<tr>
<td>Recordable injury frequency (RIF) - workforce</td>
<td>0.48</td>
<td>0.48</td>
<td>0.43</td>
<td>0.34</td>
<td>0.61</td>
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<tr>
<td>Hours worked - employees (million hours)</td>
<td>207</td>
<td>204</td>
<td>195</td>
<td>174</td>
<td>168</td>
</tr>
<tr>
<td>Hours worked - contractors (million hours)</td>
<td>236</td>
<td>241</td>
<td>245</td>
<td>216</td>
<td>255</td>
</tr>
<tr>
<td>Total number of losses of primary containment (all - not just oil spills)</td>
<td>n/a</td>
<td>n/a</td>
<td>658</td>
<td>537</td>
<td>418</td>
</tr>
<tr>
<td>Number of oil spills - loss of primary containment</td>
<td>417</td>
<td>340</td>
<td>335</td>
<td>234</td>
<td>26</td>
</tr>
</tbody>
</table>

ADDITIONAL RESOURCES

- Gulf coast restoration website:
  http://www.bp.com/sectionbodycopy.do?categoryId=41&contentId=7067505.

- Deepwater Horizon accident website:
  http://www.bp.com/sectiongenericarticle800.do?categoryId=9036575&contentId=7067541.

- How BP responded:

- Restoring the environment:

- Restoring the economy:
  http://www.bp.com/sectiongenericarticle800.do?categoryId=9036578&contentId=7067597.

- Supporting oil spill response efforts:
  http://www.bp.com/sectiongenericarticle800.do?categoryId=9036579&contentId=7067595.

- BP Code of Conduct:
  http://www.bp.com/sectiongenericarticle.do?categoryId=9003494&contentId=7006600.

- Bob Dudley’s Letter:
  http://www.bp.com/sectiongenericarticle800.do?categoryId=9036148&contentId=7066868.

- How BP is changing:
  http://www.bp.com/sectiongenericarticle800.do?categoryId=9036149&contentId=7066886.
CASE 5

NEW BELGIUM BREWING: ETHICAL AND ENVIRONMENTAL RESPONSIBILITY

CASE NOTES FOR INSTRUCTORS

This case showcases an example of a socially responsible company—Fort Collins, Colorado’s New Belgium Brewing Co. (NBB). Small companies sometimes make big contributions to surrounding communities and become leaders as they set social agendas and take initiative to actively address community issues. Such is the case for NBB, which has gone to great lengths to incorporate environmentally sensitive and energy-saving alternatives into its brewery and the brewing process. For example, it was the first brewery in America to be completely wind-powered, and its brewery is LEED certified. The company is constantly experimenting with ways to reduce water consumption and waste and to recycle a greater proportion of waste products. Currently, the company recycles around 93 percent of its waste. The brewery even donates barley and hop mash left over from the brewing process to local pig farmers to use as feed, so as to reduce the amount of waste it generates. NBB has developed an organic wheat beer, making it one of the largest craft brewers in the country to introduce an organic beer to its line.

Beyond its commitment to the environment, New Belgium Brewing has become a model for social responsibility as a result of its philanthropic efforts in the states in which it is distributed. For example, for every barrel of beer sold, NBB donates $1 to a philanthropic cause within that state. NBB also donates 1 percent of its profits to environmental causes. Because its primary product is beer, which is an inherently controversial product, New Belgium focuses a lot of efforts on education about alcohol abuse and encourages responsible consumption.

QUESTIONS AND DISCUSSION

1. What environmental issues does the New Belgium Brewing Company work to address? How has NBB taken a strategic approach to addressing these issues? Why do you think the company has chosen to focus on environmental issues?

This question asks students to reflect on New Belgium Brewing’s strategic efforts to provide quality products while creating minimal damage to the environment. The discussion should center on the following environmental topics: sustainability, recycling, reducing energy output, and reducing emissions through energy saving tactics in the brewing process and even through encouraging biking rather than driving. Students should be able to provide specifics to support their responses, such as the firm’s investment in wind energy to power its brewery; use of innovative heating and cooling and lighting systems, such as its steam condenser and sun tubes; and recycling and reusing supplies. Students can also discuss how New Belgium embraces a conservation lifestyle outside of work. The company rewards employees with their own fat tired cruiser bike to ride to work after one year of employment.

Sustainability has been a major part of the company’s mindset since its founding. One of its core values involves environmental stewardship, or “minimizing resource consumption, maximizing energy efficiency, and recycling.” For this reason, NBB strives to incorporate environmental responsibility directly into its business strategies. NBB’s founders’ values are deeply embedded in the company. There are also benefits to being environmentally responsible because it reduces waste, helps the company to adjust to stricter environmental legislation, and creates a competitive advantage in its
industry. Many consumers purchase NBB beers because of NBB’s reputation for being a responsible company, not merely because they like the taste. Sustainability has become an important concern for stakeholders, and many responsible consumers are more likely to do business with a company that incorporates green practices into its business activities. Going to such lengths to ensure minimal environmental damage wins favor with the public and has led to national recognition for NBB.

2. Are New Belgium’s social initiatives indicative of strategic philanthropy? Why or why not?

Chapter 4 defines strategic philanthropy as the synergistic and mutually beneficial use of organizational core competencies and resources to deal with key stakeholders so as to bring about organizational and societal benefits. To qualify as strategic philanthropy, corporate giving and volunteerism must be aligned with company competencies and strategies. Most students will likely argue that yes, NBB’s philanthropic endeavors are strategic. However, one also could argue that NBB’s charitable events and giving are not so much strategic as a core part of what the company stands for. One area of NBB’s initiatives that is undoubtedly strategic philanthropy relates to drug and alcohol awareness issues within the states in which it distributes. In particular, the company has created direct links between its products and programs focused on mitigating drug and alcohol abuse. NBB’s strategic philanthropy in this area seeks to identify and address a potential ethical problem area for the company—alcohol consumption. By supporting causes based on raising awareness around drug and alcohol abuse, the company seeks to pre-emptively minimize criticism about the product it produces and improve its corporate image. Other programs linked to the company’s environmental strategy also meet the criteria for strategic philanthropy.

3. Some segments of society vigorously contend that companies that sell alcoholic beverages and tobacco products cannot be socially responsible organizations. Do you believe that New Belgium Brewing Company’s actions and initiatives are indicative of an ethical and socially responsible corporation? Why or why not?

This question challenges students to consider whether a company can ever be truly socially responsible when its primary product is alcohol—a substance that is addictive and subject to abuse. There is no “correct” response; the question is designed to encourage students to think about all of a company’s actions, not just the social responsibility initiatives it promotes. Many students will argue that NBB is a good corporate citizen because of its social initiatives and efforts to minimize its negative impact on the environment. These students will likely concur that NBB does not promote excessive beer consumption, but rather advertises it as part of a healthy lifestyle where alcohol is enjoyed in moderation. Other students may feel that, no matter how NBB incorporates social responsibility initiatives into its business, it is still selling a product that is widely abused. Thus, it cannot truly be socially responsible. This is certainly a factor that NBB must consider in its social responsibility initiatives.

**ADDITIONAL RESOURCES**

- New Belgium Brewing’s Beer Ranger hip hop video: [http://www.youtube.com/watch?v=wj6Tha_ELlw](http://www.youtube.com/watch?v=wj6Tha_ELlw).
- A commercial for Fat Tire beer: [http://www.youtube.com/watch?v=pnFdEe8VxM](http://www.youtube.com/watch?v=pnFdEe8VxM).
CASE 6

Coping with Financial and Ethical Risks at American International Group (AIG)

CASE NOTES FOR INSTRUCTORS

The case on AIG discusses the circumstances that caused one rogue department to bring down a long-standing, venerable financial institution. The department in question was the Financial Products unit; its reckless financial decisions affected the entire corporation. Instructors may want to ask students whether they believe that AIG became corrupted by a corrupt system, or if the system allowed AIG’s corruption to balloon through inadequate regulation. Students will likely make comparisons to the $65 billion Ponzi scheme perpetrated by Bernard Madoff, or other cases of rampant corruption in the financial industry. Instructors also may want to discuss the notion of “too big to fail,” a term regularly thrown about in 2008 and 2009 during the height of the financial crisis and meltdown of Wall Street. Should corporations be allowed to grow so large that a single corporate failure threatens the economic stability of a nation, or should they be broken up into smaller entities? This AIG case is a good way to enter into a broader discussion of regulation, criminal versus civil charges, and the roles that the SEC and federal prosecuting attorneys should play in regulating the actions of Wall Street.

An important topic of discussion related to this case involves the corporate culture fostered by Hank Greenberg. He was a charismatic, connected leader, but how much of the blame should fall on him for the rogue actions of the Financial Products unit? Should CEOs be held ultimately responsible in such scenarios? Some students may argue that Greenberg’s age and sense of invincibility may be one cause for AIG’s ethical and legal problems. It seems clear from the evidence in the case that he felt that he could change the rules as needed in order to get himself or his company out of trouble (neither he nor his son accepted the charges leveled against him by regulators and federal authorities). Greenberg may have been partially justified in his nonchalance, as he had long influenced, and even helped to make, the federal policy regulating financial markets. His relationship with so many past and present members of the SEC may have also contributed. However, his blasé response to the charges ultimately cost him the position of CEO.

After Greenberg’s resignation, the company—and Greenberg personally as well—had to pay billions in fines to settle cases charging that it had manipulated financial statements. This was just the tip of the iceberg for AIG. All this time, larger troubles were brewing in the Financial Products unit, with its excessively risky trades of credit default swaps (CDSs), which insured collateralized debt obligations (CDOs). These financial instruments are very complex and very difficult to track; buyers of CDSs usually do not know what specific kinds of debt are bundled in their purchase. These financial vehicles were used to take debt off of AIG’s books, although the company was still liable if defaults occurred on any of the CDOs. The root of the problem was that AIG did not have nearly enough capital to cover losses from large defaults, even though it had promised investors that it did. The “perfect storm” hit in 2008 with the fall of the housing industry and the subprime mortgage crisis; people began to default on mortgages and other debt obligations that were bundled into the CDSs sold by AIG, and the company did not have enough capital to cover the losses. Because the Financial Products unit worked largely in isolation, workers in other divisions of the corporation likely had no idea what was going on. Students should have strong feelings on this situation: Is it just part of the risk of being in finance, or did AIG’s Financial Products unit act irresponsibly and forsake its shareholders and stakeholders when it began to take on such large risks?
Perhaps the incident that most infuriated stakeholders was the hefty bonuses AIG provided to its executives, even in the wake of massive failure. The U.S. government provided $182 billion in capital to the failing institution. It was later revealed that AIG used $165 million of the bailout money for bonuses to employees of the failed Financial Products unit. The company stated that the bonuses were part of the employees’ contracts and could not be revoked. The government and the public were furious. The outcry was so great that then CEO Edward Liddy asked executives who were making over $100,000 a year to return the bonuses. Most of the executives in question agreed to return the money.

Students will likely form strong opinions concerning this point. Instructors might want to have students brainstorm ways to prevent such incidents in the future.

QUESTIONS AND DISCUSSION

1. Discuss the role that AIG’s corporate culture played in its downfall.

Some students may argue that Greenberg was not at fault for AIG’s recent problems because he left the corporation years prior. However, others may note that the permissive culture that bred unethical behavior had its roots in the Greenberg years. The autocratic leadership style established by Greenberg continued on with AIG’s subsequent leaders; he had been such a strong force in the corporation for such a long time that it would be difficult to argue that he did not leave a lasting legacy on AIG’s corporate culture. AIG was a place that seemed to foster a feeling of invincibility. Because of the corporation’s close ties to regulators and its enormous size, many within the corporation appeared to feel that they could conduct business however they wanted without repercussions. This was especially true for the Financial Products unit, which essentially was run like a hedge fund that existed inside a traditional financial institution. Risk taking was common, and traders did not seem to spend much time thinking about the worst-case outcomes of their decisions. The culture of bravura almost definitely played a role in AIG’s downfall. If it had been a more cautious company, it likely never would have grown to such a huge size, but it also might still be independent today—instead of having to take billions in federal bailout money.

AIG’s decision to award $165 million of bailout money to employees of the failed Financial Products unit infuriated stakeholders. AIG’s excuse that the bonuses were part of the executives’ contracts made them appear to be skirting responsibility. Therefore, students might argue that in addition to being arrogant, AIG’s culture also tended to avoid culpability. In many ways, AIG appeared to have a toxic corporate culture—at least in its Financial Products division—that helped lead to its downfall and subsequent bailout from the government.

After the United States government took control of the organization in 2009, AIG became a very different company. It necessarily was humbled by its failures and success at AIG had to be redefined. Part of the debate about executive compensation involves whether corporations such as AIG will be able to retain their best personnel when they are hampered by government restrictions. AIG was forced to downsize its operations to pay off its debts and has already become a different company than what it was before the crisis. Instructors should encourage students to discuss the future competitiveness of this firm.

2. Discuss the ethical conduct of AIG executives, and how a stronger ethics program might help the company strengthen the ethics of its corporate culture.

A stronger ethical corporate culture likely would have caught some of the misconduct at AIG before it became an unmanageable problem. AIG should have had systemic oversight of the corporation in place long before any misconduct took place. The Financial Products unit was allowed to operate in virtual isolation from other branches of the corporation, so it was easy for that particular unit to go ahead with
decisions that ultimately damaged the entire corporation without being caught. Transparency in financial decisions should be an imperative for many of these financial firms. It is important for top executives to know what is occurring within their own companies, and it also is important for shareholders and investors, so that they can understand the true financial state of those corporations. Additionally, setting an ethical, accountable tone at the top of the organization is important in making any other changes permanent. This clearly is something that AIG lacked.

Contrary to what some students might think AIG does have a code of conduct. Instructors may want to have students examine this document and to question whether AIG adhered to its own standards. Two things that students should notice is that this code is reactive, rather than proactive—meaning that it is not meant to stop unethical behavior before it starts, only contain it once misconduct has occurred. It also is primarily a legal document, rather than a principles-based ethical document. Instructors should ask students how they think AIG should alter its code of conduct to avoid more major ethical and financial crises in the future.

3. What could AIG have done differently to prevent its failure and subsequent bailout?

This question largely is a continuation of the previous two questions. Students likely will discuss the lack of appropriate transparency and oversight, a culture that created opportunities for ethical misconduct, and the overall feeling of invincibility among executives who perceived that they were above the law. Clearly, these attitudes must change so that the corporation does not make similarly risky decisions again.

Additionally, AIG (and many other financial firms) need to stop leveraging their assets to such a high degree. The banks that emerged the healthiest from the financial crisis were also the least leveraged. Had AIG possessed ready capital to pay off its CDOs, the company would not have teetered on the brink of failure nor would it have needed federal bailout money. While tying up capital to provide a safety net prevents a corporation from growing as fast, it also prevents a corporation from becoming too deeply buried under mounting debt.

Instructors may wish to point out that the hedge fund and derivative unit of AIG primarily was at fault. Fund markets should not have been measured using mark-to-market accounting procedures. Mark-to-market accounting requires companies to value assets on their books at the price they would sell for today. When the credit crisis began in summer 2007, all of the complex financial instruments held by these companies—all the mortgage-backed securities, the credit-default swaps, and so forth—plummeted in value as their underlying mortgages failed. AIG was forced, by mark-to-market rules, to value these assets at “fire-sale prices,” that is, for virtually nothing.

ADDITIONAL SOURCES

- Background on the Wall Street financial crisis, the subprime housing meltdown, and the causes of the recession: http://www.pbs.org/wgbh/pages/frontline/meltdown/.
- Supplementary lesson guide for those instructors interested in taking their students’ learning further: http://www.pbs.org/wgbh/pages/frontline/teach/meltdown/.
Many students believe that when a company fails so miserably, the executives are to blame. Instructors may show Table 1 (see next pages) as to where AIG 2007 executives went after the meltdown. In almost every case, their new positions were at the same level as their old ones at AIG. Students should recognize that very few executives had to leave AIG.
Table 1: 2007 AIG Key Personnel and Where They Are Now

**Martin J. Sullivan:** President and Chief Executive Officer

- 2005: Maurice Greenberg is fired by the Board for accounting irregularities and Martin J. Sullivan becomes CEO.
- 2008: Martin J. Sullivan is fired and Robert B. Willumstad becomes CEO. Mr. Sullivan’s departure payment was $15 million, and a bonus of $4 million. He also holds outstanding equity and long-term cash awards valued at about $28 million. After immense criticism for such an extensive compensation package, AIG agrees to freeze $19 million.\(^1\)
- 2009: CNBC names Martin J. Sullivan as one of the "Worst CEOs of All Time."\(^2\)
- 2010: Martin J. Sullivan is Deputy Chairman of Willis Group Holdings plc and Chairman and CEO of a new business unit, Willis Global Solutions.

**Edmund S.W. Tse:** Senior Vice Chairman of Life Insurance

- 2008: Retired, received $9.9 million in compensation and $14.4 million dollars in retirement benefits.
- 2009: AIA Honorary Chairman with $250,000 annual fee. The agreement also provides him with office space, administrative support, a car and driver and first-class travel between Hong Kong and New York.
- 2011: Non-Executive Chairman, Member of Nomination Committee and Member of Risk Committee for AIA Group Limited.

**Steven J. Bensinger:** Executive Vice President and Chief Financial Officer

- 2010: Still Chief Financial Officer and Executive Vice President.
- 2011: Executive Vice President and Chief Financial Officer of The Hanover Insurance Group Inc.

**Anastasia D. Kelly:** Executive Vice President, General Counsel and Senior Regulatory and Compliance Officer

- 2009: Vice Chairman, reporting to AIG Chairman and Chief Executive Officer Edward J. Liddy. Responsibilities include Global Legal, Compliance and Regulatory matters, Communications, Corporate Affairs and Human Resources.
- 2010: Partner in the law firm of DLA Piper.
- 2011: Director of Huntington Ingalls Industries, Inc.

**Rodney O. Martin, Jr.**: Executive Vice President, Life Insurance

- 2011: Chief Executive Officer of ING Insurance U.S.

**Kristian P. Moor:** Executive Vice President, Domestic General Insurance

- 2009: Chief Executive Officer of Chartis Inc.
• 2011: Vice Chairman of Chartis Inc.

*Win J. Neuger*: Executive Vice President and Chief Investment Officer

• 2010- Present: CEO of PineBridge Investments.

*Nicholas C. Walsh*: Executive Vice President, Foreign General Insurance

• 2008-2010: AIG Executive Vice President, Foreign General Insurance

• 2011-Present: Chief Distribution Officer & Head of Global Distribution for Chartis Inc.

*Jay S. Wintrob*: Executive Vice President Retirement Services

• 2001 - Present: AIG President and Chief Executive Officer of Domestic Life and Retirement Services.

• 2001- Present: Chief Executive Officer, President, and Director at First SunAmerica Life Insurance Co.

*William N. Dooley*: Senior Vice President Financial Services

• 2010 – Present: Executive Vice President - Investments and Financial Services.

*Andrew J. Kaslow*: Senior Vice President and Chief Human Resources Officer

• AIG Senior Vice President and Chief Human Resources Officer

*Brian T. Schreiber*: Senior Vice President

• 2010 – Present: AIG Executive Vice President, Treasury and Capital Markets.

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CASE 7
Microsoft Manages Legal and Ethical Issues

CASE NOTES FOR INSTRUCTORS

The objective of this case is to help students explore why many people consider Microsoft to be an ethical company, in spite of its past legal issues and poor reputation. The case uses Microsoft as a platform from which to consider the concept of monopolies, monopolistic practices, and predatory pricing strategies that can restrain trade. In addition, students can analyze the ethical dimensions of fair competition and determine appropriate competitive practices in a dynamic industry.

The Microsoft of today is a different company than the Microsoft that existed decades ago. The computing and software industries have changed a great deal thanks to the Internet and the wide availability of alternative programs that are now available. The Microsoft antitrust decision helped to open these industries, but Microsoft had to adapt to the changing technological environment like any other company.

Students may need some background on antitrust issues in order to fully understand this case. The prevailing economic theory supporting antitrust laws in the United States is that the public is best served by free competition in business. Some businesses try to eliminate competition by using their market power to create monopolies in their industry, which allow them to fix prices and set standards of quality, or by dividing territories between competitors in such a way that each competitor has a monopoly over a region. There are different types of monopolies. Monopolies can be horizontal (involving direct competitors at the same level) or vertical (involving all participants in one channel such as manufacturer, wholesaler, and retailer). Price fixing occurs when competitors collude to set prices to maximize their own profitability. Market allocations involve situations where competitors agree to not compete with each other in specific markets or divide up geographic areas, types of products, or types of customers so that each business gets a share. Antitrust laws seek to eliminate such illegal behavior and promote free and fair marketplace competition.

The first legislation against anticompetitive practices was the Sherman Anti-Trust Act of 1890. It was a reaction to the explosive growth of powerful trusts that began to threaten, or monopolize, entire industries. The Act made it a crime to "monopolize, or attempt to monopolize trade or business." The purpose of the Act was to maintain competition in business. However, enforcement of the Act has always been problematic.

The Clayton Act (1914) represented an amendment to the Sherman Anti-trust Act and prohibits exclusive sales contracts, local price cutting to freeze out competitors, rebates, interlocking directorates in corporations capitalized at $1 million or more in the same field of business, and inter-corporate stock holdings. The Robinson-Patman Act (1936) is an extension of the Clayton Act. It tries to protect small firms from large firms dominating markets through predation and other forms of economic warfare. Congress felt that "power buyers," such as large retailers, who could use their market power to extract price concessions from manufacturers and other sellers that were unavailable to their smaller competitors. The Robinson-Patman Act is based on one fundamental principle: to assure, to the extent reasonably practicable, that businessmen at the same functional level would stand on equal competitive footing so far as price is concerned. However, even legislation is not always enough to protect businesses from anti-competitive practices. Over the past several decades no prosecution case has successfully used the Robinson-Patman Act.
QUESTIONS AND DISCUSSION

1. What unique aspects of the software industry created the opportunity for Microsoft’s monopoly and anticompetitive practices?

The software industry is highly competitive because software companies must continually develop new programs and updates in order to protect their intellectual property (and thus their market share). The sheer size, speed of growth, and market dominance that Microsoft achieved raised questions as to how it was accomplished, particularly among its less-successful competitors.

Instructors may wish to have students focus on the debate surrounding competition in the software industry. Some people see Microsoft’s actions as an attempt to bully their competitors. On the other hand, many Americans admire Microsoft’s success and view Bill Gates, its founder and former CEO, as an aspirational figure and the ultimate entrepreneur.

A key issue remains involving whether or not the company behaved ethically and fairly when engaging in competition in the software market. Microsoft has settled a number of lawsuits brought on by competitors. However, many critics view these legal decisions as having little overall effect on the powerful firm. Students may also argue that the modern software market discourages anticompetitive practices and that Microsoft is no longer the monopoly it once was. For example, with many alternative programs available via the Internet (either for free or for a price), bundling no longer prevents consumers from acquiring a new browser from a competitor when they want one.

2. Discuss the role of Microsoft’s leadership and corporate culture in generating a large volume of ethical and legal issues.

Microsoft seems to have two sides to its corporate culture—one that is devoted to helping underserved communities and nonprofit organizations and one that is solely focused on strengthening the company and its future.

Many observers believe that Microsoft has substantially reduced actual competition within the software industry, particularly in the markets for operating systems, word processors, and Internet browsers. Microsoft has a reputation as a “crush the competitors” kind of company. However, in the decade since the antitrust ruling, Microsoft has actually become a less aggressive competitor. It appears that the company’s goals and strategies have adjusted to the regulatory pressure as well as the modern technology market. Despite these changes, Microsoft is still focused on leading the software and technology industries.

Over the years, Microsoft has been proactive in addressing the needs of its many global stakeholders. The company has worked with customers, employees, partners, and competitors on how they envision Microsoft as a company and as an industry leader. In addition, Microsoft has also acknowledged its role as a global business leader and offers several programs designed to positively impact people, communities, and the environment.

Instructors may want to assign groups of students to review and critique the different aspects of Microsoft’s corporate culture. Students will likely find many resources, but the following websites can serve as a starting point:
Pro:

- Bill and Melinda Gates Foundation: http://www.gatesfoundation.org/Pages/home.aspx

Anti:


3. How do Microsoft’s social responsibility and philanthropic efforts relate to its reputation and ability to overcome its legal problems?

Generally speaking, the public holds Microsoft in high esteem, a feeling which is reflected in the company’s consistently high placement in several corporate social responsibility and media reputation indexes. In addition, the company continues to grow and be successful. Students may want to examine Microsoft’s annual reports and stock prices to examine any changes during the years of the company’s greatest antitrust struggles.

The massive scale and variety of Microsoft’s social responsibility efforts could also explain why the company has a positive reputation. The Microsoft Corporate Citizen Report (http://www.microsoft.com/about/corporatecitizenship/en-us/reporting) goes into great detail on its community and environmental efforts. In addition, many people associate Microsoft with the Bill and Melinda Gates Foundation, which could make the company’s charitable efforts seem even more expansive.

Another discussion could focus on Microsoft’s marketing strategy relative to the power of the federal government and the general public to control Microsoft.

ADDITIONAL RESOURCES

- Microsoft’s Antitrust Timeline: http://seattletimes.nwsource.com/html/microsoftpri0/2015034153_timeline_microsofts_antitrust_history.html
CASE 8

Countrywide Financial: The Subprime Meltdown

CASE NOTES FOR INSTRUCTORS

This case should familiarize students with some of the reasons for the financial meltdown of 2008-2009, particularly those aspects that pertain to the subprime mortgage industry. Countrywide was one of the largest players in the mortgage industry, and it failed on an epic scale. Given the complexity of issues, the financial crisis can be difficult for some students to understand clearly. However, subprime mortgages were a major contributing factor, and Countrywide was a significant player in this market. Countrywide is a textbook case of a company willing to engage in excessively risky—and even illegal—activities in exchange for profits.

Previously a rather small portion of the overall home mortgage industry, the subprime market flourished in the early 2000s. High growth in this sector can be attributed to the high growth of the housing market, historically low interest rates, and low delinquency rates during this period of time. There was a fever in the air, as home values increased at nearly unprecedented rates in the United States. However, the housing bubble burst in 2006, sending the prices of homes back down to earth. In some places, home values fell by 50 percent or more in the United States.

This situation has its roots in legislation passed decades ago. The passage of the Equal Credit Opportunity Act of 1974 allowed more consumers to apply for loans. While not all consumers who applied for loans received one, loan officers quickly discovered that they would make more and higher commissions on sales by approving more mortgages. In some cases, unscrupulous lenders forced loans through for clients who were clearly unqualified to handle that level of debt. With perverse incentives in place, it is possible that poor underwriting procedures increased. Countrywide was one of the top providers of “liar loans,” in which loan applicants overstated their income, sometimes by a large amount. The loan officers either encouraged the clients to do so, or looked the other way when they did. Some Countrywide employees clearly aided borrowers in falsifying information.

The current subprime crisis was created by high rates of delinquency and foreclosures of mortgages, largely because high-risk consumers were given loans they could not afford. With so much of its earnings tied up in subprime loans, Countrywide’s revenue plummeted when borrowers began to default. In 2008 Bank of America saved Countrywide by purchasing it for a fraction of what it had been worth earlier in the year.

Countrywide co-founder Angelo Mozilo did not blame himself for the poor performance of the company, but rather blamed regulators, rating agencies, legislators, and the media. Shareholders upset with Mozilo felt he did not accurately assess the risk into which Countrywide was buying. Other stakeholders, however, felt that Mozilo and David Sambol, the Executive Managing Director of Business Segment Operations at Countrywide, should be held accountable for what happened. Sambol eventually settled a lawsuit filed by the Securities and Exchange Commission for $5.52 million, while Mozilo, who also was charged with insider trading, agreed to pay $67.5 million to settle with the SEC and has been permanently barred from serving on a board or as an officer of any company.

Instructors may encourage discussions on the rights of the individual, the company, and the government as it relates to the subprime issue. Instructors might also ask students their opinions regarding the culpability of Sambol and Mozilo, particularly whether they feel the fines levied against the two men were justified or were sufficient punishment.
QUESTIONS AND DISCUSSION

1. Are subprime loans an unethical financial instrument, or are they ethical tools that were misused?

It would be very difficult for students to argue that a financial instrument is inherently ethical or unethical. However, tools can be highly damaging when used in the wrong ways. Subprime loans are loans meant for higher risk consumers that charge a higher-than-normal rate. This high interest rate is meant to protect the lender from the increased riskiness of the loan. They were created to help those who cannot qualify for regular loans realize their dreams of home ownership. The original idea was that property ownership would help instill in people a sense of stability and pride that would radiate out into their lives, creating larger benefits for society. However, subprime loans were given to people who clearly had no ability to pay them off by unscrupulous lenders. Some employees at Countrywide began treating subprime loans more like predatory or payday loans—giving large loans to people who did not understand the consequences, did not have sufficient incomes, and who would soon find themselves “underwater” on their loan payments. All of this was done in the name of higher commissions for Countrywide salespeople. It was not the instrument that was unethical, but rather the way the instrument was used.

2. Discuss the ethical issues that caused the downfall of Countrywide Financial.

Students can expand on their answer from question 1. They also will definitely want to talk about the corporate culture at Countrywide Financial and the incentives system that was in place. Although it involved lying and taking advantage of low-income clients and immigrants, salespeople felt encouraged to have consumers falsify data on applications to ensure the loans would be granted so they would obtain their commissions. Because Countrywide often targeted poor and minority communities, their customers were less likely to be well-informed and were also less aware of the consequences of falsifying information than would be wealthier and more highly educated clients. However, the real estate fever at the height of the boom even attracted consumers who would have qualified for regular loans. Rather than steer these customers toward safer loan options, Countrywide accepted them all. Students should focus on the importance of corporate culture and incentive systems in helping to mitigate opportunities for misconduct.

Students should also discuss the “tone at the top” set by Mozilo and Sambol, among others. Because the leaders at Countrywide were permissive of unethical behavior—and were even engaged in it themselves—it created an unethical atmosphere with few consequences that pervaded the organization. In fact, it seems that Mozilo and Sambol were rewarded for their unethical conduct with high paychecks and bonuses. It is interesting to note that while Countrywide’s stock prices were skyrocketing (23,000 percent between 1982 and 2007), no one thought to question the legality or ethicality of Mozilo’s dealings. It was only after the business started to head south that legal investigations began, indicating that shareholders were willing the turn the other cheek as long as they were continuing to profit. Students also can discuss the “Friends of Angelo’s” program that gave special deals to high-profile clients, such as legislators and officials. While key lawmakers deny knowing they received special treatment from Countrywide, students should ask themselves whether they believe the Friends of Angelo’s program helped provide Countrywide with a certain level of legislative immunity.

3. How should Bank of America deal with potential ethical and legal misconduct discovered at Countrywide?

Students likely will provide a wide array of answers to this question, and instructors should encourage students to be creative when brainstorming solutions for Countrywide. Instructors may also find it helpful to have students conduct research on what has happened in recent months regarding
Countrywide and Bank of America. Have students discuss what Bank of America has done to improve Countrywide’s business outlook, and whether they agree with its approach. This question is a good opportunity to discuss how a corporation recovers from an ethical misconduct disaster, particularly one as severe as that at Countrywide.

To understand how ethical and legal issues are handled in firms such as Countrywide, the following is a direct quote from their 2007 10-K report.

**Item 3. Legal Proceedings**

- We are defendants in various legal proceedings involving matters generally incidental to our businesses.
- In addition, various lawsuits alleging claims for derivative relief on behalf of the Company and securities, retirement plan, and other class action suits have recently been brought against us and certain of our current and former officers, directors and retirement plan administrators in either federal district court in Los Angeles, California, or state superior court in Los Angeles, or state court in Delaware. Among other things, these lawsuits allege breach of state law fiduciary duties and violation of the federal securities laws and the Employee Retirement Income Security Act of 1974 (“ERISA”). These cases allege, among other things, that we did not disclose complete and accurate information about our mortgage lending practices and financial condition. The shareholder derivative cases brought in federal court are brought on our behalf and do not seek recovery of damages from us. Two consolidated cases alleging claims for derivative relief on behalf of the Company are also pending in federal district court in Delaware, and allege, among other things, that certain of our proxy filings contain incorrect statements relating to the compensation of our Chief Executive Officer.
- Various class action lawsuits relating to our proposed merger with Bank of America have been filed in the state courts of California and Delaware on behalf of a proposed class of Countrywide shareholders against the Company, our directors and Bank of America. The class action lawsuits filed in state court in California have been removed to federal court in Los Angeles. These lawsuits allege that the Company's directors breached their fiduciary duties to the Company's shareholders by entering into the merger agreement with Bank of America and that Bank of America allegedly aided and abetted those alleged breaches. Similarly, the plaintiffs in the shareholder derivative lawsuits brought in California state and federal court recently have amended their complaints to add similar class action allegations relating to the proposed merger with Bank of America.
- Although we believe we have meritorious defenses to each of these actions and intend to defend them vigorously, it is difficult to predict the resulting outcome of these proceedings, particularly where investigations and proceedings are in early stages. Given the inherent difficulty in predicting the outcome of our legal proceedings, we cannot estimate losses or ranges of losses for legal proceedings where there is only a reasonable possibility that a loss may be incurred, such as those discussed in the two immediately preceding paragraphs. We provide for potential losses that may arise out of legal proceedings to the extent such losses are deemed probable and can be estimated. Although the ultimate outcome of the legal proceedings discussed above cannot be ascertained at this time, we believe that any resulting liability will not materially affect our consolidated financial position; such resolution, however, could be material to our operating results for a particular future period depending upon the outcome of the proceedings and the operating results for a particular period. Our assessment is based, in part, on the existence of insurance coverage.

ADDITIONAL RESOURCES

- To augment this case and to provide some background on the Wall Street financial crisis, the subprime housing meltdown, and the causes of the recession, instructors may want to show the following episode available on the PBS website: http://www.pbs.org/wgbh/pages/frontline/meltdown/.

- A supplementary lesson guide for those instructors interested in taking their students’ learning further: http://www.pbs.org/wgbh/pages/frontline/teach/meltdown/.

CASE 9

Enron: Questionable Accounting Leads to Collapse

CASE NOTES FOR INSTRUCTORS

The purpose of this case is to show how it is possible for a well-known and respected company to become swept up in unethical and illegal business practices, which can result in damage to thousands of employees, investors and other stakeholders. Although this case is complex and involves many actors, one important point that emerges is how a number of individuals, including attorneys, auditors, executives, and employees, apparently worked together to achieve Enron’s objectives, even though these objectives were unethical and often not in the best interests of stakeholders.

The Enron case did not end with the collapse of the company. In addition to the complex ethical issues involved in Enron’s collapse, the company, its partners, and its employees have been caught in several ongoing legal struggles. In 2004, Enron's new board of directors sued 11 financial institutions for helping Lay, Fastow, Skilling, and others to hide Enron's true financial condition. The proceedings were dubbed the "megaclaims litigation." Among the defendants were Royal Bank of Scotland, Deutsche Bank, and Citigroup. Enron sold its last business, Prisma Energy, in 2006. In early 2007, it changed its name to Enron Creditors Recovery Corporation. The sole goal of the newly-named organization was to pay off Enron's remaining creditors and wrap up Enron's affairs. By 2008 Enron had settled with all involved institutions, with Citigroup being the last. Enron was able to obtain nearly $20 million to distribute to its creditors as a result of the megaclaims litigation.

Since the collapse of Enron, many executives who worked for the company or had business dealings with it have been swept up in the investigations and prosecutions of the former energy giant. Many of the people convicted of crimes connected to Enron have already served their sentences, but Jeff Skilling remains in prison after being convicted of honest services fraud. However, in June 2010 the United States Supreme Court ruled that Skilling should not have been tried under the honest services law because it was intended for bribes and kickbacks, not for conduct that is ambiguous or vague. However, the court’s decision did not overturn Skilling’s conviction, but sent the case back to a lower court for evaluation.

Although this case may not seem so shocking now in the wake of Bernard Madoff and the failure of so many of Wall Street’s most venerable firms, students should keep in mind that at that time this case sent shock waves around the world. Instructors may wish to have students compare aspects of this Enron case with other cases provided in this book, such as Countrywide Financial, AIG, Bernard Madoff, and the Galleon Group. These cases share elements, such the type of misconduct and pervasiveness of unethical behavior in the companies’ corporate cultures. The Enron case now stands as a precursor for business misconduct that dominated the early 21st century, and it remains a valuable case.
QUESTIONS AND DISCUSSION

1. How did the corporate culture of Enron contribute to its bankruptcy?

Most students will agree that Enron appears to have had a highly unethical corporate culture. However, this point may be missed by students who are unfamiliar with business ethics and by those who view Enron’s difficulties as stemming from accounting or auditing problems. In reality, the root of the company’s downfall lay in its corporate culture that fostered a poor ethical climate and opportunities for misconduct. The “rank and yank” system created a climate of fear in which performance was prized above all other things. In order to meet performance goals, employees bent the rules when necessary. Ruthlessness toward some stakeholders seems to have been the norm. This culture also focused on short-run earnings rather than long-term strategy, and Enron did not consider the effects that company actions would have on employees, shareholders, and society at large. If people had not feared for their jobs, there is a chance that unethical conduct might have been uncovered before it became a full-blown disaster. To the end, Ken Lay asserted that he was an ethical person; Enron even had a code of ethics. The problem seems to have been a fundamental conflict between the company’s stated beliefs and the examples set by top management and the performance incentives for employees.

2. Did Enron’s bankers, auditors, and attorneys contribute to Enron’s demise? If so, how?

All corporations are supposed to have a number of different gatekeepers in place who ensure that the business’ dealings are transparent and in compliance with the law. However, in the case of Enron, these gatekeepers, such as accountants, independent auditors, and government regulators, failed to make sure that Enron conducted business in a way that was in stakeholders’ interests. For example, the auditors appeared not to have held Enron to generally accepted accounting standards, which resulted in Enron receiving certification on financial reports that did not accurately indicate Enron’s financial health. Financial reports are a key piece of information for investors and the financial community. It also appears that the attorneys may have been involved in enabling the creation of certain questionable transactions. Other large financial institutions around the world were also likely involved in enabling Enron to carry out its business unimpeded by questioning stakeholders. Again and again, one finds gatekeepers and other stakeholders willing to look the other way and not ask questions, so long as the firm continued to make large profits.

Students can also take this opportunity to discuss the roles of individuals and personal responsibility within the larger corporate structure. Several gatekeepers and employees had opportunities to uncover and report ethical lapses, but very few people ever questioned Enron's practices. Highly idealistic students could argue that individuals could have prevented the company’s collapse and worked to influence the corporate culture; however, other students may argue that it is easy to become swept away in an unethical environment, particularly if the organization is powerful and respected like Enron was.

Instructors may wish to use Table 1 as a supplement to the Enron case. They may want students to analyze the sentences that were handed down after researching what each key player did and what his/her position was in the company. Instructors can also discuss the sentencing in white collar crime versus normal crimes. Students can look at mandatory minimum prison sentences for a variety of violent and white collar crimes at http://www.cga.ct.gov/2008/rpt/2008-R-0619.htm. After students realize that, for example, having a handgun without a permit or the illegal sale or transfer of a handgun to a person under age 21 carries a mandatory one year sentence, but taking thousands of employees’ pensions (which could lead to bankruptcy, spousal or child abuse, alcoholism, drug addiction, and suicide) only yields probation, students can have a rousing debate on the fairness of white collar sentencing. Some students will argue about the inequality in the treatment of poor versus rich defendants and the sentences they receive. Others will argue that, because a violent act was not involved, the penalties for white collar crimes should be less
than for violent crimes. Students might also discuss the meaning of prison sentences, such as whether they are meant to deter or punish. Instructors may wish to debate whether there should be mandatory minimum sentences for white collar offenses.

3. What role did the company’s chief financial officer play in creating the problems that led to Enron’s financial problems?

This question should help students better understand the role of the chief financial officer (CFO), a role filled at Enron by Andrew Fastow, who was key in creating Enron’s financial problems. Representing the final word on a corporation’s finances, the CFO plays a very important role in most firms. At Enron, most believe that it was Fastow who masterminded many of the unethical/illegal financial transactions that ultimately led to the destabilization and demise of the company. In his position as CFO, Fastow had access to information and numbers to which Skilling and Lay did not. He was in a unique position to manipulate Enron’s financial reports to make Enron appear strong and profitable no matter how unstable the company actually was.

For much of the past few decades, the role of CFO has been a contentious one. The CFO was associated with major mergers and acquisitions deals in the early 1990s and was reputed for seeking out loopholes and accounting tricks in the late 1990s. However, a good CFO should be a highly ethical person because of his or her powerful and potentially sensitive position within the firm. CFOs are expected to present reliable financial information to stock analysts, as well as to ensure that their companies achieve projected financial goals.

Even upstanding CFOs often become scapegoats if their companies perform poorly. Because of the pressure, their average tenure is only about four years. After the Enron bankruptcy and the passage of the Sarbanes-Oxley Act, CFOs have necessarily been focused on the fundamentals within their companies (such as financial controls, internal auditing procedures, and accounting practices). In the case of Enron, CFO Andrew Fastow seemed to have been singularly focused on making certain that Enron “hit the numbers,” even at the expense of his duty as a gatekeeper. He should have been equally focused on being certain that financial controls, internal auditing procedures, and accounting practices were in place and operating correctly in order to protect stakeholders.

ADDITIONAL RESOURCES

- Ungagged.net: The Other Side of the Enron Story offers the perspectives of Enron employees who believe they were the victims of the federal government’s desire to get convictions and place blame. http://ungagged.net

- Interactive graph of Enron’s stock price and the actions of important Enron executives and partners: http://www.time.com/time/interactive/0,31813,2013797,00.html
### Key Enron Figures and Their Sentences

<table>
<thead>
<tr>
<th>Name</th>
<th>Sentence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jeffrey Skilling</td>
<td>24 years and 4 months in prison</td>
</tr>
<tr>
<td></td>
<td>$45 million in fines</td>
</tr>
<tr>
<td></td>
<td>Scheduled for release on February 21, 2028, when he will be 74 years old.</td>
</tr>
<tr>
<td>Andrew Fastow</td>
<td>6 years in prison</td>
</tr>
<tr>
<td></td>
<td>$23.8 million in cash and property</td>
</tr>
<tr>
<td>Lea Fastow</td>
<td>1 year in prison</td>
</tr>
<tr>
<td></td>
<td>1 year of supervised release.</td>
</tr>
<tr>
<td>Richard Causey</td>
<td>5 years and 6 months in prison</td>
</tr>
<tr>
<td></td>
<td>2 years of probation</td>
</tr>
<tr>
<td></td>
<td>$25,000 fine</td>
</tr>
<tr>
<td></td>
<td>Agreed to pay another $1.25 million to the victims' funds</td>
</tr>
<tr>
<td></td>
<td>Forfeited a claim to about $250,000 in deferred compensation</td>
</tr>
<tr>
<td>Ben Glisan Jr.</td>
<td>5 years in prison</td>
</tr>
<tr>
<td>Michael Kopper</td>
<td>37 months in prison, served 23 months</td>
</tr>
<tr>
<td>Jordan Mintz</td>
<td>$25,000 in civil fines</td>
</tr>
<tr>
<td></td>
<td>$1 in disgorgement</td>
</tr>
<tr>
<td></td>
<td>2 year ban from practicing before the SEC</td>
</tr>
<tr>
<td>David Duncan</td>
<td>$25,000 in civil fines</td>
</tr>
<tr>
<td></td>
<td>$1 in disgorgement</td>
</tr>
<tr>
<td></td>
<td>2 year ban from practicing before the SEC</td>
</tr>
<tr>
<td>Timothy Belden</td>
<td>$2.1 million in fines</td>
</tr>
<tr>
<td></td>
<td>2 year ban from practicing before the SEC</td>
</tr>
<tr>
<td>Larry Lawyer</td>
<td>2 years of probation</td>
</tr>
<tr>
<td>Jeffrey Richter</td>
<td>2 years of probation</td>
</tr>
<tr>
<td>Kevin Howard</td>
<td>1 year of probation</td>
</tr>
<tr>
<td>Rex Shelby</td>
<td>3 months in a halfway house</td>
</tr>
<tr>
<td></td>
<td>3 months of house arrest</td>
</tr>
<tr>
<td></td>
<td>$3.6 million in fines</td>
</tr>
<tr>
<td>Dan Boyle</td>
<td>3 years and 10 months in prison</td>
</tr>
<tr>
<td></td>
<td>$320,000 in fines</td>
</tr>
</tbody>
</table>
| **David Delainey** | 2 years and 6 months in prison  
| | $8 million in fines |
| **Paula Rieker** | 2 years of probation |
| **Kenneth Rice** | 27 months in prison  
| | $15 million in fines |
| **John Forney** | 2 years of probation |
| **Mark Koenig** | 18 months in prison  
| | $50,000 in fines |
| **Kevin Hannon** | 2 years in prison  
| | 2 years of probation  
| | $125,000 fine |
| **Timothy Despain** | 4 years of probation  
| | $10,000 in fines |
CASE 10

Home Depot Implements Stakeholder Orientation

CASE NOTES FOR INSTRUCTORS

The objective of this case is to familiarize students with the concept of stakeholder orientation. Home Depot is a large retail chain and therefore must consider a number of different stakeholder groups in its decision-making processes. Students should realize, however, that Home Depot was not always so stakeholder oriented. In fact, Home Depot has had to work hard in recent years to develop a positive reputation. For instance, under former CEO Robert Nardelli, employees were terrified of being fired if they did not follow his directions to a tee. The corporate culture was such that employee needs were not being considered. Having a stakeholder orientation means constantly adapting to changing circumstances. To this day, Home Depot continues to learn new ways to remain competitive and meet stakeholder needs. Having a stakeholder perspective is a crucial advantage for Home Depot as it faces competition from rivals such as Lowe’s.

In less than two decades Home Depot has grown to become a major national and international player in the home repair and do-it-yourself market. The popular chain employs well over 300,000 people, including tens of thousands of employees in Canada, Mexico, and China; operates nearly 2,300 stores; and has annual revenues of around $68 billion. Home Depot attracts a wide range of customers, from professional general contractors to average home owners seeking to do work themselves on a budget. In spite of its rapid success, the company has had its fair share of problems over the years. It has experienced issues with product quality, customer satisfaction, service quality, discrimination lawsuits, and reputation. Lowe’s, its closest competitor, enjoys a better reputation among consumers—particularly among women.

In order to improve its image, Home Depot engages in strategic philanthropy. The retailer offers educational days for children and has provided housing for victims of natural disasters. It also works with the Forest Stewardship Council to ensure that its lumber is sourced from sustainable supplies. Instructors may want to ask students what they think of Home Depot’s ethics and environmental initiatives. Does it make them think more highly of Home Depot as a company, or do they think that it is a waste of corporate money?

In addition to seeking to satisfy customers, Home Depot has taken strides to be a better place to work as well. As part of the settlement of a gender-discrimination lawsuit, Home Depot established internal mechanisms to allow employees to formally inform managers of their advancement interests. Home Depot also encourages its employees to volunteer their time by serving in local communities. Volunteerism helps employees feel more invested in the firm while also linking Home Depot to local communities. The corporation also stresses education and seeks to create educational opportunities for its employees to advance their educational status and to improve their positions within the company.

As with many retailers, Home Depot was hit hard by the 2008-2009 recession, which caused the North American home industry to grind to a halt. It also forced the company to rethink its strategy of aggressive expansion. The chain has slowed growth and is focusing on improving the look of its stores and its quality of service. It has recently undergone a technology overhaul to become more efficient and offer better services to its customers. Instructors may ask students to consider ways that Home Depot could obtain a competitive advantage over Lowe’s.
QUESTIONS AND DISCUSSION

1. On the basis of Home Depot's response to environmentalist issues, describe the attributes (power, legitimacy, urgency) of this stakeholder. Assess the company's strategy and performance with environmental and employee stakeholders.

Students likely will provide a variety of answers, depending on their points of view. They should be able to provide reasons for their thinking for both parts of this question. Students should be able to cite various examples from the case where Home Depot has acknowledged environmentalist group concerns. For the past couple of decades, Home Depot has perceived most environmentalist groups as having a high degree of legitimacy and coercive power (some students may even think that Home Depot has attributed more power to these groups than they actually have). Even though the retailer accords them a high degree of power, environmental groups are not primary stakeholders for Home Depot. While they can damage the company through negative press, they are not able to affect the company in a way that would render Home Depot unable to survive. Nevertheless, environmental groups do tend to be vocal, and working with them demonstrates that Home Depot has an interest in environmental issues. Given the company’s past issues with negative public perceptions, working with environmental groups is likely an important public relations tool (much like its strategic philanthropy efforts). However, students are not likely to think that addressing environmental concerns is the most urgent issue for Home Depot, particularly when the company is seeking to recover from a recession.

The second part of the question asks students to assess the company’s strategy and performance with employee stakeholders. After former CEO Nardelli left the company, Home Depot strived to improve its relationships with its employees. Home Depot also seeks to apply social responsibility to its employment practices, with the goal of assembling a diverse workforce that reflects the population of the markets it serves. However, in 1997 the company settled a class-action lawsuit brought by female employees who claimed they were paid less than male employees, awarded fewer pay raises, and promoted less often. The $87.5 million settlement represented one of the largest settlements of a gender discrimination lawsuit in U.S. history at the time.

Since the lawsuit, Home Depot has undertaken efforts to incorporate greater employee diversity into its business strategy. The company has joined many partnerships to support diversity and has won numerous accolades for its efforts, including being listed as number 13 for the Top 50 American Organization for Multicultural Business Opportunities in 2010 and winning the Georgia Minority Supplier Development Council (GMSDC) George Lottier Rising Star of the Year in 2009.

2. As a publicly traded corporation, how can Home Depot justify budgeting so much money for philanthropy? What areas other than the environment, disaster relief, affordable housing, and at-risk youth might be appropriate for strategic philanthropy by Home Depot?

Instructors may want to ask students to review Home Depot’s financial statements before answering this question. Undoubtedly, strategic philanthropy helps major corporations improve their reputations and build goodwill among stakeholder groups. However, the question remains: What is the right amount of money to donate to charitable causes? Instructors may want students to review Lowe’s annual reports to provide a basis for comparison with Home Depot’s charitable giving. Instructors should remind students that, when it comes to publicly traded companies, a business’ first priority must be to make a profit. Only then can it engage in philanthropic activities. Otherwise, the company risks failure and the ire of shareholders who have invested in the corporation.

For the second portion of this question, answers will vary. Instructors should ask students to review the case, and possibly the company’s website and to identify areas in which Home Depot’s charitable activities are weak or nonexistent.
It is also important to note that philanthropy could contribute to the company’s bottom line. Companies that give back to their communities are often viewed more favorably. Home Depot has worked with Habitat for Humanity, which is a good fit because of the types of products that it sells and its strategic mission as a business. This is an important aspect of strategic philanthropy as it enables stakeholders to create a clear association between the company and the cause.

3. Is Home Depot’s recessionary strategy of eliminating debt and halting growth a wise one? What would you recommend to the CEO?

Students’ answers likely will vary. It depends on the respondent’s perspective and tolerance for risk. Eliminating debt reduces the need to finance, but finding the right amount of debt is a delicate balance for any business. Reducing debt may also reduce Home Depot’s ability to return to fast growth once the recession has passed. Eliminating too much debt could encourage hostile takeovers by investors. However, not eliminating enough debt can also be detrimental. A firm does not want to find itself in a position where it is using borrowed money to supplement its cash flow. In such a case, investors would have a higher probability of selling stock, thus reducing the company’s net worth, which in turn would make it more difficult to obtain money at affordable rates. The decision to halt growth, which had been at the core of Home Depot’s strategy, also is a difficult decision. While Home Depot should be lauded for deciding to focus on improving its stores and quality of service, Lowe’s has decided to continue its expansion. By slowing growth, Home Depot puts itself in the position where it may lose market share to Lowe’s over the long term, as Lowe’s enters markets formerly controlled by Home Depot.

ADDITIONAL RESOURCES

- Home Depot embraces technology: http://www.businessweek.com/magazine/content/11_04/b4212064704660.htm
- Poor interaction between employee and middle and upper management:* http://www.bloggingstocks.com/2007/06/22/home-depot-customers-and-employees-have-plenty-to-say/.

*Note: The truthfulness of these items cannot be verified. Thus, instructors should use caution in giving them exceptional credence.
CASE 11
The Fraud of the Century: The Case of Bernard Madoff

CASE NOTES FOR INSTRUCTORS

This case will provide students with details of the Bernard Madoff scandal, as well as how it affected a variety of stakeholder groups. Because of its magnitude and the high-profile nature of Madoff and many of his victims, the Bernie Madoff case is destined to be a white-collar crime classic. The fraud perpetrated by Madoff is what is known as a Ponzi scheme. A Ponzi scheme works similarly to a pyramid scheme in that a person takes money from new investors to pay back older investors. The scheme continues to work as long as new investors keep joining. As soon as new cash stops flowing in, however, the scheme falls apart. While this arrangement is known as a Ponzi scheme, it should well be called a Madoff scheme now because Madoff’s crime was unusually large and long-running. Most Ponzi schemes fall apart in a short time, but Madoff sustained his for decades. After reading this case, students should be able to identify some of the major lapses in oversight that enabled Madoff’s Ponzi scheme to go on for so long.

Madoff began his career as a highly successful, highly respected businessman. He started a legal investment business in 1960 by buying and selling over-the-counter stocks that were not listed on the New York Stock Exchange (NYSE). In the 1990s, Madoff Securities was trading up to 10 percent of NASDAQ shares on certain days. He used his legitimate success to start another, illegitimate money-management business that promised his investors consistent returns of 10 to 12 percent. Such returns are so high that investors should not have believed him, yet many thousands of people invested because they trusted Madoff, liked the sense of exclusivity he imparted, and were swayed by the promise of high returns. Madoff told his investors that his strategy was to buy stocks while also trading options on those stocks as a way to limit the potential losses. His market timing strategy was called the “split-strike conversion.” While this is a legitimate means of managing money, it would have been impossible to earn the returns Madoff claimed. Additionally, it came out in the trial that Madoff had not invested a single cent of the money he took in as part of his illegal business.

In 2008 Madoff grew desperate for new funds while, at the same time, cash-strapped investors were asking for their investments back in record numbers because of the financial crisis. Madoff’s Ponzi scheme began to unravel quickly. He confessed his crime to his sons in December 2008, who then reported it to the authorities. In March 2009, Madoff stated his guilt in court but refused to affirm whether any other company employees or family members were involved. Although it is unlikely that Madoff worked alone, there is no evidence that even his sons knew about his illegal dealings, involved as they were with the legal portion of the business. Madoff chose to hire inexperienced, sometimes uneducated individuals with no background in finance to work in his investment management business. Some speculate that he did this so as to surround himself with unknowing participants. Madoff was eventually sentenced to 150 years in prison.

So far, thousands of people have submitted claims for restitution. However, paying back all of these investors will be a difficult task. Although Madoff’s fraud is being billed as a $65 billion Ponzi scheme, Madoff never had anywhere near that amount of money. This amount is what Madoff told people they had invested and earned with him. The actual amount may have been well below $10 billion.
The Madoff family, in particular, has been forced to deal with the consequences of Madoff’s wrongdoing. Members of the Madoff family are fighting a $200 million lawsuit filed by Madoff bankruptcy trustee Irving Picard. Madoff’s wife, Ruth, gave up claims to $80 million in assets to federal prosecutors. Perhaps most tragic, his son Mark Madoff committed suicide Dec. 11, 2010.

Instructors might want to have their students discuss who they feel is most to blame besides Madoff. A good debate issue might involve the clawback lawsuits that Irving Picard is seeking. Is it right for Picard to sue net winners—those who profited from Madoff investments—if it cannot be proven that they knew about the Madoff scheme? Should Madoff’s family members be penalized? Finally, students might want to discuss whether they feel that Madoff actually learned anything from his situation.

QUESTIONS AND DISCUSSION

1. What are the ethical issues involved in the Madoff case?

To clear up any confusion, instructors should explain the difference between legal, ethical, and moral issues. Morals are person-centered, terminal, or bedrock principles derived at early ages in life and are difficult to change. Ethics relates to the interaction between people’s morals and a firm’s set of practices. Conflict between the two is defined as being unethical. Finally, legal issues are codified social norms established by country or cultural consensus. As instructors discuss the differences between these three concepts, be aware that this discussion should always relate back to the business entity. The ethical issues involved with Madoff relate to the SEC’s rules and procedures on stock, bond, and derivatives trading. When Madoff was involved with setting rules during his time as chairman at NASDAQ, he might have made unethical decisions. However, these decisions may not have been illegal. On the other hand, ethical issues sometimes overlap with moral or legal issues, as certainly happened in this case.

It is important to realize that Madoff’s unethical and illegal activities were not the only ethical issues in this case. In fact, there are several. One major ethical issue is the fact that the SEC failed to detect the Madoff scheme, despite several investigations and warnings from whistleblowers. The ethical issue in question is whether the SEC was negligent in its duties. Many feel it was, as evidenced by lawsuits filed against the SEC. Another ethical issue is whether Picard acted appropriately in filing lawsuits against so many people. Some of these people should have suspected that Madoff was committing fraud, but others who profited from their Madoff investments, known as net winners, might not have known or suspected that their profits came from criminal activity. Is it right for Picard to pursue them because they made a profit? Finally, there are numerous bankers who invested money with Madoff through feeder funds, often without the knowledge of their investors. Since banks have more financial knowledge than the average person, should they be held liable for not detecting the fraud? These are just a few of the many ethical issues involved with the Madoff case.

2. Do you believe that Bernard Madoff worked alone, or do you think he had help in creating and sustaining his Ponzi scheme?

Information has surfaced indicating that Madoff did not act alone. A scheme of this magnitude would have been difficult for one man, even one as smart as Madoff, to pull off alone. However, it may be years before the full truth emerges about the case (if it ever does).

Because of his long career and the amounts being traded at the end of 2009, the probable answer is that some people involved with Madoff were knowingly skirting financial rules and procedures. Students should be made aware of the legal fuzziness that exists within the financial sector. Such fuzziness has,
in part, been deliberately created either by rule omissions or by tactics that circumvent such rules. Students should understand that the SEC cannot hold individuals criminally liable for breaking SEC rules. The SEC can fine companies and ostracize people and firms from publicly trading on financial exchanges, but that is all. Nevertheless, for many firms, the threat of SEC investigation and legal action motivates compliance. For very large entities, the process becomes murky, in that many corporations hire former SEC employees, thus giving them a backdoor negotiation channel.

In all likelihood, Madoff began his deception alone and took in confidantes as the scheme grew larger and more difficult to manage. Subsequent congressional testimony, as well as federal investigators, will shed more light on this case in years to come.

An easier question to answer is whether certain stakeholders should have known what Madoff was doing. The answer to this question would be yes. Savvy investors, regulators, and financial industry insiders should have known that it would be nearly impossible for Madoff to make such consistently high returns. Although it might be hard to prove that banks and other entities actually knew and aided Madoff in the fraud, it seems evident that certain stakeholders looked the other way because they were profiting from the scheme. Many bankers got significant amounts of money from investing their clients’ funds with Madoff. Such activities represent a conflict of interest, and perhaps even illegal activities.

3. What should be done to help ensure that Ponzi schemes like Madoff’s do not happen in the future?

Instructors should ask students for their input on this topic, although the truthful answer is that it is not likely that anything can stop illegal financial schemes from happening. No matter how strict the regulations, people with motivation to do so will always find loopholes. Clearly, regulation is necessary to create disincentives for Madoff-like schemes. However, students should be aware that too much regulation can be very costly, time-consuming, and anti-competitive. International businesses would be less likely to invest in the United States if the legal and compliance system were excessively complicated or expensive. Furthermore, rules are nothing without enforcement—which also requires resources. Students should discuss what might be done to deter future Madoffs, while at the same time striking a balance between an overly regulated and an under-regulated system. Increased oversight by the SEC would be one way to try and eliminate future misconduct. The following are the post-Madoff reforms that the SEC has begun undertaking since 2008:

- Revitalizing the Enforcement Division
- Revamping the handling of complaints and tips
- Encouraging greater cooperation by 'insiders'
- Enhancing safeguards for investors' assets
- Improving risk assessment capabilities
- Conducting risk-based examinations of financial firms
- Improving fraud detection procedures for examiners
- Recruiting staff with specialized experience
- Expanding and targeting training
• Improving internal controls
• Advocating for a whistleblower program
• Seeking more resources
• Integrating broker-dealer and investment adviser examinations
• Enhancing the licensing, education and oversight regime for 'back-office' personnel.1

ADDITIONAL RESOURCES

• Additional Information on the Madoff case: http://www.pbs.org/wgbh/pages/frontline/madoff/.


CASE 12

Insider Trading at the Galleon Group

CASE NOTES FOR INSTRUCTORS

The federal investigation and prosecution of members of the Galleon Group is the largest insider trading case in U.S. history. Over two dozen people were implicated, and Raj Rajaratnam, an eccentric millionaire and head of Galleon, was convicted of 14 counts of securities fraud and conspiracy. The investigation ushered in a new era in white-collar crime prosecution because wire taps and other techniques were used to secure a conviction.

Students may be particularly interested in this case because of its lasting impact on the financial industry. Insider trading cases are incredibly difficult to prove because prosecutors must demonstrate that the defendant not only acquired insider information but also that he or she used that information to trade stock in a way that damaged a company. While regulators have passed more legislation (such as the Dodd-Frank Wall Street Reform and Consumer Protection Act) that seeks to discourage insider trading, prosecutors are becoming more aggressive and are using strategies previously only seen against drug and organized crime rings. Although it was successful in convicting several members of the Galleon network, it has yet to be seen if the technique will work on other insider traders.

Since the Galleon case also covers an example of rampant criminally unethical activity, it is a natural to be paired with the Bernard Madoff case in this book. Students can examine and compare the types of misconduct, the punishments, and the influence of these two people on their personal and professional networks.

To understand this case, students need to understand some key terms. A hedge fund is a combination of assets bundled together with various strategies that minimize risk. It is created as an unregistered investment management company and is supposed to maximize returns while minimizing risk or exposure. Hedge funds invest in a broad range of assets, including equities, bonds, and commodities. Only investors who meet criteria set by regulators can participate in hedge funds. The estimated size of the global hedge fund industry is approximately $1.9 trillion. At its peak, the Galleon Group invested $7 billion.

Hedge fund managers typically invest their own money in the funds they manage. Investors typically pay management fees that go toward the operational costs of the fund. The management fee usually ranges from 1 to 2 percent of an investor's assets in the fund. Investors also pay performance fees when the fund’s net asset value is higher than that of the previous year. The performance fee typically is 20 percent of the fund's gains in a given year. For example, if a client invested $100,000 and the fund earned 40 percent in one year, the additional fee would be $8,000, or 20 percent of the investor's $40,000 gain. The performance fee was Galleon’s main source of revenue. The fees associated with hedge funds can generate massive wealth for hedge fund managers, as is shown in Table 1 (on the next page).

Because hedge funds are not sold to the general public, hedge fund managers have not been subject to the same restrictions as other investment fund advisers. After the 2008 financial crisis, new regulations were passed to increase government oversight and eliminate regulatory gaps between different kinds of investment funds. The Dodd-Frank Wall Street Reform and Consumer Protection Act of July 2010
Table 1. 2009 Top Fund Manager’s Earnings

1. David Tepper, Appaloosa Management, $4 billion
2. George Soros, Soros Fund Management, $3.3 billion
3. James Simons, Renaissance Technologies, $2.5 billion
4. John Paulson, Paulson & Company, $2.3 billion
5. Steve Cohen, SAC Capital Advisors, $1.4 billion
6. Carl Icahn, Icahn Capital, $1.3 billion
6. Edward Lampert, ESL Investments, $1.3 billion
8. Kenneth Griffin, Citadel Investment Group, $900 million
8. John Arnold, Centaurus Advisors, $900 million
10. Philip Falcone, Harbinger Capital Partners, $825 million


required hedge fund managers holding more than $150 million to register with the SEC as investment advisers. Hedge fund managers with less than $100 million in assets are subject to state regulations. Dodd-Frank requires hedge funds to provide information about trades and portfolios so that the Financial Stability Oversight Council can monitor and regulate systemic risk.

Securities fraud occurs when a person or company misrepresents or misuses information that investors utilize to make their financial decisions. The types of misrepresentation involved in securities fraud include providing false information, withholding key information, offering bad advice, and offering or acting on inside information. In Galleon’s case, it was found to be engaging in insider trading.

Finally, students should know about some of the other common unethical practices in which Rajaratnam and his colleagues engaged. A tax shelter is a kind of investment that allows investors to reduce their taxable income, such as pension plans and real estate. Not all tax shelters are legal. In the Galleon case, Rajaratnam was accused of having a fraudulent tax shelter, because he hid taxable money in foreign bank accounts. A shell corporation is a company that has legal status but provides no service or products and has few, if any, assets. Shell companies are illegal if they are used for income tax evasion or are formed to attract funding.

QUESTIONS AND DISCUSSION

1. Are information gathering techniques like Rajaratnam’s common on Wall Street? If so, what could regulators, investors, and executives do to reduce the practice?

The simple answer is yes, these practices are common. To help students understand the complexities of insider trading, the instructor may wish to explain the current methods of collecting information.

Information gatherers and their companies acquire what is called competitive intelligence (CI). Their purpose is to monitor competitors and, if possible, determine what business rivals will do before they do it. CI companies also develop different profiles on competitors, threat potential, and competitor strategies. Information gatherers may use additional sources of information, such as online discussion groups or even physical surveillance of executives.

Few clear cut guidelines and laws exist for the acquisition of CI. Hedge funds, because they had not been as heavily regulated, often engaged in unethical CI practices. Examples of common unethical behaviors include passing yourself off as someone else, stealing documents, embedding corporate spies, recording conversations, and blackmail.
The Galleon Group was operating in this unethical environment. In the case of the Galleon Group, Rajaratnam’s informant list included former business school classmates, fellow hedge fund traders, and technology industry executives. Some students may argue that Rajaratnam was simply following common practices on Wall Street, where people often network with corporate executives and industry experts to gain an investment edge. However, others may contend that there are clear ethical, if not legal, boundaries by which hedge fund managers can and should abide for their own sakes and those of their clients.

When discussing the second portion of the question, some students may introduce the passage of the Dodd-Frank Act as a sign that the financial services industry now has more regulation. Students should note, however, that ongoing enforcement of legislation is required to ensure its effectiveness. Corporate self-regulation is also important, something in which not all financial firms engage. Instructors may want to discuss other methods of self-regulation, including company codes of conduct.

2. What are the implications of sharing confidential material information? Is it something that would affect your decision about how to trade a stock if you knew about it?

According to the Sarbanes-Oxley Act, there are many severe legal consequences for trading confidential information. Punishments include heavy fines and many years in prison, depending on the violation.

A lively discussion can center on what the government says regarding punishments for white-collar crimes, and what actually happens to offenders. The most recent sentencing data from the Sentencing Commission reveal a trend of longer prison terms for white-collar offenders. However, the reality is that the average sentence imposed for an economic crime conviction is 26.2 months while the average sentence for fraud is 19 months—not exactly huge sentences. In addition, students can discuss whether the punishments have a strong enough impact on the offenders. In this case, Rajaratnam’s net worth is estimated to be more than $1 billion. The cost of his legal defense has been estimated at millions of dollars and he is subject to a potential $172.6 million criminal penalty and a $45 million fine for his nine securities fraud counts. Even with all of these costs, Rajaratnam will be left with over $500 million.

3. Do you think the secret investigation and conviction of Rajaratnam and other people in the Galleon network will deter other fund managers and investors from sharing nonpublic information?

The answer is probably yes, but much will depend on the outcome of similar cases. Insider trading cases can be complex and difficult to unravel. They can also be hard to prosecute because insider trading is defined so vaguely. The law merely says you cannot buy or sell a stock based on “material, non-public information.” Certainly the government’s use of wiretaps could encourage prosecutors and regulators to become more aggressive.

Instructors may wish to use the CNBC video listed under “Additional Resources” as a supplement to this case. It discusses the impact of the Rajaratnam case on Wall Street. Instructors may like to encourage a discussion around whether this case will ultimately reduce insider trading or give lawyers a better defense platform from which to argue their insider trading cases.

ADDITIONAL RESOURCES

CASE 13

GlaxoSmithKline Experiences High Costs of Product Quality Issues

CASE NOTES FOR INSTRUCTORS

This case gives instructors an opportunity to give students a real life example of how an ethics audit works. An ethics audit is a systematic evaluation of an organization’s ethics program to determine whether it is effective. It is important to help students understand that ethics audits review internal documents as well as corporate culture. Topics that are frequently included in an ethics audit are company executive histories, firm history, financial performance (including mergers and acquisitions), industry background, structure and leadership, corporate social responsibility efforts, and legal issues.

Instructors may wish to discuss how GlaxoSmithKline (GSK) began as a number of smaller businesses, including Beecham Pills; Smith, Kline & Co.; Burroughs Wellcome & Co.; and Glaxo, which was originally registered as the name of a dried milk product. Now a global giant with operations in over 100 countries and annual sales of over $25 billion, GSK unavoidably must deal with ethical and legal issues because of its size and industry. Upon review of GSK’s legal disputes, the instructor may point out that many of the cases are standard for the industry. It is important to help the student understand that every company experiences problems, and larger firms in controversial industries often have more legal trouble. Such cases do not necessarily represent a bad or unethical company.

Instructors may discuss the role the media plays (including the Internet) in vilifying companies and people because of sales value. News stories about good firms and well-behaved employees do not make for interesting news. This discussion should bring the student to consider the Cidra problem and GSK’s response. A subsidiary of GlaxoSmithKline pled guilty to distributing adulterated pharmaceutical drugs, including Paxil, Avandamet, and Bactroban. All together, the company paid $750 million to settle the criminal conviction.

Some indicators suggest that GSK has grown too fast, which has placed strains on its corporate culture. After careful thought, students might conclude that GSK is ethical but that the industry itself is morally questionable. They may engage in a lively debate on this point. Students should think about the many industry ethical issues mentioned in the case, including direct-to-consumer advertising, off label use, price competition between generic and branded drugs, drug safety, patents, and disclosure. Another favorite topic among students will probably be the question over whether health care is a right or privilege. Classes with international students will be able to provide extra insight into the U.S. healthcare debate because of their outsider perspective.
QUESTIONS AND DISCUSSION

1. Identify ethical lapses that may have impacted product quality at GSK.

Many students will be appalled at the Cidra manufacturing incident. A major issue is the four-year lapse between discovery and plant closure. Upon close inspection of GSK’s annual reports, one will note that the plant continued to distribute products even after investigations got underway. Luckily, no injury was filed against GSK from the Cidra plant. The key lapses in this incident occurred at the level of the plant manager, in day-to-day quality control, and in the overall lack of employee training. In this case, one might argue that the employees did not truly understand the potential harm that could be caused by not cleaning the machines before starting another drug type, using tainted water, or contaminating raw materials.

Eckard was the whistle blower in the Cidra plant case. She had worked in Glaxo quality control for over ten years and became a manager of global quality assurance. Her job was to inspect plants to make sure that the drugs had the right ingredients, the right potency, and met government standards for purity. In 2002 Eckard was assigned to help lead a quality assurance team to evaluate one of GSK’s most important plants in Cidra, Puerto Rico. Nine hundred people worked there, making 20 drugs for patients in the United States. As of 2011, Cheryl Eckard will receive $96 million of the $750 million criminal and civil settlement between U.S. regulators and the British pharmaceuticals group.

Reviews of court documents show that GSK repeatedly ignored serious failings, such as the fact that its factory had mixed drug types and doses in the same bottle. After receiving an initial presentation in July 2002 on the plant's problems from Gloria Martinez, the quality assurance manager at Cidra, Eckard contacted vice president for quality Steve Plating at GSK's headquarters. Eckard also alerted Janice Whitaker, senior vice president for global quality, and, subsequently David Pulman, then vice president of manufacturing and supply for North America. Despite GSK’s non-retaliation policies, Eckard was downsized and was left looking for a job. Retaliation against whistle-blowers is illegal under the Sarbanes-Oxley Act, yet it still regularly occurs.

2. What caused GSK’s leadership to fail in preventing ethical issues related to integrity failures?

There are many reasons why GSK’s ethical leadership could fail. First, there should be strong values tied to an effective ethics and compliance program. The firm should have an ethics officer that reports directly to the board of directors to make sure that no manager can escape oversight or scrutiny for inappropriate actions or decisions. The possibility always exists that specific individuals operate in a rogue manner, ignoring the overall ethical culture of the company. It may also be that an organization’s ethical culture is not very strong and that it rewards performance without appropriate oversight, creating opportunities for misconduct.

3. What can GSK do to prevent future ethical dilemmas and reputational damage from failures in product quality?

Students can be creative when generating answers to this question. GSK should review its ethics and compliance programs regarding its factories and global suppliers. An ethics audit might help to identify company weaknesses and to develop ways to address risks. Since it is clear that GSK’s non-retaliation policy did not halt retaliation against Cheryl Eckard, GSK should consider improving its reporting mechanisms. Another important prevention technique involves thorough training of factory workers. The company should work to establish effective compliance standards in its factories. Perhaps GSK could institute some form of checklist that outlines necessary activities in the order that they must be performed. It is essential that workers understand exactly what must be done to maintain high standards of quality as well as the penalties for noncompliance. GSK must make sure that it enforces its ethical standards among
both workers and managers. An ethical code without compliance does little good in discouraging misconduct. Finally, the company should place the safety of consumers first, even if it means a financial loss.

**ADDITIONAL RESOURCES**

- The key people in the Cidra decision making process are as follows:
  - Gloria Martinez, Cidra’s quality assurance manager.
  - Adalberto Ramirez, Cidra's director of laboratories in day-to-day control.
  - Diane Sevigny, Cheryl Eckard’s immediate supervisor.
  - Steve Plating, vice president for global product quality.
  - Janice Whitaker, senior vice president for global quality.
  - David Pulman, then vice president of manufacturing and supply for North America.
- Instructors may assign students the task of collecting additional information on these six individuals. The following are some resource suggestions:
  - GlaxoSmithKline’s gift to University of North Carolina at Chapel Hill: http://uncnews.unc.edu/content/view/3280/107/
  - David Pullman: http://www.gsk.com/about/bio-pulman.htm
CASE 14

Hospital Corporation of America: Learning from Past Mistakes?

CASE NOTES FOR INSTRUCTORS

The objective of this case is to help students understand the legal and ethical issues that can arise in the healthcare industry. Through strategic acquisitions, Columbia/HCA became one of the largest healthcare service companies in the United States. Healthcare products, because they help to support and improve users’ lives, have an inherent ethical dimension. This makes healthcare products different from many other types of products.

Another important issue for students to recognize is Columbia/HCA’s compliance with “standard industry procedures” in this regulated environment. When federal agents began investigating Columbia about shifting expenses and patient dumping, one of the firm’s justifications was that some of these actions were standard within the healthcare industry. Students should recognize by now that, while they can overlap, there also can be a difference between what is legal and what is ethical. What may be perceived as “standard practice” in some industries may, in fact, be unethical, or even illegal, in others.

Finally, this case offers an opportunity to study a firm that has implemented a strong ethics program in reaction to past misconduct as well as determine whether top executives did or will live up to those standards. Instructors may want to examine the conduct of past and present HCA executives such as Florida’s Governor Rick Scott, former head of Columbia HCA, and his continued connections to the healthcare industry. An interesting point of discussion could revolve around whether or not the misconduct could have occurred at HCA if the standards set by the new ethics program had been in place. Some students may argue that Scott and other executives believed that they were victims of hubris and conducted themselves in a way that indicates they thought they were above the law.

QUESTIONS AND DISCUSSION

1. What were the organizational ethical leadership problems that resulted in Columbia/HCA’s misconduct?

A variety of legal issues and industry standard practices led to Columbia/HCA’s misconduct. Students should be able to recognize that top management’s focus on bottom-line performance and new business acquisitions created ethical problems. Due to the failure of top management to perform its due diligence that would prevent misconduct, ethics and legal compliance was not a key consideration in strategic planning. Columbia/HCA’s mission statement was “to work with our employees, affiliated physicians and volunteers to provide a continuum of quality healthcare, cost-effectively for the people in the communities we serve.” However, organizational leaders seemed more focused on making money rather than on serving their patients’ interests. The biggest fraud involved three mid-level executives that filed false cost reports for Fawcett Memorial Hospital. It resulted in losses of more than $4.4
million from government programs. Furthermore, some top executives in charge of internal audits had instructed employees to soften the language used in internal financial audits that were critical of Columbia/HCA’s practices. There was also a systematic corporate scheme perpetrated by corporate officers and managers of Columbia/HCA’s hospitals to defraud Medicare and Medicaid.

2. Discuss the strengths and weaknesses of HCA’s current ethics program. Does this program appear to satisfy the provisions of the Federal Sentencing Guidelines for Organizations and the Sarbanes–Oxley Act?

This question is designed to help students apply the ethics program content from Chapter 8 to a real-world company. At a minimum, they should be able to specify the elements crucial to any effective ethics program—a code of conduct; an ethics officer and appropriate delegation of authority; an effective ethics training program; a system to monitor and support ethical compliance; and continual efforts to improve the ethical program—and identify whether HCA’s ethics program includes these elements. Students may wish to visit the firm’s website to provide greater detail in their responses. (The HCA Code of Conduct can be accessed here: http://www.hcahealthcare.com/util/documents/code.pdf.) If HCA’s program includes all of the essential elements and those elements are enforced, then it should satisfy the requirements of the FSGO; students should also be able to specify additional elements necessary to satisfy Sarbanes-Oxley, including having an independent audit committee on the board of directors and a specific code of ethics for the firm’s financial officers.

3. What other suggestions could Columbia/HCA have implemented to sensitize its employees to ethical issues?

The final question asks students to offer suggestions that could be implemented to further sensitize HCA management to ethical issues. Students should use their creativity to suggest ideas that would help sensitize employees to ethical issues. Chapter 8 in the text provides many examples of ways to develop effective ethics programs. Many students will appropriately recommend that the firm conduct an ethics audit to pinpoint risk areas that it can specifically address.

**ADDITIONAL RESOURCES**

- A three-part analysis of the Columbia/HCA fraud:

- Instructors may want to connect this case to a more general debate on healthcare—is it a right or a privilege? Arguments for both sides can be found at http://healthcare.procon.org.

- Video and Article: “Gov. Rick Scott's drug testing policy stirs suspicion”:

- Regarding Rick Scott and his relationship to HCA, some comments from whistleblowers, supporters, and others can be found at
CASE 15

The Coca-Cola Company Struggles with Ethical Crises

CASE NOTES FOR INSTRUCTORS

Coca-Cola is an interesting case in light of the increasing concerns over global health and rising levels of obesity and lifestyle-related diseases. Although Coca-Cola, which has long been one of the most valuable brands in the world, has dealt with many ethical issues in the last couple decades, the company has seriously taken on social responsibility initiatives in order to improve its image as an ethical business. However, many students might argue that Coca-Cola cannot truly be a socially responsible company when its signature product is so unhealthy. The widespread presence of Coke products in emerging economies such as Africa and Latin America add fuel to the debate.

This case discusses problems that Coca-Cola has encountered over the years as a result of its ethical and financial decisions. As one of the world’s most recognized brands, Coca-Cola is subject to a great deal of scrutiny. Since the 1990s, Coca-Cola has dealt with lawsuits over many topics, including product safety, union worker intimidation, inflating short-term earnings, “channel stuffing,” racial discrimination, anticompetitive behavior, pollution, depletion of natural resources, and the health implications of consumption of its products. By the year 2000 Coca-Cola had fallen so far in the public perception that it did not place on Fortune’s “America’s Most Admired Companies” list. The company made some strategic decisions to improve its image, and in 2010 it was back on the list in 10th place. Frequent leadership changes throughout the 1990s aggravated Coca-Cola’s problems in maintaining a positive image and stable corporate culture. Coca-Cola changed CEOs three times in less than a decade. This high leadership turnover negatively affected Coca-Cola’s stock price and made investors nervous as well.

Growing concern over the obesity epidemic in the United States and elsewhere has complicated Coca-Cola’s mission to be a well-regarded company. It is difficult to prove that soft drinks, the product for which Coca-Cola is most known, are part of a healthy diet. The company has launched a number of initiatives to combat negative perceptions of its products, most of which were largely unsuccessful. Even VitaminWater, a product Coca-Cola positioned as a healthier alternative to soft drinks, came under scrutiny and legal attack because of what some believe were misleading marketing tactics.

In spite of these ongoing difficulties, Coca-Cola has largely recovered from the low it hit in the 1990s and early 2000s as the company has taken steps to address most of the issues that have been raised against it. The company has taken great strides to be more active in socially responsible causes, particularly in developing nations where production of Coca-Cola products can be detrimental to local communities and natural resources, such as potable water. In 2010 Coca-Cola ranked number eight in Corporate Responsibility Magazine’s “100 Best Corporate Citizens” list, while PepsiCo was number 13. While the end of the 20th century brought with it many challenges for the company, and the beginning of the 21st century leaves some of those challenges unresolved, Coca-Cola has taken enormous strides to take on levels of responsibility equal to the corporation’s size.
QUESTIONS AND DISCUSSION

1. What role does corporate reputation play within organizational performance and social responsibility? Develop a list of factors or characteristics that different stakeholders may use in assessing corporate reputation. Are these factors consistent across stakeholders? Why or why not?

The list of factors assessing corporate reputation will vary depending on the student’s viewpoint. Instructors may find it useful in generating discussion to assemble a group list of ideas so that students can learn what their peers deem important. Also, instructors should make sure that students understand that the various aspects of corporations and their actions will affect stakeholders differently. This might be a good opportunity to discuss the differences between primary and secondary stakeholders, and who might comprise each of these groups for Coca-Cola.

Instructors can use the following list of characteristics as a jumping off point to answer the second portion of the question, “Develop a list of factors or characteristics that different stakeholders may use in assessing corporate reputation. Are these factors consistent across stakeholders?”

- Makes products that are safe
- Does not pollute air or water
- Obeys the law in all aspects of business
- Promotes honest/ethical exchange behavior
- Commits to safe workplace policies
- Does not use misleading/deceptive advertising
- Upholds stated policy banning discrimination
- Uses "environmentally friendly" packaging
- Protects employees against sexual harassment

Students should be encouraged to make their own lists as well, but these characteristics offer good examples for discussion.

Not all stakeholders will value all of these characteristics, as different groups have different needs and priorities. Even stakeholders who value the same characteristics will likely not value them to the same degree. For instance, channel members may not be interested in recycling and eco-friendly packaging if it significantly reduces profitability. Shareholders may agree with this list but only if it does not significantly decrease their ROI. On the other hand, it is generally accepted that socially responsible firms outperform firms that are not known for their responsibility. (Source: Javier Gil-Bazo, Pablo Ruiz-Verdú, and André Santos, “The Performance of Socially Responsible Mutual Funds: The Role of Fees and Management Companies,” Journal of Business Ethics, 94(2) (2010), 243-263; Bastien Drut, “Sovereign Bonds and Socially Responsible Investment,” Journal of Business Ethics, Apr (92) (2010), 131-145.) The complexity involved with these questions should showcase to students the difficulties that organizations have in considering which initiatives would please the most stakeholders.
2. Assume you have just become CEO at Coca-Cola. Outline the strategic steps you would take to remedy the concerns emanating from the company’s board of directors, consumers, employees, business partners, governments, and the media. What elements of social responsibility would you draw from in responding to these stakeholder issues?

Students’ answers will vary. Instructors should make sure that students provide specific and realistic plans.

3. What do you think of Coca-Cola’s environmental initiatives? Are they just window dressing, or does the company seem to be sincere in its efforts?

Many students likely will approve of Coca-Cola’s environmental initiatives. Being a very large company that requires huge amounts of resources to produce its products puts Coca-Cola in a difficult position in terms of sustainability. However, its actions thus far appear to be sincere. Students should be sure to provide concrete and specific reasons why they have taken a certain stance and whether they believe Coca-Cola’s sincerity or not.

One reason why students might feel that Coca-Cola’s efforts are merely “window dressing” is because of its continuing contribution to environmental problems in certain regions of the world. Water depletion continues to be an issue in India to such a degree that the state of Kerala passed a law that allows individuals to seek compensation from the company for damages (Coca-Cola disputes these claims of environmental degradation). Others might be of the opinion that Coca-Cola cannot be socially responsible when it continues to sell unhealthy products, particularly in emerging economies.

Instructors can also suggest that students read anti-Coca-Cola blogs that criticize the company and some of its initiatives. Some of these may not be highly credible, but students need to understand that in business all decisions have detractors. Even if there is no decision made, companies will still have disgruntled stakeholders and special interest groups.

ADDITIONAL RESOURCES

CASE 16

Recreational Equipment Incorporated (REI): A Responsible Retail Cooperative

CASE NOTES FOR INSTRUCTORS

This case discusses the social responsibility initiatives and business framework of Recreational Equipment Incorporated (REI). It also introduces students to the consumer cooperative business model, in which members of the cooperative receive a portion of the organization’s profits annually based on a percentage of their eligible purchases. Many students may view REI favorably; however, it is important for them to realize that all companies, even those which have earned a reputation for ethics and social responsibility, face risks. Some risks might be specific to REI, e.g. customers getting hurt on its in-store equipment. Others might be a problem for the entire market, e.g. cutbacks caused by the recession. The key for REI is to manage these risks so that they do not become ethical issues.

Through the 1970s REI focused on equipment for serious climbers, backpackers, and mountaineering expeditions, not day hikers. Their business was small, but REI gained a reputation for supplying products of exceptional quality. In the 1980s, REI expanded its target market and made changes to its Board of Directors. Clothing became a greater part of the company's product line, and it began to market to a much wider audience. Today, REI has 4.4 million active members and has generated revenues of $1.7 billion in 2010. Consumers can become members of the co-op by paying $20 for a lifetime membership. REI members are eligible to receive annual dividends consisting of member rebates and REI Visa card rebates. Even though REI maintains a cooperative form of business organization, in many ways, REI must operate in a similar manner as profit-making corporations in order to be successful and maintain competitive advantages.

REI enjoyed record member enrollment and saw a historic number of active members do business with its co-op in 2010. Customers are drawn to the company’s culture and its image as committed to conservation and getting people outdoors. The company even gives grants that are aligned with its business purposes as part of its strategic philanthropy initiatives. Students may want to think about whether REI is a true cooperative. While the business form may technically be a cooperative, its size and market position are not that of a typical cooperative. A question could even be posed about whether REI might one day change its form of business model.

Students will be introduced to a number of important issues in this REI case, including its relationships to its employees, its sustainability efforts, and its involvement within the community. REI has earned a spot on Fortune magazine’s "100 Best Companies to Work For" every year since 1998. REI offers a generous benefits package, and despite cutbacks during the recession, employees remain very loyal. In regards to the environment, REI has five major priorities: 1) greenhouse gas emissions and energy use, 2) green building, 3) paper sourcing, 4) reducing waste and recycling, and 5) responsible product stewardship. Finally, REI has linked much of its community involvement to its business model. REI’s mission statement directly relates to communities as it desires to “inspire, educate and outfit for a lifetime of outdoor adventure and stewardship.” REI participates in programs like PEAK to encourage outdoor engagement among younger generations, encouraging a love of the outdoors and physical fitness while also building a future customer base.
This case should get students thinking about REI’s ethical climate and the risks it faces. Instructors should encourage their students to brainstorm on ways to manage the risks and potential ethical issues that REI may experience in the future.

QUESTIONS AND DISCUSSION

1. Is REI successful because it is a consumer cooperative or because of effective stakeholder orientation?

Students might argue for the former. At first glance, it seems that because REI is member-owned, the members can make daily decisions that are in the best interests of the customer. However, because REI’s operations are so big, members in reality do not have a major impact in the daily decision-making of the organization. Instead, REI’s emphasis on its different stakeholders, including customers, employees, suppliers, the community, and the environment, demonstrates a strong stakeholder orientation. This stakeholder orientation allows the company to make decisions that are in the best interests of its constituents.

2. Who is responsible for managing ethics and social responsibility at REI?

Just because REI is a cooperative and member-owned does not mean that it automatically has an ethical culture. REI faces the same ethical issues of any other organization and has to manage similar risks. A mistake made by many non-profit organizations is to assume that, because they focus on a worthy cause, they do not have to maintain the same level of vigilance when it comes to ethics, compliance, and responsibility. REI has to have the same type of ethics and compliance program as any other organization.

The board of directors operates by committee. The current REI committees are Executive, Nominating and Governance, Compensation, and Audit and Finance. The closest committee related to ethics and social responsibility concerns is the Audit and Finance Committee. Another board committee, the Nominating and Governance Committee, recommends nominees for director positions and oversees corporate governance policies. The CEO is responsible for the day-to-day decisions at REI. Therefore, part of her job is to make sure that employees are following ethics and compliance procedures.

3. Assess REI’s ethical and social responsibility risks and suggest how these risks can be managed effectively.

REI acknowledges some of the issues it faces in its Stewardship Reports and is proactive in addressing them. For instance, the company has partnered with the Fair Factories Clearinghouse (FFC) to promote a deeper collaboration across several industries. It also commissioned an external audit of the co-op's Fair Labor Compliance Program (FLCP). While not identifying any material deficiencies, the audit recommended improvements in the reporting and governance of the compliance function. Specifically, the firm cited industry best practices and recommended more direct oversight and reporting to senior leadership and the board of directors. Additional audit recommendations were to allocate more resources (staff and budget) to factory oversight, increase industry collaboration, and improve supply chain visibility. These practices seem to have the support of senior management. Other REI concerns are fair wages for labor, factory monitoring, diversity and inclusion, employee engagement, and retention.

The future ethics and social responsibility for REI rests in the hands of the current board. Instructors should help students understand that REI may be ethical, but this does not mean it does have not areas where it can improve. For instance, because REI sells equipment, including its own branded products, it must remain vigilant in identifying potential defects. Because some of the products REI sells could result in serious harm to consumers if defective, the company must take great care in ensuring a high level of quality in everything that it sells.
As REI grows, students might also suggest the creation of an ethics officer position. It is only natural that as REI expands, it will face more ethical issues. An ethics officer can help identify these issues before they become ethical disasters. REI might also choose to implement an ethics audit to identify areas of improvement. It is important for students to realize that ethics audits are not only for companies that have experienced ethical misconduct. Ethics audits are also a good way for ethical companies to maintain their ethical reputation and identify problem areas.

ADDITIONAL RESOURCES

- For a look at the ethical component of the Finance and Audit Committee: http://www.rei.com/pdf/aboutrei/afemtecharter.pdf
- A current lawsuit against REI regarding a defective product under the Novara brand: http://seattletimes.nwsource.com/html/localnews/2014158615_bikesuit08m.html
Better Business Bureau: Protecting Consumers and Dealing with Organizational Ethics Challenges

CASE 17

CASE NOTES FOR INSTRUCTORS

This case asks the question: Who does the Better Business Bureau (BBB) represent? As students may know by now, this is a question related to stakeholder theory. The BBB was created to reduce consumers’ fear of being taken advantage of by unethical or illegal businesses. It also created a channel for consumers to voice their complaints and warn other consumers about problematic businesses. As it has grown, the BBB has added different services for consumers.

At the BB’s inception, companies paid a small fee, underwent a vetting process, and then were informally graded. They could use this grade as a means of promoting their business to new consumers. When the BBB began it did not make much by way of profits. It aimed to breakeven. Yet as the decades passed, the BBB has grown in size and influence. Students may have a hard time distinguishing between the work of the BBB and Consumer Reports. The central difference is that Consumer Reports grades products, while the BBB rates businesses.

To currently qualify for membership, an applicant firm completes an application, pays membership dues, and provides evidence that it conforms to local BBB accreditation standards. The National Council of Better Business Bureaus establishes minimum standards, but each local BBB can augment those standards with stricter policies. To qualify for accreditation, a company must have been in business in the local area for at least a year. There are some exceptions for branch offices of companies that have been in business in the local area for more than a year or for business owners who ran the same BBB-accredited business in another area. As part of the application process, a company or charity must supply detailed information as to the nature and structure of the business. If the business requires a license to operate, the company must prove that it has obtained all applicable state and federal licenses. The local BBB will ask for contact information and employment histories for all principal owners and officers and for references from entities such as banks, other businesses, and customers. A reliability report contains the following information:

- The status and length of the business's BBB accreditation
- A BBB rating (not all BBBs have the same rating system or criteria)
- Contact information and business profile
- Brief information about products and services
- Licensing information, if applicable
- Customer complaint history, including the total number of complaints, complaints broken down by type, and how many have been resolved
- Any government action against the company
- Any advertising reviews initiated by the BBB
QUESTIONS AND DISCUSSION

1. Which is the Better Business Bureau’s most important stakeholder, businesses or consumers?

Students’ answers will vary, depending on their perspective. It should be obvious that both businesses and consumers are primary stakeholders for the BBB. The revenue for operating the BBB comes from businesses, and the BBB is undoubtedly conscious of its income source in the same way that other businesses rely on consumers for income. Students may also mention the regulatory stakeholders who depend on the BBB for information on businesses’ conduct. Instructors may want to use some of the supplementary materials below to investigate instances of misconduct and conflict of interest within the BBB and with the BBB’s treatment of businesses. For instance, at the Los Angeles BBBB chapter, it was discovered that several people started bogus companies and received 'A' ratings. At this same chapter, non-member businesses with poor ratings paid to join the BBB and their ratings increased. In this case, it seems that BBB representatives did not consider either businesses or stakeholders, but only profit.

Some may argue that the BBB is using a pay-to-play scheme and that conflicts of interest are bound to arise any time a ratings agency receives money from the organizations which it rates. Students need to be aware that both BBB and non-BBB members are graded; however, there is a high probability that if a non-member is graded, it is because of a complaint. Instructors may want to ask students for examples of similar situations in other industries or with other organizations. Financial institution credit ratings agencies before the 2008 financial crisis might be a good example. These firms also were paid to rate companies by the companies that were being rated.

It can be difficult to police reviews submitted to the BBB, with many cases of disgruntled customers seeking to damage the reputation of a business through a poor review on the BBB. On the other hand, some consumers claim that the BBB is too slow to post information on companies that are under criminal investigation. Consumers who are unhappy about the BBB itself do not have easy channels for voicing their frustrations because the Better Business Bureau is not a member of the Better Business Bureau.

2. Do you believe the BBB can be truly impartial given its financial dependence on businesses?

Students will likely have a variety of opinions on this question. Instructors should steer the discussion toward suggestions of how the BBB can improve its level of impartiality. Can students think of any structural changes or gatekeeper-type organizations that would help the BBB maintain a neutral position relative to consumers and to the businesses it represents? Membership dues represent the vast majority of the BBB’s income. One might argue that it is in the BBB’s best interest to keep members happy so that they keep renewing their membership. The majority of BBB board members are corporate executives, some of whom inevitably come from industries that generate complaints to the BBB. How can board members, whose industries are being criticized, maintain neutrality?

An argument in favor of the BBB is trust. The BBB is well-established and consumers tend to trust the information. Finding verifiable information on businesses is increasingly difficult in the age of the Internet, where anyone can publish anything about anyone. There is no guarantee that a business review posted online somewhere will be legitimate or accurate.

3. What actions would you take to ensure that an ethical misconduct disaster such as the pay-for-play scheme does not happen again?

This entire textbook emphasizes the importance of ethics and compliance programs in organizations. Organizations such as the BBB, which report on the ethical conduct of other organizations, may fail to develop their own ethics and compliance programs. In the LA example given in question two, one might
argue that the Council of Better Business Bureaus has failed to have enough oversight and compliance-driven requirements to prevent the Los Angeles chapter from engaging in unethical activities.

Instructors could ask students to form two groups, one representing the BBB and one representing consumers. The BBB group should think about the responsibilities of the BBB CEO Steve Cox and the problems he faces, which were outlined in the case. Have each group develop a list of potential conflicts and ways to solve them. Groups could review the links provided in the Additional Resources section to help in developing their lists.

ADDITIONAL RESOURCES

- BBB scandal 20/20 report: http://www.youtube.com/watch?v=Yo8kfV9kONw, 8 minutes.
- BBB National President’s apology: http://www.youtube.com/watch?v=GN4MKqDXGmY&feature=related, 2 minutes.
- The business benefits of “In Pursuit of Ethics” program: http://www.youtube.com/watch?v=J6J7hPeFlk
- Steve Cox: http://youngstown.bbb.org/article/cbbb-names-stephen-a-cox-as-president-and-ceo-12265
- Grading system revisions: http://www.nhregister.com/articles/2010/11/19/business/bb1_bbb1119111910.txt
CASE 18

The American Red Cross Faces Organizational Challenges

CASE NOTES FOR INSTRUCTORS

The American Red Cross (ARC) is one of the largest and best known charitable institutions in the United States. However, as a large non-profit that utilizes the services of many volunteers, the organization has suffered from accusations of mismanagement and misconduct. Historically, the ARC is primarily staffed by volunteers. The organization teams with other nonprofits and the government in times of emergencies. The ARC is one of 800,000 NGOs in the United States alone, all of which operate in a complicated and fluctuating world to which they must adapt in order to serve stakeholders.

As with many long-standing organizations, the world has changed dramatically since its founding and the ARC has struggled to modernize. The Internet, text messaging, and growth of social media have revolutionized the way information is disseminated. However, the ARC has been reluctant to change its image or how it operates, and it has strayed from some of its core principles as it has grown larger. The ARC has also suffered from highly negative press related to its handling of recent major disasters, such as 9/11 and Hurricane Katrina. These disasters underscored the need for the ARC to become more nimble in order to react quickly and efficiently when disasters strike and to conduct business in a transparent and honest way.

The ARC has been subject to a number of other complaints as well, such as excessively paid executives; problems with too many government appointments; resources being spread too thinly in times of multiple natural disasters; insufficient training of volunteers; and a lack of skilled healthcare, fire, psychological, and medical professionals. All of these factors have increased the probability of unethical occurrences at the ARC, a problem with which the organization is grappling. Because the ARC does not keep a large and trained staff on hand, it relies on volunteers when its needs swell. Anytime that large numbers of volunteers are brought into the mix, an organization can struggle to manage all of them. There is no guarantee that these individuals abide by the ARC’s corporate culture or code of conduct, for example.

In spite of the criticisms levied against it, the ARC provides many benefits to people around the world. Instructors should also seek to draw attention to the positives of ARC, such as blood donation, tissue services, research, cellular therapies, health and safety services, disaster services, international services, and service to the armed forces. Students can compare the costs and benefits of the ARC’s size and governance as it applies to the organization’s accomplishments as well as its struggles.
QUESTIONS AND DISCUSSION

1. Explain the possible problems in the ethical culture of the Red Cross that created the issues discussed in this case.

Students’ answers will vary, but they might discuss cronyism among managers, the board of directors, high executive compensation, leadership turnover, and a general lack of accountability in the organization. The lack of transparency and a clear chain of command obviously created problems for the ARC, particularly in times of disaster when the organization most needs to be at the top of its game.

In addition, the ARC has experienced problems with how it collects and how it uses donations. After mismanaging funds directed for 9/11 and Hurricane Katrina disaster relief and experiencing general problems with its donations, it became clear that the ARC needed to reevaluate its processes. It is clear from fundraising for victims in Haiti and Japan that the ARC has made great strides to improve its donations process.

While the ARC is one of the largest and most recognized nonprofits in the country, it is not immune from competition from other NGOs. There are many hundreds of thousands of nonprofits in the United States, all of which are fighting for donations to do their work. In this environment, good publicity and savvy public relations effort become extremely important. Because of this competition for donations, the ARC has been forced to focus a great deal of energy and time on campaigning for donations.

Instructors may want students to perform some additional research on the ARC and other nonprofits to analyze the general tone of press coverage of the ARC. Instructors may also choose to have students search for additional information on issues introduced in the case as well as issues not covered.

2. Name some of the problems the ARC has encountered with handling donation money.

The primary example pointed out in the case is the problems the ARC encountered with electronic donations after Hurricane Katrina. The organization was unprepared to handle such a massive influx of donations and the system crashed. However, by partnering with outside companies, the ARC has been able to increase the amount of donations it can accept via text messaging and the Internet.

Other problems with donations relate to where the money is allocated. In addition to possibly overpaying its executives, the ARC has been accused of dubious accounting and bookkeeping practices. Questionable use of ARC donations was a major problem during both the Hurricane Katrina relief effort as well as the response to 9/11. The organization has also struggled with some of the ethical issues associated with corporate donations—do the cultures and reputations of the corporations donating funds match the ARC’s mission? All of these problems relating to how donation money is collected and spent have further damaged the ARC’s reputation.

3. What are some of the reasons for the ARC’s ethical dilemmas, and how can the organization guarantee that these problems will not recur in the future?

A key problem for the ARC has been staying true to its original organizational goals and objectives. The ARC allowed itself to become bogged down with accusations of corruption, ineptness, and cronyism, which distracted from the mission of the organization. This is not to say there are not good people working at the ARC—undoubtedly, there are many. However, for years the tone at the top was not desirable for a nonprofit of the ARC’s stature. Additionally, the ARC’s structure allowed for too much opportunity for misconduct.

Students might respond that better bookkeeping and accounting practices, more oversight, better coordination with other organizations, and the elimination of cronyism and nepotism in hiring practices
would be a good start in cleaning up the ARC’s reputation. The organization already has a code of business ethics and conduct (available at http://www.redcross.org/www-files/Documents/Governance/file_cont5875_lang0_2860.pdf), and a discussion could center on what aspects of the code are in congruence with the organization’s behavior. Instructors may want to follow up by asking students what methods and protocols they might use to implement some of their suggestions.

4. What effect does organizational structure and compensation have on ethical behavior among chief executives at ARC?

Clearly, unethical behavior has been a problem among management of the ARC. The ARC even reorganized its charter in 2006 to address some of the most pressing issues. In addition, executives have received very high pay for what many would call their mismanagement of the organization. It seems obvious that the ARC must rethink its hiring practices and its organizational structure in order to be more transparent, to improve accountability, and to maintain a high level of service for the groups which it seeks to aid.

Currently, the ARC occupies a gray area between government entity and NGO, with much government influence in both the board of directors and the running of the organization. If one defines the ARC as an NGO, as most people would, its organizational structure should change to fit this status. If the ARC is a governmental agency, then the standard Federal pay grade system should be applied to executives, which would substantially lower many of their salaries. ARC executives have often earned far more than the average government employee (or than the average NGO employee, for that matter). Students should discuss the issue of executive pay in charitable organizations. Is it ever justified to pay a very high salary to an NGO employee and when?

**ADDITIONAL RESOURCES**

CASE 19

Nike: Managing Ethical Missteps—Sweatshops to Leadership in Employment Practices

CASE NOTES FOR INSTRUCTORS

The Nike case is one of redemption, and it provides a good model of how a company can recover from ethical and strategic errors. In the 1990s, allegations that Nike’s shoes were made in sweatshops under inhumane conditions and that the company allowed environmental pollution to occur at its contract sites deeply tarnished the company’s reputation. Nike did not respond quickly to these problems because it did not see them as its problems. Technically, all of the ethical problems stemmed from the unethical treatment of the employees of the subcontractors that the contractors used in the production of Nike products. From Nike’s perspective, the contractors were responsible. However, Nike’s stakeholders did hold Nike responsible and demanded that the company do something to address the issues. Instructors may wish to discuss how companies that are not directly under the firm’s control can have a strong negative effect on the firm’s reputation and profitability. The Nike case can also be used to discuss issues related to supply-chain management and maintaining transparency along the full length of the supply chain. Much of the protesters were calling for a living wage for workers, as well as humane treatment and access to health care, a clean work environment, adequate water, and hygiene.

After a short delay after the onset of its problems in the 1990s, Nike jumped into being a socially responsible industry leader. The company now monitors its production plants using independent auditors. It has created a strong code of conduct that the company distributes to all its employees. It has worked hard to decrease waste and pollution at its textile plants, which are notoriously bad for the environment. Nike now has a better reputation and is considered a socially responsible leader in its industry. It may not have wanted to take on this role, but responding to consumer demands—and developing a reputation for high ethical standards—certainly has helped Nike restore its brand’s luster.

Instructors will want to emphasize the crisis management techniques Nike used along with the five stages of corporate social responsibility described in the case. Students may want to discuss whether they feel that Nike has achieved the highest levels of corporate social responsibility or whether there is still room for improvement.

QUESTIONS AND DISCUSSION

1. Why did Nike fail to address corporate social responsibility early on?

Students may provide a variety of speculations as to why Nike would let problems with suppliers get as bad as they did. The most important thing for students to keep in mind is that Nike did not see subcontractor issues as its problem. Because Nike did not directly hire the subcontractors, the company did not believe it was responsible for the problems. Corporations must be aware that they must know
what occurs at every step of their supply chains. Negative press, such as the coverage of the Nike scandal, can seriously damage a firm, and many firms never recover. Students also must keep in mind that before the mid-1990s, issues such as sweatshops, child labor, and low wages in international manufacturers were not the large issues that they are today. Nike’s problems came at the beginning of a global cry to improve conditions in low-wage factories, particularly in Asia and Latin America.

2. Evaluate Nike’s response to societal and consumer concerns about its contract manufacturing.

Nike did not take its manufacturing issues seriously at first. It was not until consumers started demonstrating—and news outlets began covering the negative reactions—that Nike developed a social responsibility plan. It definitely began as a reactive response to negative publicity, but Nike has remained committed to social responsibility for decades. Nike has taken great strides to clean up its act and to become an ethical and responsible company. Nike has made an effort to improve its supply chain and make it more transparent. It also has taken steps to reduce waste and pollution in the production of its products, and it implemented a code of conduct that pertains to all employees. These steps appear to have worked for Nike, as negative press is now uncommon. Nike is a rare case of recovery, as it once again is one of the most desirable athletic shoe brands in the world.

3. What are the challenges facing Nike in the future?

Students should be encouraged to brainstorm and then discuss as many challenges as possible. All businesses that are as thoroughly international as Nike will continually face new and complex issues. Labor conditions and workers’ rights will be an ongoing problem for Nike, as the more recent issue with Honduran factory workers demonstrates. Pollution, dwindling resources, and sustainability will be problems that grow over time and will affect many industries. All companies will have to figure out how to be less wasteful with resources. Nike also is a fashion brand and, as such, will always have the problem of how to market its products to sustain market share and profits.

ADDITIONAL RESOURCES


- An in-depth look at how factories hide violations: http://www.businessweek.com/magazine/content/06_48/b4011001.htm.

- The advantages and disadvantages of taking responsibility for overseas suppliers: http://www.businessweek.com/debateroom/archives/2007/06/overseas_sweatshops_are_a_us_responsibility_1.html.
CASE 20

Best Buy Fights Against Electronic Waste

CASE NOTES FOR INSTRUCTORS

This Best Buy case encourages students to contemplate the important ethical issues of stakeholder relationships and sustainability. Best Buy, a major electronics and entertainment retailer, has become known for its extensive recycling program. This program has even earned the company a spot on Ethisphere magazine’s World’s Most Ethical Companies. Best Buy has also been recognized for its emphasis on ethical conduct. Its Chief Ethics Officer, Kathleen Edmond, won the honor of being listed in Ethisphere’s Most Influential People in Business Ethics two consecutive years.

Best Buy has a strong stakeholder orientation in its operations. It engages its customers by offering incentives for recycling, publishing a Corporate Social Responsibility Report to communicate its initiatives to consumers, and providing helpful services such as Speakeasy and the Geek Squad. Best Buy has also instituted programs to increase morale among its internal stakeholders—employees—such as the Open Source Approach and the ROWE System. The ROWE System allows employees to work outside the workplace if it makes them more productive. This popular approach has been very successful in terms of increasing productivity, as well as popularity among employees. Additionally, Best Buy has a number of community engagement initiatives. Best Buy encourages future generations of leaders by providing awards to teenagers for stimulating positive change; it donates money for disaster relief; and it actively engages in community outreach and encourages employees to do the same.

However, consumers are most likely to be familiar with Best Buy’s recycling program. Many students have probably even used it. Because electronic waste is becoming an enormous problem, Best Buy encourages consumers to recycle their old electronic products with the company. The program allows consumers to recycle two electronics per day per household at all of its stores. Best Buy charges $10 to recycle electronics over 32 inches, but gives the customer a $10 gift card to use in-stores. Best Buy also has a trade-in program, recycling kiosks in its U.S. and Canadian stores, and a TV and appliance pickup service.

This case should introduce students to the growing problem of e-waste and show what innovative companies like Best Buy are doing to combat it. They should note the impact that Best Buy has had upon its suppliers. Because of their large size, companies such as Best Buy, Walmart, and Starbucks have a major influence with their partners, suppliers, and consumers. Therefore, students should recognize the potential for companies to make a positive difference upon a variety of stakeholders.

QUESTIONS AND DISCUSSION

1. Why do you think Best Buy has been able to gain competitive advantage in the retail electronics market while also driving many initiatives to support sustainability?
Students should be able to identify that the two objectives—competitive advantage and supporting sustainability—are not mutually exclusive. Best Buy has been the leading big-box electronics retailer for several decades. The company has utilized its market position to provide the cutting-edge products that consumers want and has moved into sustainability as its stakeholders have become more concerned about this area. Best Buy has market leadership and has also taken leadership in recycling electronic products.

Students need to realize that sustainability can be a valuable asset to Best Buy and other retailers, particularly in areas where recycling is less common. First, it gives it a more solid reputation as a sustainable company. Additionally, although Best Buy swallows the costs of recycling, it encourages consumers to visit their stores and thereby increases sales and revenue. Best Buy can sell older items to companies like eBay or recycle the parts. Often Best Buy recyclers will resell certain components and split the profit with Best Buy.

By encouraging consumers to recycle, Best Buy is also giving them an opportunity to upgrade to new products—preferably from Best Buy stores. Best Buy charges consumers who recycle products over 32 inches a $10 recycling fee, but it then gives the consumers a $10 Best Buy gift card. This encourages consumers to stay in the store and look for products to purchase. In the process, Best Buy hopes to generate new customers.

In other words, Best Buy can use sustainability to maintain—and even create—competitive advantages. As this case has revealed, sustainable initiatives can be an asset rather than a cost.

2. Do you think the resources that Best Buy is dedicating to help consumers recycle their old electronic devices represent a good investment for Best Buy?

Most students will likely answer in the affirmative. Best Buy is reducing the risk of the ownership of electronic products that can become obsolete quickly through its buy-back program. It is creating consumer trust by reducing the risk of obsolescence and generating a socially responsible image. In addition, by recycling electronic products, consumers can identify Best Buy as being a sustainable organization. Through its gift card incentives, Best Buy is encouraging consumers to purchase items, which may prompt them to purchase more than one item and/or return to Best Buy in the future.

It is important to realize, however, that a good investment does not mean that Best Buy will succeed financially. It has struggled in recent years due to price competition from rivals such as Amazon.com and a sluggish economy that has caused consumers to cut back on discretionary purchases. Like any other business, Best Buy faces the difficulties of trying to maintain its advantage in an increasingly competitive market.

3. How do Best Buy’s social responsibility efforts impact key stakeholders such as employees, shareholders, consumers, and suppliers?

Best Buy is taking a stakeholder orientation and recognizing the importance of good relationships with employees, shareholders, consumers, suppliers, regulators, and the community. Best Buy does not seem to be elevating one stakeholder above others and has developed an effective program of social responsibility that enhances its reputation. Customer loyalty is positively correlated to an organization’s good reputation and consumer trust. Therefore, by earning a reputation as a socially responsible company, Best Buy will most likely increase its consumers’ loyalty to the chain.

Positive relationships with customers are not the only component of a successful stakeholder orientation. Best Buy also creates mutually beneficial relationships with other stakeholder groups, like its employees, suppliers, and shareholders. Best Buy has also generated loyalty through programs that address employee needs, such as the ROWE system. Best Buy works with its suppliers to increase the sustainability of its products. The company also tries to maintain positive relations with its shareholders. While Best Buy’s
Corporate Social Responsibility Reports were created as a response to consumer demands to know what Best Buy was accomplishing in the realm of sustainability, they are also an important resource for shareholders and investors. Since many investors are looking for socially responsible companies in which to invest, Best Buy’s report gives a clear signal that ethics and sustainability occupy important areas in the company’s operations.

**ADDITIONAL RESOURCES**

SIMULATIONS

WHY USE SIMULATIONS?
The behavioral simulation is an exercise in which the class is divided into teams of five to six students each. The students read a short case situation and are then assigned roles in the organization portrayed in the case. Their roles provide them with varying levels of information about an ethical issue. The teams then interact to provide recommended courses of action for the short-term, mid-range, and long-term. Each team experiences the group dynamics and tension that can occur between different departments seeking to protect their own interests.

These simulations were developed to offer an additional technique for enhancing the learning outcomes of business ethics-related courses. The simulation addresses important issues that companies, management, and employees may face on a daily basis. The simulation is a teaching tool that provides students with a very realistic experience in a simulated organizational setting. Through students’ participation in business ethics simulations, we hope to increase their interest in ethical decision making and help make them more aware of current issues and how to handle those issues. Beyond a case analysis approach, a simulation underscores the complexities of relationships and incomplete information that are pervasive in an organizational setting. Also, the simulation seeks to draw students’ attention to the inherent conflicts between certain departments within an organization. Therefore, a key goal is to improve individual awareness of the complexity involved in dealing with business ethics issues. Finally, we hope to gain students’ absolute involvement and participation in class. By participating in business ethics simulations, students will be able to develop their leadership skills and engage in problem-solving activities directly related to ethical issues.

Specific learning objectives of simulations include:

1. Increasing students’ awareness of the ethical, legal, and social dimensions of business decision making
2. Legitimizing ethical issues as a necessary part of business decision making
3. Developing students’ analytical skills for resolving ethical issues
4. Exposing students to the complexity of ethical decision making in business organizations
INSTRUCTIONS FOR CLASSROOM USE

The simulation complements and enhances traditional approaches to business learning because it:

1. Gives students the opportunity to practice making decisions that have business consequences.
2. Recreates the power, pressures, and information sharing that affects decision making at upper levels in an organization.
3. Provides students with a team-based experience enriching their skills and understanding of group processes and dynamics.
4. Uses a debriefing and feedback period to allow for the exploration of complex and controversial issues in business decision making.

The simulations can be used in classes of any size, as the instructor can run independent role-play case teams to fit the class size. Teams generally consist of five to six members. Several possible implementation methods exist. Two options are provided below.

Option 1: Implementation in a 50–75 minute class period

1. Develop teams of five members (depending on roles used). If only three to four participants are available per team, then the more important and complex roles should be selected for the members of the team.
2. As an introduction to the exercise, have each person read the role-play simulation background page.
3. Assign each person a role to play and give him or her the specific role description to read. Ask each person (role) to present their feedback and interaction with the group, based on the role that they are assigned.
4. Indicate the desired outcomes of the process (for example, press conference, written, or oral presentation of short-term, mid-range, and long-term recommendations to address the ethical issue, etc.).
5. Depending on the outcomes specified above, allow the teams to proceed without interruption for at least 45 minutes. The instructor may visit teams to answer questions and stimulate discussion on key issues.
6. Create a classroom situation appropriate for teams to share their insights, decisions, or recommendations. The instructor may require each team to turn in a written report.
7. Link simulation issues, processes, and outcomes to both experiences in the course and learning objectives. Debrief the class about the alternatives, team perspectives, and potential implications. Discuss issues that emerge commonly which appear to provide significant insights in helping the organization deal with the ethical issue.

Option 2: In class and outside independent work

1. Follow step #1 from Option 1.
2. Follow step #2 from Option 1.
3. Follow step #3 from Option 1.
4. With a discussion in class (as the instructor allows), indicate that the desired outcome is a specific decision, but then assign students to conduct independent research and reflection before the next
discussion session to be held in class. At this second in-class meeting, each participant brings in a short, written position statement and rationale to inform the discussion. This statement should be based on the participant’s role and understanding of the situation and its consequences.

5. Let the teams meet during class for brief discussion sessions (30 minutes or so) over the next two weeks. Indicate that outside meetings are permissible and encouraged.

6. In the third week, each team makes a presentation on the decision with supporting rationale. Allow questions and comments after each presentation, and encourage other students to critically examine each team’s decision.

7. Conduct a debriefing session to examine consistency in the decisions and rationale.

8. Link role-play case issues, processes, outcomes, and experience to course concepts and learning objectives.
TEACHING OVERVIEW ON SOY-DRI

The Soy-DRI behavioral simulation was designed with the goal of improving student skills, confidence, practice, and efficacy with respect to ethical decision making. The simulation centers on a product misuse allegation and the pending broadcast of an investigative report examining the case. To complicate the situation, the CEO is out of town and has given decision authority to a group of five to seven employees. Specifically, Soy-DRI involves a firm that manufactures three products, all soybean derivatives, and markets them to three distinct target markets.

The students’ recommendations and discussion should involve issues related to evaluating packaging, labeling, pricing, product color, and consistency issues in the short- to mid-term, as well as whether a product recall should be implemented. More mid- to long-range issues should involve the manner in which information is provided from distributors and retailers back to the manufacturer. In addition, the need to implement a comprehensive ethics and compliance program for all Soy-DRI employees and customers should be evaluated. New risk areas have emerged with this recent issue, and they need to be addressed with all employees.
SIMULATION ONE

Soy-DRI*

Background

(Everyone reads)

Two former employees of a large chemical manufacturer founded Soy-DRI (Soybean Derivative Research Initiatives) in 1985. One of the company’s product lines consists of three soy-based powders with additives to enhance their moisture-absorbing properties. The products are used to absorb and eliminate excess moisture in a variety of consumer and organizational settings. In their powdered form, Soy-DRI products can absorb as much as ten times their weight in moisture. The products are environmentally friendly, a critical value of Soy-DRI. The company has been acknowledged for accomplishments in the area of environmental sensitivity.

Initially, Soy-DRI targeted the industrial market with the Slab-Dri brand. Slab-Dri is marketed primarily to commercial establishments for the purpose of eliminating moisture and oil from paved surfaces. The product soaks up spills and can then be swept dry. The product is white to enhance its visibility and ease of removal. Slab-Dri is distributed in 64-ounce tin containers with adjustable lids for application. The retail price of Slab-Dri is $2 per 64-ounce container, with a product cost of $1.50. The product is available to industrial buyers through catalogs and, more recently, through AutoZone, Discount Auto Parts, and other consumer automotive outlets. Slab-Dri has generated the company’s second highest sales levels.

In 1990, Soy-DRI expanded its product line with two new products targeted at distinctly different end users. The first of these new products is Pet-Dri, which is used in pet litter boxes to facilitate moisture and odor absorption. Pet-Dri has the same formulation as Slab-Dri, but the product is beige so that it blends with other pet litter products. The product is available in a 32-ounce plastic container with an adjustable lid for application. Pet-Dri is distributed through major discount stores such as Wal-Mart, Target, Kmart, and supermarkets. The suggested retail price is $4 per 32-ounce container, with a product cost of $1.25. Pet-Dri has become Soy-DRI’s best-selling product.

The final derivative product is Baby-Dri, which is used in place of traditional baby power. As a relatively new addition to Soy-DRI’s product line, Baby-Dri has the lowest sales. Because tests of Soy-DRI’s first two products indicated that their high moisture absorption properties cause rashes and irritate babies’ skin with prolonged use, Baby-Dri’s moisture-absorbing properties were modified to make it absorb five times its weight in moisture. Baby-Dri is also purified to meet federal regulations for consumers’ personal use. The product is white in color, the same as Slab-Dri. Baby-Dri is sold in 8-ounce plastic containers for a suggested retail price of $4, with a product cost of $2. Baby-Dri is distributed through major discount chains such as Target, Wal-Mart, Kmart, Toys R’ Us, supermarkets, and baby supply stores throughout the country.

* This simulation was prepared by Linda Ferrell and Debbie Thorne for classroom use.
General Council
(Only the student assigned to this role reads this page)

You are the general counsel for Soy-DRI. You report directly to the CEO and work closely with the human resources managers who deal with compliance issues (that is, equal employment, safety) as well as the vice president of international operations. You have just been informed by the CEO that consumers are buying Pet-Dri and, in some instances, Slab-Dri for use as a baby powder on their children. The CEO wants an action plan from several key executives and managers within the organization to address this issue.

You are deeply concerned about this revelation because the moisture-absorbing properties of Soy-DRI’s three products differ even though the ingredients listed on each product’s label make them appear identical. Everyone in the company is well aware that Slab-Dri and Pet-Dri are not intended for the same use as Baby-Dri, which is why Baby-Dri is a reformulated product. You are concerned not only about consumers misusing the product and the long-term implications of such use, but also about the potential for civil litigation. The company never placed any kind of disclaimer on the packaging stating that Slab-Dri and Pet-Dri were not intended for use on people. You are currently conducting an investigation into the alleged incidents of product misuse.

Right now, you are checking to see what the company has done to prevent any product misunderstanding:

1. Different labeling
2. Different packaging
3. Different pricing
4. Varying channels of distribution
5. Derivative names

Your greatest concern lies in the fact that the company was aware that Slab-Dri and Pet-Dri are too harsh for use on babies, but the products are not specifically labeled to discourage customers from using them on their children. Looking at the list of ingredients on the packaging, the products appear basically the same in composition and formulation.

The CEO has also informed you that the news program 1-Hour is preparing a story on the product misuse, which will air in the next several weeks. As the company’s legal counsel, you are mindful of the company’s need to act quickly and responsibly to protect consumers, distributors, and the owners. You have called an emergency meeting to discuss the issue.
Chief Financial Officer and Vice President of Finance
(Only the student assigned to this role reads this page)

You are the chief financial officer for Soy-DRI. You have traditionally managed the company’s financial, accounting, and auditing operations with a firm hand. You were hired right after the company introduced Slab-DRI and deftly guided the company through its initial public offering three years ago. You look forward to presenting information on Soy-DRI’s continued financial success with shareholders at the annual meeting next month. In addition to the re-election of two officers (including yourself), one of the issues on the agenda is the issuance of stock to support future research and development efforts and expansion of the -Dri product lines and applications.

Your previous position was with a major producer of soy, the primary ingredient in all of the Soy-DRI brand products. You were hired for your reputation as a cost-cutter. Because you have so much responsibility for the financial success of Soy-DRI, you are insistent that the sales force and sales management meet their sales and market share goals. Fortunately, you have a great relationship with the vice president of sales and marketing.

Late yesterday, you received a communication from the general counsel indicating there may be a potential problem with customers’ misusing Slab-Dri and Pet-Dri. The CEO has requested that you two meet and come up with a comprehensive action plan to resolve this matter.
Marketing Manager
(Only the student assigned to this role reads this page)

You are the marketing manager in charge of overseeing the design and implementation of marketing strategies for Slab-Dri, Pet-Dri, and Baby-Dri. You have been with the company since graduating from a prestigious business school and aspire to move into executive management. Additionally, your grandfather is one of the founders of Soy-DRI.

You have three product managers who report to you, one for each of the different products within the product line. In order to grant them greater flexibility, autonomy, and creativity, you have traditionally favored a rather “hands-off” approach when working with your product managers. For example, the product manager for Pet-Dri recently implemented sales incentives for wholesalers in order to better support the product line. To relay to customers through their distributor’s corporate websites, the product manager for Slab-Dri has created an innovative online coupon. Although you have a good working relationship with most employees at Soy-DRI, you believe the chief financial officer and vice president of sales and marketing do not really understand the long-term priorities of “new marketing” approaches.

You prefer a relationship-building approach with customers, rather than an insistence on immediate sales, and you believe that the best way to build relationships with large retailers and wholesalers is by developing new products and applications on a regular basis. You enjoy working closely with the director of research and development on new product development. The director of research and development actually came up with the idea that led to the start-up of Soy-DRI.

Last month, at a trade meeting, a few of your distributors indicated that some customers are using the Dri products in ways in which they were not intended to be used. Because you were aware of only a few incidents, you did not report the misuse or document it in any manner.

Late yesterday, you received a communication from the general counsel indicating there may be a potential problem with customers’ misusing Slab-Dri and Pet-Dri. The CEO has requested that you both meet and come up with a comprehensive action plan to resolve this matter.
Director of Research and Development

(Only the student assigned to this role reads this page)

You are the director of research and development at Soy-DRI. Your mission is twofold:

(1) to locate and identify the best environmentally sensitive resources and processes for all of the products Soy-DRI manufactures, distributes, and sells, and (2) to come up with at least one new product (or derivative/alternative use for an existing product) every two years.

You have been with Soy-DRI almost since its inception, when you were a struggling graduate student. The company funded your biohazard research and your still-unfinished doctorate. You have been a pacesetter with the organization, but are looked upon with some disfavor. You are often criticized for your overzealous push for innovation in product development. Some think you are too big a risk-taker for the well-being of the organization, and many in the organization complain bitterly about the elitist compensation and benefits you have at your disposal for yourself and your department. You take it all in stride, knowing that Soy-DRI’s market expansion is due in large part to your creativity and that of your staff.

You were also a key figure in supporting the entire environmental initiative, and had to fight an uphill battle to convince other executives that the cost to produce a line of environmentally sensitive products was worth the endearment it would earn in the eyes of customers and the government. Your biggest complaint now is that the global market has opened doors to some low-cost soybean growers whose use of toxins is unrestricted. Soy-DRI has been purchasing soybeans in areas where certain pesticides and herbicides have been linked with exceedingly high rates of certain cancers and skin ailments.

Soy-DRI went public three years ago and has performed well since then, a fact that should sit very well at next month’s shareholders’ meeting. One of the issues on the agenda is the adoption of tighter corporate governance mechanisms, including methods for incorporating stakeholders’ concerns into Soy-DRI’s strategic planning efforts.

Late yesterday, you received a communication from the general counsel indicating there may be a potential problem with customers’ misusing Slab-Dri and Pet-Dri. The CEO has requested that you two meet and come up with a comprehensive action plan to resolve this matter. A meeting has been scheduled.
Vice President of Sales and Marketing
(Only the student assigned to this role reads this page)

As vice president of sales and marketing, you are essentially responsible for the economic viability of Soy-DRI. You find that not everyone in the organization recognizes how much pressure you are under for the success and failure of new products such as Baby-Dri. With more than fourteen years of sales and sales management experience, you have been with the company for more than six years. Since joining Soy-DRI, you have risen from regional sales manager to vice president.

You were heavily involved with every aspect of developing and testing the Baby-Dri product. You recognized the potential for the consumer application for such a product, and helped foster buy-in for the product idea from many departments throughout the organization. In fact, you were instrumental in rushing the product tests to get the introduction off on schedule.

You have a tenuous relationship with both the marketing and research and development departments, mainly because you feel they do not always understand the realities of selling products in intensely competitive consumer markets and the retailers (for example, national discount chains) who put enormous pressure on you to trim your margins. So, while you and your salespeople are out selling the product, you feel that others in the organization, including the marketing manager and product managers, are often disconnected from the pressure and responsibility to achieve sales and market share objectives.

Late yesterday, you received a communication from the general counsel indicating there may be a potential problem with customers’ misusing Slab-Dri and Pet-Dri. The CEO has requested that you both meet and come up with a comprehensive action plan to resolve this matter.
Vice President of International Operations
(Only the student assigned to this role reads this page)

You are vice president of international operations. You have been with Soy-DRI for six years, two in your current position. Your job is to ensure Soy-DRI’s international profitability. Your area of responsibility includes manufacturing, distribution, and sales in the European and Asian sectors. The directors of sales, marketing, and manufacturing (one each in Asia and Europe) report to you.

At a recent meeting, the board of directors decided to establish a new manufacturing facility in northwestern Argentina. The company’s business has grown rapidly, especially in Western Europe and Asia where Soy-DRI has been made welcome by various governments. You hope the company’s ventures into Latin America will be just as successful.

In terms of the -Dri product line, Slab-Dri, Pet-Dri, and Baby-Dri are popular among Europeans. Baby-Dri sells well in Asia, but Pet-Dri and Slab-Dri are not faring so well in Asian markets. The entire -Dri product line can be manufactured in parts of East Asia at a fraction of domestic operations costs, such that even with high distribution costs, it is still cheaper to manufacture the products in Asia and export them to other markets.

Although you stand behind Soy-DRI’s domestic and foreign operations, when your own children were born (two in the past five years), you and your spouse bought another company’s baby powder, rather than Soy-DRI’s. Something about using a garage floor grease absorbent or litter box odor absorbent powder on your own children—despite the extra processing—never sat well with you.

You have been a pacesetter with the organization since you joined, and are looked upon with favor by most. However, you are often criticized for overlooking the demands, needs, and responsibilities of domestic operations in favor of operations overseas. You take it all in stride, however, knowing that globalization is a significant source of any corporation’s competitive advantage.

Late yesterday, you received a communication from the general counsel indicating there may be a potential problem with customers’ misusing Slab-Dri and Pet-Dri. The CEO has requested that you meet to come up with a comprehensive action plan to resolve this matter. A meeting has been scheduled.
Assistant to the Chief Executive Officer
(Only the student assigned to this role reads this page)

You are the assistant to the CEO of Soy-DRI and have been with the company since its inception. Late yesterday, you received a communication from the general counsel indicating there may be a potential problem with customers’ misusing Slab-Dri and Pet-Dri. The CEO has requested that you meet in order to come up with a comprehensive action plan to resolve this matter. The CEO is overseas and has therefore instructed you to attend this meeting as her/his representative to ensure that Soy-DRI stakeholders’ interests are represented. The CEO, remembering the scandal surrounding BeechNut, the company that promoted fake apple juice as “100% natural,” is concerned about the impact any bad publicity could have on the company.

Soy-DRI has long valued the environmental sensitivity and health safety of its products, especially Baby-Dri. Soy-DRI puts no additives into its products, but instead uses complex processes to remove the unhealthy additives present in its raw materials prior to their delivery to Soy-DRI.

From the general counsel and CEO, you have heard that some lower-income families and cost-conscious adults are using the less inexpensive Pet-Dri and Slab-Dri, in lieu of Baby-Dri. The CEO wants you to remind the meeting attendees that product liability juries generally find in favor of the plaintiff where babies and toddlers are concerned, even in the face of evidence of the plaintiffs own culpability. Also, you are to make sure they remember the upcoming shareholders’ meeting next month and the CEO’s strong position that good ethics is good business.
TEACHING OVERVIEW ON NATIONAL FARM AND GARDEN

The National Farm and Garden simulation was designed with the goal of giving students the opportunity to use their knowledge and skills in solving an ethical dilemma related to a product defect. The simulation centers on a garden tiller that has a safety protection guard that is difficult to reattach after cleaning. There have been incidents of injuries to animals and children when the tiller is run without the guard. Various functional members of the organization have to be prepared for a meeting to make recommendations for dealing with the negative publicity and possible legal liability associated with damages related to product use. The class should be looking not only at the right thing to do, but also how to implement the decision.

The students’ recommendations should consider product recalls and classes to properly address cleaning and reinstallation of the guard. Re-labeling the instructions to clarify the reattachment process for the guard should also be addressed. For the longer term, the company should consider a product redesign to provide a more foolproof mechanism for attaching the guard. Also, there is a need to evaluate the public relations damage and legal liability associated with product injury cases.
SIMULATION TWO

National Farm and Garden, Inc.*

Background
(Everyone reads)

National Farm and Garden, Inc. (NFG) was incorporated in Nebraska in 1935 and has been a leading supplier of farming equipment for more than 60 years. Over the last five years, however, demand for NFG’s flagship product, the Ultra Tiller, has been declining. To make matters worse, NFG’s market lead was overtaken by the competition for the first time two years ago.

Last year, NFG expanded its product line with the “Turbo Tiller,” a highly advertised and much anticipated upgrade to the Ultra Tiller. The product launch was timed to coincide with last year’s fall tilling season. Due to the timing of the release, the research and development process was shortened, and the manufacturing department was pressed to produce large quantities to meet anticipated demand. All responsible divisions approved the product launch and schedule. In order to release the product as scheduled, however, the manufacturing department was forced to employ the safety shield design from the Ultra Tiller. When attached, the shield protects the user from the tilling blades; however, it is necessary to remove the shield in order to clean the product. Because of differences between the Ultra and Turbo models, the Turbo’s shield is very difficult to reattach after cleaning and the process requires specialized tools. Owners can have the supplier make modifications on-site or at the sales location, or leave the shielding off and continue operation. All product documentation warns against operating the tiller without the shielding, and the product itself has three distinct warning labels on it. Modifications are now available that allow for the shield to be removed and replaced quite easily, and these modifications are covered by the factory warranty. However, most owners have elected to operate the Turbo Tiller without the safety shielding after its first cleaning.

Over the last year, a number of farm animals (chickens, cats, a dog, and two goats) have been killed by Turbo Tillers being operated without the guard. Two weeks ago, a seven-year-old Nebraska boy riding on the back of an unshielded tiller fell off when the tiller caught the sleeve of his shirt; his arm was permanently mangled, requiring amputation. One of the child’s parents owns the local newspaper, which ran a story about the accident on the front page the next day. NFG’s CEO has called an emergency meeting with the company’s divisional vice president, director of product development, director of manufacturing, director of sales, and vice president of public relations to discuss the situation and develop a plan of action.

* This simulation was prepared under the direction of O.C. and Linda Ferrell for classroom discussion. The research and conceptual assistance of Larry Gonzales, Pat Hansen, Heidi Hollenbeck, Marilynn Hill, Michael Mitchell, Craig Hurst, Bill Haskins, and Dana Schubert is gratefully acknowledged.
Divisional Vice President

(Only the student assigned to this role reads this page)

You are the divisional vice president and have been with the company for many years. Historically, you have not been a pushy individual, generally preferring to stay in the background. When there are major decisions to be made or crises to address, you are frequently not available. The CEO recently put you on a 60-day “action plan” to improve your division’s output; failure to achieve this plan will result in your termination, even though you are just a few years shy of retirement. Therefore, you now find it necessary to satisfy not only your own objectives, but the CEO’s very high expectations as well. This has caused great turmoil within all divisions of the company as you place increasing pressure on your subordinates.

As the divisional vice president, you are focused on coordinating all departments. You are responsible for output from the sales, manufacturing, and field service engineering departments. The Research and Development department, which must sign off on all new products before they are approved for production, is not under your supervision.

Recently, you received a memorandum from the director of R&D outlining some potential problems with the development and testing of the Turbo Tiller. The memo was copied to you, the director of manufacturing, and the director of sales. You agreed with the director of manufacturing not to share the contents of the memo with your CEO because you felt that bringing this small concern to his attention would cause unnecessary problems for each division. Moreover, the CEO is known for his abrasive personality and has a history of yelling at bearers of bad news.

The CEO has called an all-hands emergency meeting at 7:00 a.m. tomorrow. You are expected to bring all knowledge of this situation with you for discussion and creation of a comprehensive action plan.
Director of Product Development

(Only the student assigned to this role reads this page)

You are the director of product development. Although you have a master’s degree in mechanical engineering from Stanford University, you are originally from the inner cities of Chicago, where you grew up in the school of “hard knocks.” From previous experience, you tend to be rather uncompromising about products that are engineered within your organization. Your engineering team has been very successful in the past, and you are quite proud of the many new successful products your department has developed.

You originally fast tracked the Turbo Tiller product due to constant pressure, particularly from the director of sales. However, upon further investigation, you have become concerned about the implementation of the product’s safety shield. Consequently, you recently sent a memorandum to the director of manufacturing, director of sales, and the divisional vice president outlining the fact that consumers could sue National Farm and Garden under the state’s strict liability doctrine, which holds manufacturers, distributors, wholesalers, retailers, and others in the chain of distribution of a defective product liable for the damages caused by the defect regardless of fault. Moreover, plaintiffs could cite the state’s concept of defect of manufacture when the manufacturer fails to (1) properly assemble a product, (2) properly test a product, and (3) adequately check the quality of the product component parts or materials used in manufacturing. You now believe that NFG has violated all of these “defects of manufacture.”

Having received no response to this memo, you are contemplating whether to escalate the issue by going to the CEO. The only reason you have not already done so is the CEO’s historic temper when confronted with negative situations.

The CEO has called an all-hands emergency meeting at 7:00 a.m. tomorrow. You are expected to bring all knowledge of this situation with you for discussion and creation of a comprehensive action plan.
Director of Manufacturing

(Only the student assigned to this role reads this page)

You are the director of manufacturing. A graduate from the University of Alabama with a bachelor of science degree in industrial manufacturing; you have worked for NFG for twenty years. You are required to provide reports to top management on a weekly, monthly, and quarterly basis. Top management creates the exact measures of performance that you provide; although you have a say in what these reports focus on, you often disagree with their exact focus. Your overall performance is evaluated based more on numbers of units produced than on their quality. Despite this, you enjoy working for the company. You consider the group like family, and especially appreciate the effort the CEO has made to make you feel valued and supported.

You are aware of the difficulties the Ultra Tiller guard poses, when used on the Turbo Tiller. Due to the Turbo Tiller’s larger size, the guard is nearly impossible to replace after removal. Re-attachment of the shield requires a professional machine shop and additional assistance. However, with your knowledge of statistics, you know that, even without the shield in place, the chances of an animal or a person being injured by the Turbo Tiller are small. Thus, you agreed with the divisional V.P. to bury a memo sent by the director of R&D stating related concerns. You both felt that the risks were small enough and that raising these concerns to your superiors would only cause headaches and paperwork. Furthermore, you need to stay on schedule in order to reach your volume goals if you are to earn your bonus.

You have also received several e-mails from the manager of the field service engineering department about reports of farmers operating the Turbo Tiller without the guard. When you requested statistical data regarding the number and location of occurrences and any related accidents, the field service engineering manager replied with field data indicating that more than 85 percent of all Turbo Tillers are eventually operated without the guard.

The CEO has called an all-hands emergency meeting at 7:00 a.m. tomorrow. You are expected to bring all knowledge of this situation with you for discussion and creation of a comprehensive action plan.
Director of Sales

(Only the student assigned to this role reads this page)

You are the director of sales and have been with NFG for more than ten years. You were recruited from a competing firm and have more than 25 years of sales experience in the industry. Because of sagging sales, you face extreme pressure from above to meet your numbers. However, you feel that sales forecasts have been set unrealistically. Furthermore, these aggressive forecasts create churning within your department as your sales staff consistently complain that their quotas are unrealistic. Although you are adamant that declining sales are industry and product-offering issues, you are reluctant to raise these concerns to the CEO because of his history of ripping the heads off the bearers of bad news. You have witnessed this phenomenon firsthand as the CEO literally screamed at a coworker who brought a problem to his attention. On the other hand, the CEO has promised you a new BMW if your department reaches its numbers this year. Of course, you enthusiastically promised to achieve these results and quickly ran from the room.

The Turbo Tiller has been a much-anticipated addition to your stagnant product portfolio, but you were concerned that it would be delayed due to red tape and wrote daily e-mails to the R&D manager about getting it to market in a timely manner. You have received a memo from the R&D manager about some legal concerns over the Turbo Tiller; however, you feel that these concerns are manufacturing’s, and not your department’s, problem. Furthermore, because the director of manufacturing received a carbon copy of the memo, you are sure that the concerns will be addressed appropriately.

You have organized training on this product for your sales staff that included proper operating procedures and the dangers of standing within five feet of the tilling blades. Independent of these training sessions, you arranged a separate class on how to address and downplay these concerns with customers.

The CEO has called an all-hands emergency meeting at 7:00 a.m. tomorrow. You are expected to bring all knowledge of this situation with you for discussion and creation of a comprehensive action plan.
V.P. of Public Relations

(Only the student assigned to this role reads this page)

You are the most recent addition to the management staff at NFG, having been with the company for just three years. You obtained a bachelor’s degree in human resources from Ohio State University and a master’s degree in communications from Florida State University. Prior to working with NFG, you handled public relations at a nonprofit organization for five years. You took this job because you thought it would be a personal challenge to represent a larger for-profit business. Besides, you were raised in Nebraska, and are a farmer at heart.

Nearly six months ago, you learned that the company had developed and released a product that has some safety concerns. Most department heads were not concerned about the problem because of a lack of solid evidence that a danger existed. You have been monitoring the situation, although it has not been your highest priority due to recent union negotiations. Recently, the CEO informed you that a corporate meeting is imminent. As the V.P. of public relations, it is your responsibility to gain information about public opinion to present to the CEO. As you begin to collect this information, you find disturbing news. Many consumers don’t trust NFG because of its handling of a chemical spill five years ago. Additionally, many rumors are circulating about NFG’s hiring practices.

You know that a single negative event can wipe out a company’s reputation and destroy favorable customer attitudes established through years of expensive advertising campaigns and other promotional efforts. In this situation you need to minimize the negative publicity, yet still address the media. You suddenly wish the company had developed a crisis plan before this happened.

The CEO has called an all-hands emergency meeting at 7:00 a.m. tomorrow. You are expected to bring all knowledge of this situation with you for discussion and creation of a comprehensive action plan.
After our meeting on March 1, Lara Bruger, Director of Product Development, Annie Hodges, Director of Sales, Shannon Quinn, VP of Public Relations, Jeff De Weese, Director of Manufacturing, and myself met in order to develop a comprehensive plan of action regarding the Turbo Tiller as well as work to change the climate within the organization. We have a lot of work to do—we need to not only improve our market share, we also need to improve our public image. The attached plan includes short-, medium- and long-term goals and addresses a number of ethics issues within the company. I am sending a copy of this plan to the legal department so they can start working on several recommendations.
PHASE 1

NATIONAL FARM AND GARDEN

Short-Term Goals
The most pressing matters facing the company in the short term include handling the problems with the safety shield on the Turbo Tiller, negative publicity, and our liability.

We, in the short term, will:

- Issue a public statement addressing the confusion created by the tiller modifications, as well as stressing the fact that all owners can take the tiller to the supplier or sales location to have the modifications made free of charge. The statement will be placed in all prominent farming magazines and in all sales locations. The legal department will review the statement to make sure we are not creating liability for the company. This measure will help us to control the problem and hopefully stop the use of the tiller without the proper safety shield.

- We will recall all Turbo Tillers in order to make the shield changes. This will be a preventative measure to insure that more tillers are fixed. We will issue a press release stressing that our company, and not the government, issued this recall in order to keep our customers safe.

- We are going to set up a team to evaluate the possible product defects. Representatives from product development, manufacturing, and legal departments will evaluate all of our products starting with the Turbo Tiller. We will look at the state’s strict liability doctrine to make sure that not only are we protected, but also our distributors, wholesalers, and retailers are protected as well. We would not want to jeopardize these relationships. In addition, the team will look at the products using the Nebraska’s concept to defect of manufacture. This team, before release, will clear all future products.

- Manufacturing is evaluating the labeling on the Turbo Tiller and will be changing the labeling to be more colorful and larger, thereby being more noticeable. The warning labels will be placed on the shield itself to make sure the consumer understands the danger of not replacing the shield.

- We will be hiring a company to develop a website to create more opportunities to communicate with both present and potential customers. The website will include e-mail for customer support as well as all company official names, press releases, company information, product information, customer service, and public financial information. An employee-only section will also be created on the website to answer personnel questions, announce job promotions, opportunities, etc. We will also be contacting the parents of the little boy injured in the tiller accident. We will cover the costs of the medical bills contingent on the parents signing a silence agreement. We are a Nebraska company, and he is a Nebraska boy, so it is the right thing to do to pay his medical bills, but we do not want any publicity (positive or negative) drawn to the company in this matter.

- Since the climate of the company has been somewhat negative regarding goal setting, sales numbers, etc., a team will be established from the appropriate departments in order to create goals for each department. Having members of various departments on the team will help to establish realistic and attainable goals. The departments will then work together to achieve the goals instead of individual departments feeling that they are trying to meet unrealistic quotas.
PHASE 2

NATIONAL FARM AND GARDEN

Mid-Term Goals

Once we set our short-term goals into motion, we will then address our mid-term goals. Probably the most important of these is acknowledging where we stand in relation to the Federal Sentencing Guidelines and then fixing any problems. The corporate culture will change once we improve our internal structures concerning ethical issues.

In response to the Federal Sentencing Guidelines for Organizations, the following goals will be implemented:

- The human resources department will create a code of ethics and business conduct that will be posted throughout the company as well as printed in both the employee handbook and in all training manuals. This will include conduct toward employees, customers (both our retailers and the end consumer), suppliers, or toward anyone to whom we have an obligation.
- An ethics officer will be appointed from the human resources department. The ethics officer will also be responsible for further development of our ethics compliance program.
- All personnel involved in authority positions will attend at least three ethics training seminars a year in order to minimize misconduct in their departments.
- Ethics training will be held yearly for all employees through a seminar. Included in the monthly employee newsletter will be articles related to ethics issues.
- Within the newly created website will be a link to the ethics officer so employees can anonymously report ethics violations.
- Progress discipline forms will be created to ensure consistent enforcement of standards. The form will explain a description of the infraction, how to correct it, action to be taken, date for review, and include a place for employee comments.

Other mid-term goals include:

- Modifications to the tiller in order to change the shield to an attached design instead of being taken off for cleaning.
- The director of sales will re-evaluate all training programs and create comprehensive training that teaches the sales staff to instruct the consumer on removing and reattaching the shield on present products. The training will stress that safety is the most important issue in the operation of our tillers.
PHASE 3

NATIONAL FARM AND GARDEN

Long-Term Goals
In order to protect our company, not only must our short- and mid-term goals be implemented, but we must also invest in the long term. The following goals will help us improve our standing within the customer community as well as help us to achieve our obligations to our shareholders.

- Create a team to evaluate various philanthropic endeavors to improve our image, increase customer and employee loyalty, and to create goodwill relationships with future customers. Some potential charities could include:
  
  On a national level:
  
  a. The American Farmland Trust: This organization helps to stop the loss of farm and ranch land to development. It works with communities on smarter growth, which includes local farms.
  
  b. Future Farmers of America
  
  c. 4-H
  
  On a more local/state level (improving our community):
  
  a. Center for Rural Affairs (Walthill, NE): This charity serves and advocates for family farms and rural communities.
  
  b. Farm and Ranch Museum (Gering, NE): Donate machinery with our corporate name on it to preserve the history of farms and ranches.
  
  c. Farm Safety 4 Just Kids: Chapters across the state educate kids about farm safety.
  
  d. North American Farm Alliance Educational Project in Newman Grove, NE

- Set up a system to evaluate our hiring practices and to create programs to recruit from all backgrounds and various parts of the country.

- Create advertising and a promotional campaign that promotes the safety of our products and our commitment to work with the consumer to create products to meet their needs.
TEACHING OVERVIEW ON VIDEOPOLIS

Videopolis provides a more complex case and decision-making process than the other two simulations. Therefore, we recommend that you use it last (after the class has experience using Soy-DRI and National Farm and Garden). This simulation features a technology company that is assisting in information transfers between different organizations and among different divisions of the same organization. Videopolis manages the electronic transfer of videos, training materials, and other electronic content. Two major issues exist for the company. First, there are issues related to facilitating the transfer of copyrighted materials (similar to the Napster case). Second, there are major issues related to how employees are being treated within the organization (promises have been broken with respect to compensation and other issues). The president of Videopolis does not like to hear bad news and gets angry very easily. Various functional members of the organization have been asked to meet and make recommendations to address these two major issues.

Some important concerns include intellectual property issues associated with the transfer of copyrighted materials. This issue is discussed in Chapter 2 of the text. The Napster case in the text may provide a helpful background before students attempt the Videopolis simulation. The human resources issues are more straightforward and deal with honesty in communications and organizational relationships. You may want to ask students to focus on one issue more than the other. A solution to the current situation should involve developing checks and balances to received copyright releases, legal oversight, and ethical directives associated with the use of copyrighted materials within the organization. A key issue is that students will often think that it is acceptable to do something as long as you will not be caught or no one will ever know. This case provides for lengthy discussion of these issues.
SIMULATION THREE

Videopolis*

Background

(Everyone reads)

Videopolis was founded as VideoNow in 1993 by two former employees of RCA, where they had learned television broadcasting, electrical engineering, satellite downlinking, and telephone networking applications. Today, Videopolis is a communications company that specializes in connecting videoconferencing equipment over digital telephone lines to cities around the world. The company does not produce meetings, conferences, or programs, but instead facilitates the videoconferencing process. Videopolis’ most profitable product, the “Broadcast Service,” involves storing and playing prerecorded programs on its DVDs and broadcasting them through its computer equipment to clients’ meeting rooms around the world. If a remote site is not immediately available to view a meeting or program from Videopolis, the client can record the program by connecting a DVDs to a television monitor. Videopolis does not explicitly state that recording programs is forbidden. Company policy is that all viewing sites must obtain their own permissions from the owners of the content to record any copyrighted materials. There are some concerns that this policy may be facilitating the copying and distribution of copyrighted material.

VideoNow became Videopolis after it was acquired by TeleWide Corp. fifteen months ago. When VideoNow was started, the founders had a clear vision for growth, hiring only the best employees and purchasing the best equipment in more than sufficient quantities to ensure a high level of service and plenty of reserves for growth. Many of VideoNow’s original employees joined the firm with high hopes of stock options, promotions, and bonuses based on future growth prospects. Many employees had purchased expensive homes and cars in anticipation of these bonuses and promotions. Unfortunately, the founding partners sold out directly to TeleWide before granting any options or bonuses to VideoNow employees. After the merger, TeleWide immediately instituted a hiring and equipment-purchasing freeze and virtually froze all salaries. The new corporate parent also set aggressive sales and growth goals for Videopolis and developed a highly incentive-based pay structure for upper managers who achieved their goals. This resulted in a considerable amount of turnover, as those employees who could afford to leave promptly did so, placing tremendous stress on those who stayed and had to take up the slack. Many of the employees who remained after the buy out believe that promises have been broken and that they were misled about advancement opportunities.

Videopolis’ chief legal counsel has sent an e-mail message to arrange a meeting with the CEO, vice president of operations, vice president of human resources, and the vice president of marketing and sales to discuss a number of legal and ethical issues concerning potential legal issues at the company.

* This simulation was created under the direction of O.C. and Linda Ferrell for classroom discussion. The research and conceptual assistance of Dana Schubert, Brian Hayes, Carrieann McDonough, Jeff Sawyer, and Jon Mullen is gratefully acknowledged.
Bryce Kerwin, Vice President of Marketing and Sales

(Only the student assigned to this role reads this page)

Bryce Kerwin is the vice president of marketing and sales for Videopolis. One of the first employees hired by the VideoNow founders, Bryce was among the core group of employees who were promised stock options and promotions if the company ever went public. Bryce is middle-aged, divorced, and has two children. Bryce drives an old beat-up car and has used all the family’s financial resources to get into a new, larger house. Relying on the promised stock options, raises, and bonuses, Bryce is now stretched to the limit and is beginning to deeply resent the company because the promised money may never materialize. Alex Rockwell, Videopolis’ CEO, has told Bryce that the marketing and sales department can make the difference in helping the company achieve its objectives. Rockwell has implemented a very attractive bonus plan for Bryce if the department achieves its objectives, but the numbers are so aggressive that Bryce feels they are unattainable.

Bryce has been concerned recently by reports that operations can’t handle the current workload, and by rumors that Videopolis has lost its edge. Bryce wonders if this is indeed the case and whether the company can grow at all, let alone by the 100 percent target number set by the new CEO. Bryce’s sales force is also young, inexperienced, and not very familiar with the company’s products. Bryce has been driving the sales force very hard in an effort to reach the company’s goals (and because Alex has made several threats referring to Bryce’s “lack of motivation”). Bryce senses the tension in employee morale, but doesn’t know how to address the issues. Bryce was a pivotal employee who helped make the company successful through hard work and wonders why, instead of rewards and recognition, the new management delivers orders to work even harder.

In response to Bryce’s incessant pushing, in order to book sales the sales reps are stretching the truth and making promises that the company can’t keep. Although Bryce personally hates this practice, it does bring in customers who later learn what Videopolis can actually do, and usually stay with the company (once Bryce meets with them to do “damage control” and pacify them). Videopolis has also started doing business with unfamiliar companies that have high demands for secrecy and privacy. Unfortunately, promises to satisfy their demands remain unfulfilled due to limitations in current technology. Videopolis’ most profitable product is the “Broadcast Series,” which involves playing feature-length videotapes and broadcasting the signal around the world. Unlike many of the company’s other products, the Broadcast Series is not interactive, so aside from equipment costs, it’s virtually pure profit for Videopolis.

Yesterday Bryce received an e-mail from M.J. Marshall, the company’s chief legal counsel, indicating that there may be intellectual copyright infringement issues with the Broadcast Series and some of the firm’s contracts with customers. The attorney has called a meeting with all of Videopolis’ upper managers tomorrow to discuss the issues. The CEO has indicated that the vice president of human resources also wants to address some employee issues at the meeting. Bryce hopes that the meeting does not relate to the sales force’s tendency to stretch the truth to customers, because Bryce has really stretched both company policy and personal morals in order to achieve the high goals. Bryce is not looking forward to the meeting.
Alex Rockwell, CEO

(Only the student assigned to this role reads this page)

Alex Rockwell was brought in by TeleWide as the CEO of Videopolis at the time of the VideoNow buyout. Alex is a young executive whose entire seven-year professional career has been with TeleWide. Upon graduation from the University of New Hampshire with a B.S. in Marketing and an MBA, Alex began working in TeleWide’s marketing department and quickly worked his way up within the organization.

Prior to taking the reins at Videopolis, Alex had a successful two-year stint as the CEO of a small voice messaging company that had also been acquired by TeleWide. After making some cuts and refocusing the staff, Alex was able to turn a mediocre company into a very profitable one. Because of the cuts, some of the voice messaging company’s employees began to refer to Alex as “Hacksaw” which gave Alex a strange sense of pride because it suggested that Alex had the guts required to make unpopular but necessary decisions to make the company profitable.

Alex believes that this appointment to Videopolis will be the final stage of professional grooming prior to landing a corporate vice presidency at TeleWide itself, with its greater responsibility and prestige. After observing other successful executives being appointed to posh TeleWide corporate positions, Alex believes that two to three successful years at Videopolis will guarantee Alex’s own appointment to one of these coveted positions.

Alex is a loyal TeleWide employee to the bone. When a corporate mandate came down to increase revenue by a minimum of 50 percent, Alex confidently replied that anything less than 100 percent would be unacceptable. Alex claimed to have studied Videopolis’ bottom line and determined that it was simply not being run efficiently. In reality, Alex had made this assessment by gut feeling, without taking the time to actually sort though the figures in order to identify areas for improvement and savings. Alex gauged the average company employee to have little sense of urgency and observed many unnecessary (in Alex’s opinion) tasks being performed. Thinking a fear tactic would be the best method to achieve results, Alex has been on a fifteen-month rampage to get the desired bottom-line numbers. The word around Videopolis is, “it’s Alex’s way or the highway.” Through terminations and employee turnover, more than half of the current staff has tenure of less than one year. Now it seems that Alex has a problem with the firm’s chief legal counsel, M.J. Marshall. Alex feels that M.J. is too young and lacks the drive to do what it takes to get things done the Alex Rockwell way; perhaps M.J. should be the next one to be “Hacksawed.”

Alex is quite excited about Videopolis’ new Broadcast Series of programming. The product involves an employee putting a feature-length tape into a DVD (at the request of a client) and, with a few mouse clicks, broadcasting the requested program to various videoconferencing facilities throughout the country. The margins on this service are very high, and Alex believes that expanding the service could greatly assist the company achieve its goal of a 100 percent increase in revenue. Unfortunately, he questioned the legality of the service from its inception.

Alex recently received a vague e-mail from M.J. Marshall requesting a meeting to discuss potential legal problems that could be brewing within the company. Upon learning of the meeting, Sam Arnold, the company’s vice president of human resources, asked that employee issues be placed on the agenda as well. Alex is deeply concerned because potential lawsuits of any magnitude or employee dissatisfaction could dramatically affect the bottom-line numbers and Alex’s chances for a corporate V.P. position at TeleWide.
M.J. Marshall, Chief Legal Counsel
(Only the student assigned to this role reads this page)

M.J. Marshall is the bright young attorney hired by VideoNow’s founding partners to act as their chief counsel just before the TeleWide buy out. M.J. is single and has been practicing law for just a few years. Before coming to work at VideoNow, M.J. was on the fast track to a partnership in a firm that specialized in intellectual property and copyright protection. M.J. jumped at the opportunity to be chief counsel at an interesting high-tech company that offered better than average pay and the potential for stock options. Soon after being hired by VideoNow, M.J. purchased a new sports car and a loft in a renovated warehouse in the trendy downtown area. When VideoNow was bought out by TeleWide, M.J. was one of the few employees who retained their original salary and received stock options in Videopolis. Being the chief counsel, M.J. was concerned about making a good impression on the new owners, not to mention the much needed salary to cover a large student loan, mortgage, and car payments.

Things have finally settled down after the merger, and M.J. is just now reviewing the contracts signed by VideoNow’s founders in order to identify problems. Many of the old VideoNow deals were open ended, based on a handshake, and some had strange provisions especially concerning copyright violations. M.J. has identified some specific concerns about the company’s Broadcast Series. M.J. has received complaints from some employees regarding the tapes that are being broadcast over company lines. Being familiar with the laws surrounding intellectual property and copyright protection, M.J. suddenly realizes that Videopolis could be liable for copyright infringement if the copyright owners view the broadcasts and recognize their programs as unauthorized copies. M.J. also knows that the federal government has been threatening to crack down on Internet companies for violations of copyright laws. M.J. learned a great deal about intellectual property issues and laws at the law firm and knows that intellectual property losses in the United States total more than $11 billion a year in lost revenue from illegal copying. In order to protect against such losses, the United States has enacted copyright laws, including the Digital Millennium Copyright Act, to protect original works in text form, pictures, movies, computer software, multimedia, and audiovisual formats. Although M.J. recognizes that these issues must be dealt with, M.J. also knows that the Broadcast Series is the CEO’s baby and that Alex will be very sensitive to any changes in the profitable program. Nonetheless, these issues could potentially be time consuming and very costly to Videopolis.

To add to the pressures M.J. faces, the CEO has hinted to M.J. that if the situation is not managed satisfactorily, TeleWide will bring in a new legal counsel who can satisfy the company’s needs. Recognizing the need to get a handle on the situation, M.J. has decided it is time to call a meeting with the top executives. M.J. dreads the meeting, knowing it could affect a number of employees, but believes that these issues must be brought out into the open.
Jerry Abacarian, Vice President of Operations

(Only the student assigned to this role reads this page)

Jerry Abacarian, another holdover from the old VideoNow days, is the vice president of operations for Videopolis. Jerry came to the United States from the Middle East in search of riches and cherishes the newfound successful American lifestyle. Jerry has come a long way from humble beginnings as the child of a goat farmer. Jerry is married and has two teenage daughters. The girls attend the most prestigious private school in the community. Jerry hopes that the investment in their primary education will pay off because the family has not saved enough money to send both girls to college. Jerry spares no expense for the family, buying the best quality merchandise. A recent acquisition is a Mercedes 560 SC, he bought on credit through a financing company. Jerry’s family is never seen in anything that could be considered middle class and looks down upon people who do not meet their social standards. Now approaching middle age, Jerry worries about what the future holds for a person who has really not done an effective job of saving for either the future or retirement.

As an upper manager at VideoNow, Jerry was promised future benefits such as stock options and a dramatically increased salary. Jerry feels betrayed by the founders, believing they sold VideoNow employees out for a fast buck and left them stuck with inadequate salaries and minimal chances for attaining a higher financial status. Thus, Jerry’s loyalty to the new company is in question, and Jerry is looking for any way to obtain the promised compensation. The only means for Jerry to reach the expected compensation level is to achieve the new objectives and, hopefully, receive the huge promised bonus.

Since the merger, Jerry’s job has become increasingly demanding as the pressure of the day-to-day operations has increased dramatically. In Jerry’s opinion, the company is attempting to book too many sales, creating unrealistic daily and quarterly objectives, and forcing the staff to work harder than ever. Many key subordinates and lower-level employees have already left the company for more stable and rewarding work environments. With the loss of these individuals, the operations department is having trouble retaining competent employees. The high turnover and generally lower level of knowledge among the remaining work force mean that many of the repetitive and simple tasks, which were always taken for granted in the past, are no longer getting done. For example, employees are being told to put the tapes in the correct slot, without previewing them for copyrighted material, as was standard practice at VideoNow. Employees are supposed to follow orders because, according to top management, they will never understand what they are supposed to do anyway.

Before leaving for home, late as usual, Jerry received an e-mail from M.J. Marshall, the chief legal counsel, asking Jerry to attend a meeting with the executive staff. The e-mail did not specify the meeting’s agenda but hinted about some potential legal liabilities that Videopolis may face. Jerry isn’t aware of any possible legal problems, but welcomes the opportunity to meet with the executive staff. Sam Arnold apparently also wants to talk about employee issues at the meeting, and Jerry hopes this means the end of the hiring freeze, so that he can bring in some more qualified people and give his overworked staff some relief. Things simply cannot continue as they have for much longer.
Sam Arnold, V.P. of Human Resources
(Only the student assigned to this role reads this page)

Sam Arnold was hired in 1997 as the new vice president of human resources after the previous V.P. quit when, after the merger, the corporation failed to address promised pay raises and stock options. This management position was the only one to be filled after the hiring freeze went into effect. CEO Alex Rockwell hired the inexperienced Arnold instead of a seasoned HR manager in an effort to reduce costs.

Sam graduated from Ohio State University in 1995. After two years at a pharmaceutical firm, Sam was ready for a change. Sam was familiar with the company after using its services, and was strongly interested in working for a high-tech firm. Sam was not promised the same stock options, raises, and bonuses that other employees were, but Sam had other motives for taking the position. Sam felt that Videopolis represented an excellent opportunity to learn about, and ease into, the high-technology industry. After two years with this corporation, Sam plans to enroll in the Computer Information Systems Masters program at Colorado State University.

A month into the new job, Sam began to understand why the former V.P. quit. Recently, Sam has been completing several employee termination packets every month. Most are former VideoNow employees who cite broken promises as their reason for quitting. It seems to Sam that Videopolis is hemorrhaging employees, and the business is really starting to suffer from the high turnover. The company simply cannot continue at this rate without lifting the hiring freeze.

In addition to the high turnover, Sam recognizes that many employees are disenchanted, demoralized, and ready to quit. The climate at Videopolis has become negative, and many people dread coming to work. Employees often speak of questionable management practices, possible copyright infringement, and a nearly desperate need for better compensation. Most of these complaints have come from employees in marketing and sales and the operations divisions. As the vice president of human resources, Sam hears their complaints and understands the situation better than anyone.

Recently, M.J. Marshall, the company’s chief legal counsel, sent out e-mails to all top managers calling a meeting to discuss possible copyright infringement issues. Unfortunately, Sam feels that Videopolis’ problems aren’t that simple. Accordingly, Sam has contacted the CEO, Alex Rockwell, to add human resources issues to the meeting agenda. Although the copyright issues are important, Sam feels that the people issues warrant greater attention because, without satisfied employees, nothing will get accomplished.
TO: ALEX ROCKWELL (Annie Hodges)
FROM: M.J. MARSHALL (Louann De Coursey)
RE: MEETING 2/1/XX

Alex,

After meeting with Sam, Jerry, Bryce, and you on Thursday, Videopolis’ positions became much clearer, and I know that we can resolve many of the issues facing this company.

The following is an overview of the decisions made. We can proceed with delegating the various jobs later today and establishing a more concrete timeline.

In regard to the employee issues:

- We will lift the hiring freeze in order to meet production/sales goals. Jerry is already coordinating recruiting efforts with Sam, in order to start hiring immediately, so that production goals can come closer to sales goals this quarter.
- All new employees will work under a tiered salary system with set benefits, bonuses, and stock options. Previous employees will be placed appropriately on the scaled system also with benefits, bonuses, and stock options. The longer you work for the company the more benefits you will receive. Bonuses will be linked to concrete goals such as performance, sales, or efficiency and will no longer be arbitrarily given.
- We will schedule a companywide meeting to explain the new system and that previous promises made with TeleWide are no longer valid but, under the new system, they should be receiving comparable compensation in pay bonuses and stock options.
- The employee handbook will also be redesigned to include the new salary and benefits package.
- Sam has already started addressing these issues with the HR team.

In regard to the copyright issues:

- My team is developing two contracts, one for employees to sign and one for the customer that includes copyright infringement issues as well as forbidding the copying of any portion of the programs by the customer.
- We will add a statement at the beginning of all videos warning the viewer of any potential violations.

* Used courtesy of Louann De Coursey.
• HR is working on a job description to create tech support personnel to control the systems at job sites. We will change the pricing structure to keep the same profit margins, but the customer will be receiving better customer service.

There are a few other loose ends we need to tie up in regard to the Digital Millennium Copyright Act to ensure compliance, and the legal team is reviewing those issues right now.

We also need to schedule the company meeting ASAP to start changing the negative climate.

Let’s schedule the meeting for later this afternoon or tomorrow to set a timeline and delegate jobs. One other topic we need to discuss is the Federal Sentencing Guidelines for Organizations. Under these guidelines we need to evaluate several things including our standards regarding misconduct (consistent enforcement, training, systems to report), our communication with the staff, our mission/ethics statement, as well as looking at our levels of oversight and how authority is being delegated. I think we need to create the position of an ethics officer either within the HR department or the legal department, or even a team of two from both departments to develop our responses, monitor the guidelines, and create ways to improve our systems. I will have a report on where we stand currently on the guidelines at the meeting. We need to have a system with standards in place by the employee meeting, and we will need to have the systems in the employee handbook. This is something we cannot ignore!

MJ

CC: Sam Arnold (Lara Bruger)
    Jerry Abacarian (Shannon Quinn)
    Bryce Kerwin (Jeff De Weese)
This education and training tool focuses on the issue of sexual harassment in the workplace. Specifically, this role play exercise involves a jury deliberation on a sexual harassment case brought before a civil court. Although the case is fictitious, actions and parameters have been drawn from recent court cases in the United States. The jury situation creates a high level of responsibility and accountability and ensures participant motivation and interest. In order to enhance the learning experience, however, the exercise incorporates elements not normally allowed in jury deliberation or case resolution procedures. For example, jurors are instructed to provide recommendations on preventing sexual harassment in the future. The exercise can be used with groups of any size, as it is possible to develop multiple juries and/or to include observers in the process.

The primary purpose of the sexual harassment exercise is to provide an opportunity for trainees to consider the process, content, and outcomes of sexual harassment in the workplace. Through this exercise, participants will engage in group decision making on a complex and controversial topic in business and law. After completing the exercise, participants should be able to (1) describe current sexual harassment law and its interpretation, (2) delineate various actions that may constitute sexual harassment in the workplace, and (3) recommend remedies and mechanisms for preventing sexual harassment.

* The research and conceptual assistance of Michael Benstock, Catherine Horton, Terry Lupo, Kevin Sample, Stephen Stumpf, Gwyneth V. Walters, and Linda Wright is gratefully acknowledged.
OTHER ISSUES ON SEXUAL HARASSMENT IN THE WORKPLACE

(Only instructor reads)

Prevention is the best tool to eliminate sexual harassment in the workplace. Employers are encouraged to take necessary steps to prevent sexual harassment from occurring. Companies should communicate clearly to employees that sexual harassment will not be tolerated. They can do so by establishing an effective complaint or grievance process and taking immediate and appropriate action when an employee complains.

Recent U.S. Supreme Court decisions indicate the degree to which organizations and managers are responsible for detecting and preventing sexual harassment on the job. For example, the U.S. Supreme Court recently held that “an employee who refuses the unwelcome and threatening sexual advances of a supervisor, yet suffers no adverse, tangible job consequences, can recover against the employer without showing the employer was negligent or otherwise at fault for the supervisor’s actions.”

In addition, the court has also indicated, “An employer is subject to vicarious liability to a victimized employee for an actionable hostile environment created by a supervisor with immediate (or successively higher) authority over the employee. (The employer’s) defense comprises two necessary elements: (a) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and (b) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.” In the past, sexual harassment lawsuits were dismissed by federal judges because the employer argued it was unaware of the harassment.

The U.S. Supreme Court recently made it easier for victims to win sexual harassment lawsuits against an employer if the supervisor is guilty of sexual harassment. The Court held that an employer is liable under the Federal Civil Rights Act for any harassment by a supervisor that results in a tangible job detriment. If the harassment doesn’t result in a tangible job detriment, the employer is still liable but the jury may consider in defense that (1) the employer used reasonable care to prevent and correct harassment, and (2) the employee unreasonably failed to complain.

SIMULATION FOUR

Sexual Harassment: Cordoza v. Foodservice, Inc., Creative Marketing Solutions, and Harrison*

JURY INSTRUCTIONS

(Everyone reads)

This exercise examines the issue of sexual harassment in the workplace through a simulated jury deliberation on a case brought before a civil court. Although the case is fictitious, actions and parameters have been drawn from recent court cases in the United States. The exercise incorporates elements not normally allowed or required in jury deliberation and case resolution procedures. Please follow these instructions for the jury deliberation and process:

1. Elect a foreperson. The foreperson ensures that all jurors have the opportunity to participate in discussions, keeps the jury focused on the task at hand, and reports on the jury’s recommendations at the end of the exercise.

2. Read the following: Facts About Sexual Harassment, Recent Court Decisions, and Case for Deliberation.

3. The instructor will assign one of three outcomes for your jury to accomplish. Thus, you will evaluate both guilt and possible damages for (a) all defendants as a group, (b) all defendants considered individually, or (c) one defendant as assigned by the instructor.

4. Based on the readings, begin the process of determining (a) guilt of the appropriate party or parties through a majority vote; (b) any damages to be awarded to the plaintiff; and (c) other recommendations, such as training in the workplace, counseling, policy development, etc.

* The research and conceptual assistance of Michael Benstock, Catherine Horton, Terry Lupo, Kevin Sample, Stephen Stumpf, Gwyneth V. Walters, and Linda Wright is gratefully acknowledged.
Facts About Sexual Harassment

(Everyone reads)

- Sexual harassment is a form of sex discrimination that violates Title VII of the Civil Rights Act of 1964.
- Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitutes sexual harassment when submission to or rejection of this conduct explicitly or implicitly affects an individual’s employment, unreasonably interferes with an individual’s work performance, or creates an intimidating, hostile, or offensive work environment.
- Sexual harassment can occur in a variety of circumstances, including but not limited to the following:
  - The victim as well as the harasser may be a woman or a man. The victim does not have to be of the opposite sex.
  - The harasser can be the victim’s supervisor, an agent of the employer, a supervisor in another area, a coworker, or a nonemployee.
  - The victim does not have to be the person harassed but could be anyone affected by the offensive conduct.
- Unlawful sexual harassment may occur without economic injury to, or discharge of, the victim.
- The harasser’s conduct must be unwelcome.
- It is helpful for the victim to inform the harasser directly that the conduct is unwelcome and must stop. The victim should use any employer complaint mechanism or grievance system available.
- When investigating allegations of sexual harassment, the Equal Employment Opportunity Commission looks at the whole record: the circumstances, such as the nature of the sexual advances, and the context in which the alleged incidents occurred. A determination on the allegations is made from the facts on a case-by-case basis.

Court Decisions

(Everyone reads)

Meritor Savings Bank v. Vinson
Prior to this 1986 case, sexual harassment was not a specific violation of federal law. In this case, the Supreme Court ruled that sexual harassment creates a “hostile environment” that violates Title VII of the Civil Rights Act, even in the absence of economic harm or demand for sexual favors in exchange for promotions, raises, or related work incentives.

Harris v. Forklift Systems
Teresa Harris claimed that her boss at Forklift Systems made suggestive sexual remarks, asked her to retrieve coins from his pants pocket, and joked that they should go to a motel to “negotiate her raise.” Lower courts threw out her case because she did not suffer any “severe psychological injury.” The Supreme Court overturned these decisions and ruled that employers can be forced to pay damages even if the worker suffered no proven psychological harm. This case brought about the “reasonable person” standard in evaluating what conduct constitutes sexual harassment.

Ford Motor Company
Ford Motor Company settled a class-action lawsuit for $7.75 million, the fourth largest sexual harassment settlement in the Equal Employment Opportunity Commission’s history, after 1,600 female employees at two different Ford plants claimed they were groped and sexually harassed. The settlement also requires that the company spend an additional $10 million on sensitivity training programs.

Mitsubishi
Mitsubishi Motors agreed in 1998 to pay $34 million to settle lawsuits with 350 women. Their allegations of sexual harassment included the distribution of lewd videos and photos, inappropriate conversation and jokes, and general tolerance by management for these actions and overtones. As part of the settlement, the company agreed to periodic monitoring by a three-member panel and implementing an effective sexual harassment policy.

U.S. Supreme Court Rulings
Recent U.S. Supreme Court decisions on sexual harassment cases indicate that (1) employers are liable for the acts of supervisors; (2) employers are liable for sexual harassment by supervisors that culminates in a tangible employment action (loss of job, demotion, etc.); (3) employers are liable for a hostile environment created by a supervisor, but may escape liability if they demonstrate that they exercised reasonable care to prevent and promptly correct any sexually harassing behavior and that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective measures offered by the employer; and (4) claims of hostile environment sexual harassment must be severe and pervasive in order to be viewed as actionable by the courts.
Case for Deliberation*

(Everyone reads)

**Plaintiff: Michelle Cordoza**

Michelle Cordoza, a former account executive with Creative Marketing Solutions, has filed a sexual harassment suit against the defendants named below. Before joining Creative Marketing Solutions, Ms. Cordoza worked in sales and marketing at several firms in another city. As an account executive with Creative Marketing Solutions, the plaintiff served as a liaison between her employer and several client accounts, including FoodService, Inc., one of the defendants. Ms. Cordoza’s duties also included determining clients’ marketing needs, designing proposals and projects to help them reach their marketing and business goals, and building professional relationships with key decision makers throughout the process. Like all account executives, Ms. Cordoza was expected to spend a great deal of time with client representatives, including socializing at dinners and other activities. Account executives at Creative Marketing Solutions handle about three major accounts at any one time and earn between $50,000 and $65,000 a year.

The plaintiff was employed by Creative Marketing Solutions for one year, during which time she received below-average evaluations. Specifically, supervisors documented instances in which Ms. Cordoza ignored company operating policy and directives. For example, she occasionally “over-promised” with respect to the delivery of marketing collateral and reports to clients. These promises created tension in the office.

**Defendants: FoodService, Inc., John Harrison, and Creative Marketing Solutions**

FoodService, Inc. is a distributor of fresh and prepared foods, kitchen equipment, supplies, and related products to restaurants, cafeterias, and other food service outlets in the United States. The company was founded in 1965 by William and Henry Creighton and went public in the mid-1990s. FoodService, Inc. has 755 employees and annual sales of approximately $58 million. The company has a sexual harassment policy that is discussed with all new employees during their initial orientation session (see attached document). All employees must certify that they have read and understand the sexual harassment policy.

John Harrison is currently the director of marketing at FoodService, Inc. He has been with the company for ten years and has received consistently favorable employment evaluations. He is considered a valued member of the FoodService “family,” as his uncle worked with the company during the 1970s and early 1980s. As part of his duties, Mr. Harrison is expected to be active in community events, professional associations, and other client-building opportunities.

Creative Marketing Solutions, a marketing and business communications agency with 75 employees, is Ms. Cordoza’s former employer. The company was established in 1984 and is owned by Anna Carlyle and Joseph Ruiz. Known as an aggressive competitor, Creative Marketing Solutions has received numerous awards for its marketing campaigns. The agency has also been recognized by the community for providing its services free of charge to several area nonprofit organizations. The company cites the importance of “respect for all persons” in its vision and mission statement (see attached document), but does not have a formal policy on sexual harassment.

* Names, organizations, and situations used in this description are fictitious, although case elements are consistent with real court cases and documented claims about sexual harassment.
Case Facts:

Ms. Cordoza alleges that, over the course of eight months, her work relationship with John Harrison and other employees at FoodService, Inc., involved sexual harassment. She claims that both Creative Marketing Solutions (her employer) and FoodService, Inc., (Mr. Harrison’s employer) were aware of this harassment, but failed to take the proper steps to remedy the situation. She has therefore filed for damages in a civil court.

Mr. Harrison, the current director of marketing for FoodService, Inc., testified that he and Ms. Cordoza developed a close friendship during the development and implementation of several marketing campaigns. Because Ms. Cordoza was new to town and had indicated that she was looking for ways to network in the business community, Mr. Harrison agreed to introduce her to people and to invite her to business events. He felt that she was a likable person who would benefit from networking within the community.

Ms. Cordoza alleges that the sexual harassment began on Tuesday, November 2, several weeks after Creative Marketing Solutions and FoodService developed the first marketing program. Mr. Harrison and Ms. Cordoza attended an evening networking reception hosted by the Chamber of Commerce. After the event, they went to dinner at a restaurant across the street from the reception hall. According to Ms. Cordoza’s testimony, Mr. Harrison insisted on paying for dinner. Although she offered several times to pay for her share of the meal, she finally relinquished because she did not want to make Mr. Harrison uncomfortable. After dinner, Mr. Harrison walked Ms. Cordoza to her car, with his hand touching her back as they crossed a busy intersection.

Ms. Cordoza and Mr. Harrison continued to meet on a weekly basis at the offices of FoodService, Inc. The meetings, which normally included several people, involved discussions of various marketing strategies to help FoodService, Inc., reach its sales and market share objectives. Mr. Harrison testified that he and Ms. Cordoza became good friends as a result of their working relationship. In many sales encounters and phone calls, they often chatted about personal issues before discussing business. In one phone call, Ms. Cordoza complained about the “lack of eligible men” in the city and asked Mr. Harrison if he knew of any. Mr. Harrison, who is single, indicated that he found her “interesting and attractive” and told her that he would like to take her to dinner and the musical *Kiss Me, Kate* when it opened at the local performing arts center. Ms. Cordoza testified that she declined this invitation because she was not attracted to Mr. Harrison. However, she told him that she “was busy that weekend and really did not like musicals that much, anyway.” Ms. Cordoza later told several colleagues about Mr. Harrison’s invitation and wondered whether the date could have improved the amount of business that FoodService, Inc., was doing with Creative Marketing Solutions. Her supervisor, Darren Walters, laughed and said, “You know what we always say—anything to please the client. Maybe you ought to reconsider that date.”

Their working relationship continued, with FoodService, Inc., nearly reaching the market share and sales objectives it established for the year. Mr. Harrison testified that he was under increasing pressure to produce better marketing results. He also stated that the firm’s vice president of sales and marketing, Bob Creighton, had asked him to look for “larger, more professional” providers of marketing and communications advice, meaning that Creative Marketing Solutions could lose the account. Mr. Creighton had also questioned Ms. Cordoza’s experience, stating that she looked very young and probably did not have the expertise to manage a large national account. Mr. Harrison told Ms. Cordoza about this because he “liked her and wanted to save the account relationship.” She became worried about the situation, especially since she was relatively new to the job and did not want to lose a major account. Ms. Cordoza also testified that it troubled her that Mr. Creighton would question her competency, particularly since FoodService, Inc., had been an integral part of all marketing planning and was equally to blame if marketing objectives were not reached.
In order to appease the vice president, Mr. Harrison talked with several other marketing firms. He also invited Ms. Cordoza to a company picnic so that Mr. Creighton and other executives could meet her and feel more comfortable with Creative Marketing Solutions’ work. She accepted the invitation, hoping that a more casual atmosphere might give her the opportunity to salvage the relationship. The Saturday picnic was an annual event that started with activities for employees’ children in the early afternoon. After sunset, the children left, and a band started playing upbeat dance songs. Everyone was encouraged to sample the “Rum Runners,” a drink made with liquor and fruit juice.

Ms. Cordoza testified that she spent some time talking with Mr. Harrison and several managers and executives from FoodService, Inc., at the picnic. She was pleased to get to know them better, and Mr. Harrison indicated she was making a good impression. When he asked her to dance, she thought, “Why not, it’s just a dance.” As they approached the dance floor, the band started playing a slow, romantic song. Mr. Harrison pulled Ms. Cordoza close to him, then rubbed her back and nuzzled her neck during the dance. After they returned to the table, Jay Weiss, a FoodService manager, commented, “You two look like real naturals out here. Have you practiced before tonight?” Mr. Harrison leaned over and whispered something to Mr. Weiss, who nodded and then laughed. Ms. Cordoza tried to find out what was said, but was greeted with “drunken laughter” and jokes about how well she and Mr. Harrison danced together. After a few minutes, she told the group that she was tired and needed to go home. Most people at the table insisted she stay, with Mr. Creighton, the vice president, saying, “Look Sweetie, you’ve had a few Rum Runners. Why don’t you stick around and convince one of your best clients to stay with Creative Marketing Solutions?” Ms. Cordoza left immediately.

On Monday, Ms. Cordoza talked about the FoodService, Inc., picnic with some of her colleagues at Creative Marketing Solutions. When she asked if they had encountered similar situations, she learned that client interactions did occasionally take a sexual turn. Mr. Walters, her supervisor, asked, “Why are you so sensitive? It’s in everyone’s best interest if you just forget about the picnic and things said about you. Look, this is a tough business. If you don’t do all you can to keep FoodService, another agency across town will surely get their contract. We just lost a big account last week. I don’t think Anna and Joseph would be pleased to know that you botched the FoodService relationship.”

Later that week, Ms. Cordoza met with Mr. Harrison at FoodService, Inc., to discuss the next steps on the marketing contract. She felt a bit intimidated going into the headquarters building. As she entered the conference room, she knew the account was already lost. Along with Mr. Harrison sat Mr. Creighton and other managers. They explained that because Creative Marketing Solutions had not fulfilled expectations, they were putting the account in play for other proposals.

Ms. Cordoza testified that she drove back to her office in a daze. She had been with Creative Marketing Solutions for less than a year and already, she had lost a major account. It was nearly time for her next evaluation. She knew that her supervisor and the company owners were not going to take this lightly because it was the time of year that rarely brought new clients.

After collecting her thoughts, Ms. Cordoza walked into her supervisor’s office. She explained that FoodService, Inc., was putting its account into play. Mr. Walters wanted to know why she lost the account, especially since they had discussed its importance earlier that week. Mr. Walters also inquired about problems on another account, where once again the advertising production department was having trouble meeting deadlines that Ms. Cordoza had promised a client. The conversation ended with Mr. Walters suggesting that Ms. Cordoza start looking for other employment options.

Ms. Cordoza testified that she has not found new employment and is currently under treatment for depression and anxiety related to the situation. As a result, she filed a civil suit against FoodService, Inc., Creative Marketing Solutions, and Mr. Harrison, alleging that all three contributed to a hostile work environment that included little regard for Ms. Cordoza’s rights to a sexual harassment-free workplace.
Case Exhibits:

FoodService, Inc.

Sexual Harassment Policy

It is our policy to promote a productive and respectful workplace. We will not tolerate any employee conduct that harasses, disturbs, or interferes with another employee’s performance or that creates an offensive or hostile environment. No harassment will be tolerated, including that based on race, religion, marital status, age, gender, ethnicity, or sexual overtones.

All employees have the responsibility to maintain a harassment-free workplace. Supervisors and managers carry additional accountability in this regard. For example, no supervisor or manager is ever to threaten or insinuate that an employee’s refusal or willingness to submit to sexual advances will affect employment. Other sexually harassing or offensive conduct in the workplace, whether committed by supervisors, managers, or nonsupervisory employees, is also prohibited. Examples of prohibited conduct include: (1) Unwanted physical contact of any kind, (2) Verbal harassment of a sexual nature, and (3) Display of demeaning, insulting, or sexually suggestive objects or pictures.

An employee who experiences, witnesses, or learns of a potential violation of this policy must report it to the Human Resources office or through the confidential employee help line. Any of the above conduct, or other offensive conduct, may result in employment termination.

I have read the sexual harassment policy and agree to abide by its provisions as a condition of my employment at FoodService, Inc.

Employee Name (printed)    
Signature  
Date  

Creative Marketing Solutions

Excerpt from Vision and Mission Statement

*Effective communication is our business. This requires an unwavering trust between Creative Marketing Solutions and our clients, respect for all persons involved in the communication process, and a dedication to meeting client needs first.*
TEACHING OVERVIEW ON DEER LAKE MARINA: FOREVER PROUD?

Deer Lake Marina: Forever Proud is a relatively complex role-play exercise that requires students to complete outside team work and research. The exercise addresses the complicated intersection of private and public interests in environmental protection. In this exercise, students take part in a meeting to determine whether Deer Lake Marina should expand and build a restaurant, boating supply store, and boat repair and service facility on potentially environmentally sensitive land and water. The exercise requires three small teams representing (1) marina owners, (2) the Deer Lake Forever Proud community group, and (3) the County Council. Multiple simulations can be run in the same class.

1. Determine how the exercise roles will be assigned. There are three roles (i.e., marina owners, Deer Lake Forever Proud, and County Council) that should be played by small teams of three or four students each. Multiple teams with the same role can be used in a class, as long as each “meeting” takes place between the three roles.

2. Make copies of the role-play exercise pages (one copy of background page for each student; one copy of each role for each team assigned that role).

3. Have each student read the background page as an introduction to the exercise and give each team a specific role description to review.

4. Indicate that each team is to develop a position paper and short presentation on its role, stake, and views on the environmental situation.

5. Instruct teams to work on their position papers and presentations outside of class. Students will need to conduct research, brainstorm, and create persuasive, concise, and reasoned positions before attending the meeting. Students will need to learn more about possible arguments for and against their viewpoints by perusing news articles, government web sites, and other information sources.

6. Set aside class time for each meeting to take place between the marina owners, Deer Lake Forever Proud, and County Council. Each team should make a brief presentation (5-7 minutes) to the County Council.

7. After the marina owners and Deer Lake Forever Proud have presented their arguments, members of the County Council should ask questions, negotiate and, ultimately, make a decision on the expansion proposal. The county must approve building permits and other business activities involved in the expansion.

8. If multiple exercises are used in the same class, let each group report to the entire class on the outcomes and decisions made in its respective meeting.

9. Create feedback mechanisms appropriate for the desired outcome (e.g., grade the papers for persuasiveness and use of factual information).

10. Link exercise issues, process, outcomes, and experience to course learning objectives.
SIMULATION FIVE

Deer Lake Marina: Forever Proud?

Background

(Everyone reads)

Deer Lake Marina has been in existence since the late 1960s. The marina is located on Deer Lake, which connects to the Tennessee River. Residents of Alabama, Mississippi, and Tennessee enjoy the water and surrounding natural environment. Camping, boating, swimming, fishing, and other outdoor sports are very popular in this region. Deer Lake is located in a historic part of the United States, as the area has several Civil War battle sites. Because of the area’s beauty, mild climate, interesting cultural history, and relatively modest cost of living, more and more retirees are moving to the area. In fact, Deer Lake was recently named on a list of “best places to retire in America.” Most of the county’s development has taken place in the last twenty years; the area was somewhat economically stagnant before that time. The county encouraged rapid real estate development during the last fifteen to twenty years and has been fairly “hands-off” with respect to environmental issues.

Today, Deer Lake Marina includes 150 in-water boat slips, dry storage for 125 boats, a fuel dock, and lifts for launching boats. The owners of Deer Lake Marina hope to expand by building a large boating supply store, restaurant, and boat repair and service facility. Because the land and water space available for expansion includes a wetlands area, the marina owners obtained a permit from the Army Corp of Engineers. The next step is to secure business and building permits from the county. A public notice was issued to discuss the Deer Lake Marina application for permits. Two groups, the marina owners and the Deer Lake Forever Proud, a local conservation and historical group, have requested time to state their cases to the County Council.

Wetlands are low-lying areas saturated with water that connect land with large bodies of water. In the last 200 years, the continental United States has lost over 50 percent of its wetlands. Flooding and poor water quality are often the result of destroying wetlands. When the marina was originally built, environmental laws were virtually nonexistent. Environmental regulation has steadily increased since the 1970s, especially at the federal level. The United States Environmental Protection Agency (EPA) (http://www.epa.gov) provides information on wetlands and related projects that conserve and maintain the natural environment. The Clean Water Act provides most of the regulation on wetlands and waterways. According to its web site, the Army Corps of Engineers (http://www.usace.army.mil/) determines “which areas qualify for protection as wetlands … (and makes) decisions on whether to grant, deny, or set conditions on permits…”

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Marina Owners

(Only the students assigned to this role read this page)

Your team represents the owners of Deer Lake Marina. Your parents started the marina in the late 1960s before the area was popular with tourists from surrounding states. The marina has always operated as a family business, with strong values and a commitment to customer satisfaction. Over the past few decades, your parents have gradually built the marina into a fairly large and upscale operation. The marina’s growth paralleled the county’s development, and your parents have been very involved in the local chamber of commerce and economic development initiatives. Deer Lake Marina has a strong reputation and is active in supporting community events and programs. For example, you were the major contributor to the new Little League baseball field located less than one mile from the marina. You know many people in the Deer Lake area and are considered a valued member of the business community.

Your parents are now retired and leave day-to-day and strategic decisions to their children (your team). At this point in its life cycle, the marina needs to expand. By adding a large boating supply store, restaurant, and repair and service facility, your team will improve the marina’s prospects for meeting customer needs, ensuring future growth and profitability. The marina is barely profitable, as several newer marinas are capturing portions of the market. The store, restaurant, and repair facility will differentiate Deer Lake Marina from competitors and help serve the growing population in the area. In addition, the expansion will create new jobs and other economic effects. A local bank has agreed to fund the $950,000 expansion, which includes dredging the two acres of wetlands area, building a seawall, and constructing and partially equipping the buildings.

You each live on Deer Lake and one of you happens to live next door to a Corps of Engineers shoreline management specialist. You have been friends for many years and your families have enjoyed many seasons of get-togethers. Your neighbor issued a permit for dredging the wetlands and, by law, the permit is made public through a newspaper notice. Permit #26 from the Army Corps of Engineers allows for dredging or filling wetlands of two acres or less.

Several years ago, expansion would have been no problem. Today, environmental groups are very diligent in protecting wetlands, and the county government is increasingly concerned. You have applied for business and building permits, which are open to public comment.

Your task is to develop a concise and persuasive position in order to convince the County Council to approve your building and business permits. You will be meeting with the County Council to discuss the matter. A local community group, Deer Lake Forever Proud, is opposed to the development and will also be present at the meeting. Be prepared to effectively state your case.
Deer Lake Forever Proud

(Only the students assigned to this role read this page)

Your team represents Deer Lake Forever Proud (DLFP), a community group dedicated to environmental conservation and historical preservation. Although environmental and historical causes are not always joined, DLFP has been quite successful at developing public support for retaining the natural beauty and cultural significance of the Deer Lake area. Your team is currently working on a plan to have Deer Lake designated as a National Heritage Area.

This designation would make the area eligible for large federal grants; draw more tourists and residents to the area; and preserve Deer Lake’s past, present, and future. For example, hiking and bike trails, visitors’ centers, and ecological improvements could result from grants. A major factor supporting both the designation process and eventual outcome is the total commitment by private and public groups. In order to receive federal monies, local and state governments must also contribute. Thus, DLFP has to work with government, businesspeople, other community groups, and many stakeholders to secure support for making Deer Lake a National Heritage Area.

In addition to the National Heritage project, DLFP is involved in numerous projects around the city. The group has an environmental task force that is especially concerned about acreage bordering the lake. The lake and surrounding land are not only environmentally important, but served as a major shipping route and battleground during the Civil War. This area would have great potential as part of the National Heritage Area.

Many members of DLFP know the marina owners and appreciate their strong business sense and success. A few DLFP members have boats stored at Deer Lake Marina and can see the value of adding a restaurant, store, and repair facility. However, these members are very loyal to the DLFP and tend to side with the community group on this particular proposal. One member of DLFP recently read about the Wetlands Reserve Program (WRP), a voluntary program operated by the United States government that provides financial incentives for private property owners to enhance wetlands. Property owners agree to limit future development of the land in exchange for federal dollars and assistance in restoring and maintaining the wetland. To be eligible for the program, the land must have some wildlife benefits, farming ability, or related advantage.

Your task is to develop a concise and persuasive position on Deer Lake Marina’s application for business and building permits. Your team is opposed to commercial development in the wetlands and will be meeting with the marina owners and the County Council to discuss the proposal. Your team also has other ideas on how the area could be used to serve community goals. Be prepared to effectively state your case against the proposal and recommend an alternative to the County Council.
County Council

(Only the students assigned to this role read this page)

Your team consists of the elected officials to the County Council. You have all moved to the Deer Lake area within the last twenty-five years and are still considered “newcomers” by some members of the community. Your terms are staggered, so only one of you is facing an election in the coming year (designate who this person is). This council member was elected from the part of town that is most progressive on social issues, including environmentalism.

Deer Lake is a growing community, one that has made tremendous strides over the last two decades. The climate has been business-friendly and many new businesses have opened in the Deer Lake area. Because the economy, school system, and local government are healthy, the largest and most vocal community group has taken historical preservation and environmental conservation as its emphasis. Active members of Deer Lake Forever Proud (DLFP) include both longstanding and newer members of the community. A major project for DLFP is to get Deer Lake designated as a National Historical Area. This designation requires local government commitment and could bring large federal grants, draw more tourists and residents to the area, and preserve Deer Lake’s past, present, and future.

At a national meeting for governmental officials, you learned about the federal approach to environmental protection. Specifically, the County Council is starting to use the EPA’s community-based environmental protection (CBEP) method, whereby many stakeholders are involved in preserving, protecting, and enhancing the area’s natural environment. CBEP focuses on local issues, encourages goals that reflect many stakeholders’ views, and brings longer-term solutions. In addition, the County Council hopes to meld social, environmental, and economic objectives.

Your task is to decide whether to approve Deer Lake Marina’s application for various building and business permits. At an upcoming meeting, you will meet with the Marina Owners and Deer Lake Forever Proud to hear arguments for and against the proposal. One issue is a loosely worded state law that protects wetlands from commercial development when major damage to the ecosystem is likely. Deer Lake Marina is situated in a historically significant area but there is conflicting opinion about whether dredging two acres near the marina would cause environmental harm. The Army Corps of Engineers issued a permit to Deer Lake Marina to dredge the wetlands in the expansion process.
Teaching Overview on Parcel International Express

Parcel International Express is an international shipping and contract logistics company. PIE competes with other major shipping companies such as FedEx and DHL. The company’s goal is to practice customer orientation by developing loyalty through efficiency and quality of all services offered. While PIE must conform to all regulatory agencies in the areas that it operates, it operates in a highly competitive environment that requires employees to meet specific performance requirements. PIE therefore faces many risks related to organizational decisions, employee conduct, and external environmental issues created by numerous stakeholders.

Employee misconduct is a major area of concern for an international company such as PIE. Investigations, fines, and legal breeches have created negative publicity that can harm profits as well as damage relationships with customers. In this case, PIE is being accused by a leading labor negotiator of engaging in bribery and other forms of misconduct. Management has called a meeting to discuss ethical risk areas and what should be done to improve ethics and compliance at PIE.

**PROCESS**

1. Determine how the exercise roles will be assigned. There are five roles that should be played by teams of four or five students each. Multiple teams with the same role can be used in a class, as long as each “meeting” takes place between the five roles.
2. Make copies of the role-play exercise pages (one copy of background page for each student; one copy of each role for each team assigned that role).
3. Have each student read the background page as an introduction to the exercise and give each team a specific role description to review.
4. Indicate that each team is to develop a position paper and short presentation on its role, stake, and views on the environmental situation.
5. Instruct teams to work on their position papers and presentations outside of class. Students will need to conduct research, brainstorm, and create persuasive, concise, and reasoned positions before attending the meeting. Students will need to learn more about possible arguments for and against their viewpoints by perusing news articles, government websites, and other information sources.
6. If multiple exercises are used in the same class, let each group report to the entire class on the outcomes and decisions made in its respective meeting.
7. Create feedback mechanisms appropriate for the desired outcome (e.g., grade the papers for persuasiveness and use of factual information).
8. Link exercise issues, process, outcomes, and experience to course learning objectives.

**KEY ISSUES**

1. Handling ethical misconduct disasters
2. Developing ethics and compliance programs in multinational corporations
3. Customer relationship management
4. Managing and minimizing negative publicity
SIMULATION SIX

Parcel International Express

Background Information
(Everybody Reads)

Parcel International Express (PIE) located in Europe provides international shipping of documents and freight as well as contract logistics. PIE’s global headquarters are located in Paris and Brussels in Europe, Atlanta in North America, and Hong Kong in Asia. Major competitors include FedEx, DHL, UPS, TNT and national Post carriers such as the United States Postal Service and Royal Mail. The goal of PIE is to practice customer orientation by developing loyalty through efficiency and quality of all services offered. While PIE must conform to all regulatory agencies in the areas that it operates, it operates in a highly competitive environment that requires employees to meet specific performance requirements. PIE therefore faces many risks related to organizational decisions, employee conduct, and external environmental issues created by numerous stakeholders.

One of the major areas of risk that is impacting PIE today is employee misconduct. While prevention of employee misconduct has been a major concern, the ability to maintain compliance with laws and the avoidance of a breach of confidentiality has been difficult. As a result, investigations, fines, and penalties have created negative publicity. While negative publicity can harm sales and profits they can also damage relationships with key stakeholders including government regulatory agencies. Relationships with employees, unions, and special-interest groups are influenced by the firm’s reputation. A major concern is that employees will engage in misconduct and severely damage the firm.

Today a number of firms are living through their own version of scandals similar to the scandals at Enron, WorldCom, and others. One headline grabbing scandal after another is giving capitalism a negative image with key stakeholders. Most of the current scandals do not lead to bankruptcies, but the impact on government policy could be great. More recently there have been questions about transparency related to underhanded dealings and the undermining of public trust. Key issues of interest to the company relate to wage inequities, financial reporting, tax avoidance, and conflict of interest in carrying out corporate responsibilities.

In this case, PIE is being challenged by the alleged conduct of one of its labor negotiators. Peter Hult has been accused of bribing labor representatives with lavish trips and prostitutes. Another PIE executive, Hans Smyth was recently investigated for personal tax evasion and prosecutors raided both his home and business offices. There are also some mid-level managers that have been questioned through internal investigations, for linking business travel with personal holiday events. At the service contract level there have been incidences related to the confidentiality of customers’ personal information. Financial reporting and the use of company funds create issues on a regular basis.

An executive committee has been formed to address these issues and determining appropriate steps for both improving employee conduct and minimizing any negative publicity related to the events that have occurred. The committee includes Casey Evans, VP of Ethics and Social Responsibility, Robin Maignan, Vice President of Marketing, Loren Chanchey, VP of Operations, Sidney Dolce, VP of Finance, and Terry Nely, VP of Human Resources. Their charge is to develop a plan for improving ethics and compliance at PIE in order to deal with employee issues related to payment of bribes, conflicts of interest, financial reporting accuracy, and personal conduct that could
damage the reputation of the company. In this meeting, the objective is to identify ethical risk areas in the each area of responsibility. The goal is to make recommendations for immediate action, changes over the next six months, and finally a longer term strategic approach to improving ethical conduct related to these risk areas.
Casey Evans Vice President of Ethics and Social Responsibility
(Only the student assigned to this role reads this page)

You have been with PIE for the past 20 years. You started working in a customer contact center while you finished a college degree in management. After finishing your degree you became a front-line manager and supervised operations in a transportation center. Next, you moved to two corporate headquarters and worked in human resources. After finishing your Masters of Business Administration on a part-time basis, you developed an interest in ethics and social responsibility. You were invited to join this newly formed ethics and social responsibility department. Your concentration in social responsibility, ethics, and legal issues in your Masters program helps provide the background you need for this position. Last year, you were offered the newly established position of vice president of ethics and social responsibility.

After accepting this position, you met with the CEO about the company's priorities. His priority list included improving communication about the company’s mission and goals related to key stakeholders. At the top of his list were issues such as sustainability, green marketing, recycling, and energy conservation. Overall, the idea was to create public awareness of the company's efforts to be a responsible corporate citizen. More recently, the CEO brought you to his office and said that there are increasing concerns about employee misconduct. After a number of incidents, there is concern that employee conduct is a major risk area, and that it is having a negative impact on the reputation of PIE.

In the beginning, you thought the CEO had good intentions but felt that his true intent was to support the Vice President of Public Relations and Vice President of Human Resources in smoothing out image issues related to the company's citizenship. With the launch of a new ethics and compliance program, your job is shifting—to gain employee support for this new initiative. You're involved in designing an ethics training program and improving the ethical culture of PIE. You've been asked to come to the meeting to provide insights about approaches that could be used to prevent future misconduct. You are trying to help other key managers identify risk areas where employee misconduct has the potential to damage the reputation of the company. At the meeting you will be in charge of finalizing the list of risk areas, and communicating this information to the board of directors for their use in providing oversight of ethics and compliance at PIE.
Robin Maignan, Vice President of Marketing
(Only the student assigned to this role reads this page)

You have been vice president of marketing for the past five years. During this time, you notice that sales have been increasing at a slower rate. You are tasked with managing those numbers and driving revenue for PIE. Before joining PIE you were the marketing manager for the European division of FedEx. In this position you faced severe competition and had to work hard to make the numbers. As you have moved from positions as a middle manager and local manager you have excelled at operational and tactical plans to achieve goals set by the CEO. You have developed marketing strategies for PIE to become an industry benchmark for innovation and performance. Without new ideas the company will become stagnant and lose market share. By being innovative, the marketing department can continue to put forth the best possible performance. You don't believe that it is possible to maintain performance without being both entrepreneurial and allowing employees to be creative. You're concerned that the new requirements of the ethics and social responsibility initiatives will curtail standard operating practices that are absolutely necessary in acquiring new business and maintaining customer loyalty. You're concerned that some of the gifts, entertainment, and special events planned for customers will be questioned. You feel that salespeople must be aggressive and persuasive or they will lose out to the competition.

While you're concerned about the importance of organizational ethics, you're more concerned about being able to make the numbers. Therefore, you enter into this meeting with reservations that it will be an effort to curtail activities that are not illegal and are necessary to stay competitive. You have been asked to come to the meeting prepared to identify risk areas related to bribery, conflicts of interest, and personal misconduct that could damage the reputation of PIE. You're willing to do this but remain concerned about your ability to stay competitive.
Loren Chanchey, Vice President of Operations
(Only the student assigned to this role reads this page)

As the Vice President of Operations, you're responsible for coordinating the efforts of worldwide operations and focus on the importance of staying competitive. This past year, when profits began to slow, the CEO expressed concern that operations needed to improve its performance, because the cost of basic commodities and supplies were increasing at a rapid rate, and that there was a need to monitor and improve procurement. The value of the euro has increased, driving up the prices of services provided to companies in countries such as the United States. There is no room in your operation to slow down or fail to push employees to perform.

Last year your spouse called you a workaholic and filed for divorce. Your career and loyalty to PIE is now your main focus in life. Each month you travel to different operational facilities and witness firsthand the efficiencies that are being achieved with new technology. You have all the processes in place and do not want to disrupt the system. The new ethics and compliance program is something you don't have time to invest in, and you feel that employee misconduct is not your responsibility. You are not happy with being at this meeting because it is a threat to operational efficiency. In your position you can't afford to compromise competitive advantages in favor of performance objectives. You will be out of a job if you don't deliver operational excellence.

You have been asked to voice risk areas related to operations. Specifically there are opportunities for conflicts of interest, and in your area confidentiality of information is always a concern. Getting the best prices on purchases always creates situations where entertainment and social relationships are important. Also, in your area good employees are encouraged to be creative and everyone seems to be willing to forgive stellar performers for minor issues of misconduct. You agree to try to identify some risk areas that relate to operations.
Sidney Dolce, Vice President of Finance
(Only the student assigned to this role reads this page)

You joined PIE ten years ago after leaving the position of Vice President of Finance with a trucking company. You enjoy evaluating projects to see if they will be profitable, and deciding how to best invest the company’s money. The industry is expanding, but faces many challenges such as increasing fuel costs, as well as increases in the cost of supplies and labor.

You have found your career educational and rewarding, but very stressful. Every night you take long walks and mentally review the day’s numbers for the next day's meeting. It is hard for you to stop thinking about challenging issues related to managing the finances of PIE. As a finance person, you are used to a regulatory environment that provides rules and exact procedures to maintain compliance. In addition, you believe that if you obey the law and follow the regulations there should be no misconduct issues. You do not want to question the ethics of employees because you believe that is their concern, and not yours. In your opinion, any misconduct that occurs in the finance area can be eliminated by following the rules. The idea of an ethics and social responsibility department concerned you, because you do not believe that the cost of this operation will yield significant benefits. You're more concerned with having a good legal department, and maintaining rule-based training to maintain compliance with the law.

On the other hand, you understand that it is your responsibility to contribute to this meeting by identifying employee misconduct risk in your area. You have been asked to identify risk areas related to financial reporting accuracy and personal misconduct. You also have been told that there have been some issues related to conflicts of interest in the accounting area.
Terry Nely, Vice President of Human Resources
(Only the student assigned to this role reads this page)

You are a member of the seasoned management team. You started working at PIE in 1992, three weeks after finishing your undergraduate studies in human resource management. Being the youngest V.P. has posed several challenges including not having an equally weighted role in important decision making. Although it is negligible to outsiders, several employees have noticed your lack of clout. You have worked diligently to move up through the ranks to obtain your current position, and have a mild resentment for those who consider you and your human resources function trivial. Nobody better understands the pool of employees than you do.

Corporate culture is an important aspect at PIE, and the company’s leaders have strived to make the job enjoyable. Creativity and risk taking are both encouraged. PIE’s mission statement even emphasizes the importance of intrapreneurship (an entrepreneurship-like attitude within the company’s framework) and innovation for the company’s success. PIE has been a leader in providing employee compensation and benefits. You personally advocated the introduction of medical benefits for same-sex partners of employees, a measure that has fostered diversity since.

You know that many employees are skeptical and afraid of the potential changes. The company is going to need to address the employees’ concerns about an ethics and compliance program. In its effort to make the best decisions, in the past PIE has alienated the workers through a lack of communication.

You have been asked to identify potential risk areas in the human resource area. Specifically, you are to address conflicts of interest, wage inequities, union relationships, and personal misconduct issues in the workforce.
SUPPLEMENTAL/EXAMINATION CASES

Using teaching cases for examination purposes can help the instructor gauge a student’s depth of understanding of the material. The instructor should deduct points if the student fails to identify the key ethical issues and important stakeholders or to justify their decision relative to their stated moral philosophy base. To help instructors with this exam type, we have included three cases that can be used for exam purposes.
SUPPLEMENTAL CASE 1

Great State Wheat Flakes Can’t Be Beat*

Betty, who has been employed for three years as a copywriter for HK&M, a small advertising agency specializing in consumer packaged goods, has been feverishly working for the past week on a new ad campaign for Great State Wheat Flakes, a regionally-distributed breakfast cereal. The agency has worked with this account for several years. Although Charlie, the brand manager on this cereal, has been pleased with the agency’s work, he feels that the old positioning, which stressed taste attributes and fun-filled family breakfasts, has become tired and dated. Marketing research shows a high degree of consumer wear-out—people are bored, even annoyed, with the campaign and are ready for something fresh. Betty’s task is to rejuvenate the brand by repositioning it to take advantage of, and tie into, the health and well-being trend, specifically the current interest in physical fitness and eating “good-for-you” food. The brand was to be pitched as an important part of an active, healthy lifestyle.

Betty thought she had come up with the perfect line, “Great State Wheat Flakes will give a great start to your active day,” and she had developed what she believed were some clever scenarios for TV and print ads featuring the product being consumed after workouts in health clubs, following a morning jog, after a snowboarding expedition, and even while zipping along on a scooter (“Look Ma, no hands!”). However, upon reviewing her proposals, Charlie said that while the vignettes were on target because health-conscious customers would relate well to them, the slogan was off base. He wanted something more specific and hard-hitting. Charlie developed the theme line, “Great State Wheat Flakes can’t be beat. No other wheat flakes offer you more vitamins and minerals for fewer calories.”

Betty tried to tell Charlie that this was misleading because it implies that Great State’s brand is healthier than most, if not all, of the other brands. In reality, all wheat flake cereals are parity products—they are virtual photocopies of each other in terms of taste, texture, and, most importantly, composition and nutritional value. In fact, studies had shown that between 70 and 80 percent of consumers could not identify their favorite brand of wheat flakes in blind taste tests and that loyalty levels were low. This means that, with price incentives, consumers would switch brands readily. Charlie, obviously irritated, explained that his tag line was a perfectly acceptable exaggeration—what the advertising trade termed “puffery”—and that consumers see through it. He felt that it offered the point of difference needed to increase brand loyalty.

Betty, feeling uneasy, approached her boss Steve, the copy chief at HK&M, asking his counsel. Steve explained that Charlie’s suggested slogan was an “implied superiority” claim.

Steve explained that such claims are commonly made for commodity brands. They stake out a parity position that does not claim to be superior to, but only as good as, other brands, while using copy that suggests or implies superiority for the named brand. He cited several current and classical examples, such as “Nothing else cleans better,” “The maximum fluoride protection in any toothpaste,” “You can’t beat the savings,” “You can’t buy a more effective pain reliever,” and “Nothing is proven to work better or last longer.” In effect, these brands are hinting that they are unsurpassed. However, none claims to be

*This case was prepared Geoffrey P. Lantos, Stonehill College, and edited by Jennifer Jackson for classroom use and is strictly hypothetical. Any resemblance to real companies, situations, or persons is coincidental.
truly better than their competitors. Betty, recalling several other such implied superiority claims she had recently seen, realized that it was, indeed, a popular technique.

Steve reminded Betty that there is a distinction between deceptive advertising, which creates false impressions and misleads a consumer acting reasonably, and “trade puffery,” which is exaggerated praise of the product (e.g., Almost Home cookies are the “moistest, chewiest, most perfectly baked cookies ever”; “Nestlé makes the very best chocolate”). Puffery is viewed as acceptable in a society accustomed to superlatives. Consumers are assumed to see through the exaggeration, or at least to engage in a “willing suspension of disbelief.” He explained to her that, while deceptive advertising is illegal, the Federal Trade Commission, which monitors national advertising for accuracy and fairness in claims, views puffery as legitimate.

“What’s more,” Steve concluded somewhat sarcastically, “using your line of reasoning, Betty, we shouldn’t advertise parity products at all, since all brand advertising is designed to create a brand distinction in the buyer’s mind. Advertising is necessary to differentiate yourself from the pack of imitators. And it helps a small, underdog brand like Great State get a leg up on its big, deep-pocketed competitors.”

Betty thought that Steve’s comment might, indeed, have some merit. In fact, she feared that it might force Great State’s competitors to improve and differentiate their cereals, thereby benefiting consumers (but harming Great State). Nonetheless, she still felt uneasy. It seemed to her that the “implied superiority” claim crossed the boundary between puffery and deception.

QUESTIONS FOR DISCUSSION
1. Identify the ethical issues facing Betty regarding the nature of the proposed “implied superiority” advertising claim.
2. What are the ethical issues Betty encounters with respect to organizational relationships and conflicts?
3. What are Betty’s possible decision alternatives, and what are the ethics of each alternative?
4. Which alternative would you recommend to Betty, and why?

ANSWERS TO QUESTIONS FOR DISCUSSION
1. Some issues and suggested “talking points” raised or suggested by the characters in the case to discuss the “implied superiority” advertising claim follow.
   * Are implied superiority claims like the given examples in the case as misleading or deceptive as Betty believes, or are they merely honest exaggeration (“puffery”) which consumers will see through, as Charlie suggests? Where should one draw the line between puffery and deception? Regulatory agencies historically have recognized the legitimacy of a certain amount of puffery while ruling against deception. Puffery has been legally defined as “advertising or other sales presentations which praise the item to be sold with subjective opinions, superlatives, or exaggerations, vaguely and generally, stating no specific facts.”* Deception, on the other hand, according to a 1983 FTC ruling, occurs when “there is a misrepresentation, omission, or practice that is likely to mislead the consumer acting reasonably in the circumstances to the consumer’s detriment.”* Deception involves (1)

materially false advertising (materially false, i.e., there is a claim-fact discrepancy—not the case here) or (2) misleading advertising, whereby false subjective consumer impressions or perceptions are created—possibly the case here. Consumer research could be used to determine whether a significant number of buyers are fooled or whether they merely suspend their disbelief willingly. If consumers are fooled, the comparative claim is unethical since it misleads them. If people willingly suspend their disbelief; then no deception is involved and making a comparative claim does not violate any ethical standard.

- Because implied superiority claims are commonly used by commodity brands, as Steve notes, (perhaps by Great State’s competitors too) does that make them acceptable? A common fallacy is that something is acceptable simply because many people engage in it. Relativists (also known as situation ethicists) would say that morality can be determined by what the majority believes or by what many others are doing.

- Because puffery and implied superiority claims are legal, does that make them ethical? The legality argument raised by Steve is another common fallacy in ethical reasoning. Civil laws reflect a general consensus of what society believes is morally right. Laws can be deemed immoral and can change over time and place. Generally, the law provides a moral minimum. Thus, although the FTC allows puffery and implied superiority claims, this is not sufficient justification for their use.

- Does the fact that Great State is a small brand justify making the suggested comparison, as Steve suggests? This is a relativistic justification; in effect a rationalization. To make such ethical distinctions among players is discriminatory. Wrong behavior is wrong regardless of who or what you are.

- Does the possibility that competitors will respond to Great State’s comparison advertising by improving and differentiating their cereals, thereby benefiting consumers, justify making the suggested comparison, as Betty fears? This is utilitarian thinking (a moral act results in the greatest good for the greatest number of people), in effect asserting that the ends justify the means. If society (consumers in this case) ends up with a net gain in satisfaction, then supposedly the act is justifiable. However, ends don’t necessarily justify means.

- There are also issues regarding the advertising claims which, while not raised by any of the characters in the case, might be raised by students or by the instructor.

2. This cases raises several organizational issues. Chapter 7 notes that personal-organizational ethical conflict occurs when the values and norms taught through the socialization process contradict an employee’s personal values. Situations in which going along with coworkers and managers might conflict with an individual’s moral standards are not uncommon in business, creating a source of ethical dilemmas. Significant others are the most influential variable impacting ethical decisions in business.

Here, Betty is the conflicted employee who needs to decide whether her goals and values or those of the organization will prevail. She must decide if she will be among the approximately 40% of employees who go along with the work group on most matters (including ethical judgments), or whether she will be among the roughly 10% who stick to their own moral standards, even if they conflict with others because they believe that their values are superior to others in the firm. Students should be reminded that, even if Betty goes along with the organization, she remains personally responsible for the consequences of her behavior.

3. At one extreme, Betty could always opt to quit her job. Although quitting might be an ethical choice which could lead to increased feelings of self-esteem from doing the right thing even at a
personal cost, it might not be feasible, especially if Betty is helping to support a family, the job market is tight, she has student loans to pay back, etc.

At the other extreme, Betty could adopt Charlie’s implied superiority claim. While this allows her to keep her job and might be a demonstration of loyalty to her supervisor and the client, it compromises her moral beliefs. Furthermore, if using the suggested slogan is wrong, she could be responsible for any adverse consequences, such as deceived consumers. Claiming to be merely an agent of the organization is unacceptable legally and morally.

Betty could ask to have the account reassigned to someone else. However, since this is a small agency, reassignment might not be feasible.

Betty could argue more persuasively against using an implied superiority claim by explaining that it would be ineffective. The proposed slogan might encourage Great State’s competitors to improve and differentiate their cereals. Another argument might be that this slogan isn’t specific and hard-hitting enough, which is what Charlie wanted. She could also argue that the proposed slogan is unethical. She could suggest conducting consumer research to discover whether a significant number of consumers are fooled by the claim.

Betty could suggest that Great State improve the quality of its product and then advertise this, benefiting the company in the long run.

Betty could ignore Charlie and Steve and develop her own original copy which focuses solely on the positive aspects of Great States Wheat Flakes and hope this will please Charlie and Steve. If she comes up with something persuasive and creative enough, this might work. She will be most effective if she ties in with the active, healthy lifestyle positioning desired by the client. Another tactic might be to focus on price incentives (assuming this is profitable) since these are important to consumers.

4. Answers will vary based on individual perspective and choice.
Joe reflected on his situation at Acme Title Pawn while mowing his lawn. He had been working there for about a year, but was having ever-greater reservations about his job. During all of those years of struggling to care for his family while planning for, attending, and ultimately graduating from college, he never envisioned a career at a firm like Acme Title Pawn. He wrestled with the question of whether to quit. His doubts about the business began by the end of his very first day at work and they had only increased since then. As he went back into his house for a breath of cool air, he once again reviewed his situation.

Joe Collata was 36 years old with a wife and three children. His first full-time job was as an accounts payable clerk at a medical center. He worked there for four years. He quit that position to accept a similar position at a printing plant in the town where his soon-to-be wife was employed. He remained employed with that firm, Ace Printing, for a total of nine years until he lost his job due to downsizing. By that time, he realized that he needed a college education if he hoped to have a meaningful career with some degree of job security. While attending college part-time at night, he held a succession of jobs, none of which lasted more than a year. He was a clerk in a hospital, an appliance salesman, and an accounts payable clerk for a small manufacturing firm. Approximately one year ago he accepted the position of accounting staff member at Acme Title Pawn.

At the time he accepted the position he knew virtually nothing about the title pawn industry. He believed this firm might offer him the possibility of increased responsibility, an advantage not offered by many of his previous positions. Also, the pay was good compared to his previous positions. Six months after beginning his employment with Acme, he graduated with a degree in accounting. It had been a struggle, but Joe hoped that soon there would be a payoff. Now he found himself wondering: “is this it?”

He had become disenchanted with the title pawn industry in general and Acme in particular because of activities that he believed to be unethical. It was apparent to him that the industry preyed on the poor and uneducated. Joe had learned a bit about usurious interest rates in his business law class, but he had imagined that they were of concern only to the loan shark on the street corner. The rate on his only credit card was 30 percent annual interest on the unpaid balance, and he was not aware that interest rates could legally go much higher than that. He was truly shocked when he found out how Acme conducted business and that it was legal—for the most part.

When a customer needed a loan, Acme would lend money, holding the title of the individual’s automobile as collateral. The maximum amount Acme would lend was usually 50 percent of the car’s book value. The customer was allowed to keep driving the car as long as the specified payments were made. The standard loan was for one month with an interest rate of 25 percent compounded monthly. Therefore, if a customer borrowed $1,000 on the car, $1,250 would be due at the end of the month or the car would be seized and sold at auction to satisfy the debt. Occasionally, Acme would extend the

* This case was prepared by Roland B. Cousins, LaGrange College, and edited by Jennifer Jackson for classroom use. All names and locations have been disguised to assure anonymity. Certain other facts about the company are disguised, although this case represents an actual situation as perceived by an employee.
credit for several more months as long as the interest was paid every month. A customer borrowing $1,000 for a four-month period would have paid $1,000 in interest and still owe the $1,000 principal at the end of the fourth month. At that time, or at the end of any month when the principal remained unpaid, the vehicle could be seized.

The business of repossession can get ugly, so subcontractors were employed to perform that service in each city in which Acme maintained an office. State laws generally required that the debtor be paid the difference between the amount owed and the proceeds from the sale of the vehicle, minus any expenses incurred. Acme paid the repossessor an average of $100, a locksmith was typically paid $25, and the clean-up and sale of the vehicle at auction usually cost Acme about $75 to $100. Sometimes a transportation charge was assessed depending on the distance from the seizure location to the auctioneer.

Joe soon learned that the company occasionally did not return this excess to the debtor. If the debtor called and asked about it, a check would be sent. If the debtor did not ask, the company often did not send the check. It seemed to Joe that the decision whether or not to send the check was based on the likelihood of a complaint being made by the debtor.

The individuals who pawned their car titles generally were people who had no alternatives. Often they had bad credit or no credit, but Acme did not investigate credit if a clear title was presented. Acme seemed to be the lender of last resort for most of its clients, although Joe suspected some would find other alternatives if they understood the cost of doing business with Acme. But most clearly did not understand.

The company targeted minority groups, locating offices in poorer neighborhoods in most cities in which they did business. In Florida, Acme’s business was highly visible in Hispanic neighborhoods. The company directed its marketing efforts toward gamblers in areas likely to have down-on-their-luck gamblers, such as Nevada and the Mississippi Gulf Coast. The company presently operated in twelve states. If a state in which Acme was operating lowered the legal interest rate that could be charged to less than 25 percent per month, Acme stopped doing business in that state. Acme suspended operations in North Carolina and Kentucky for this reason.

Acme had many difficulties in the field, as one would expect, considering the nature of the business. There had been a number of armed robberies at Acme locations even though very little cash was kept on the premises. Advertising that stressed “cash for your title” might have misled would-be armed robbers, the company had toyed with the idea of emphasizing payment by check instead of cash in their ads—especially billboards—to discourage robbers. Acme had also been plagued with very high employee turnover in most branches. Occasionally, an incident of embezzlement was uncovered at a branch. No one at the home office seemed especially surprised when such activity was uncovered.

It appeared to Joe that the company did not attract very high-class personnel for any positions. Joe thought the employees at the home office where he worked did not seem to be of a much higher caliber than those employed at the branches. Once he had commented to his supervisor on what he perceived to be a lack of professionalism on the part of his coworkers. The Accounting Manager’s response was, “Of course, if there were not something wrong with each one of us, why would we work here?” Joe thought of that statement often. The founder and CEO of Acme was rumored to have mafia connections. Joe had seen no evidence of this, but it remained a widely held perception. The CEO lived in another state and was rarely seen in the office.
As Joe thought more about his situation, he concluded that he could sum up most of his reservations about working at Acme with a single sentence. It seemed that he was working for a sleazy company in a sleazy business surrounded by sleazy individuals.

Joe still believed that he would acquire responsibilities sooner at Acme than at most other firms because of the high turnover in his department. He thought it possible that he could be promoted to the controller’s position within five or six years if he continued to work as he had. Management seemed very pleased with his performance. Joe wondered, though, if his association with this firm and industry might lessen other job prospects if he stayed on. He was also concerned that his resume might portray a “job hopper.” For years he had rarely stayed longer than one year with any employer. He was concerned that leaving Acme at this time would give future prospective employers additional reason to question his stability. Several more years at Acme would strengthen his resume both in terms of the higher-level responsibilities he could claim and the added stability that would be implied by a longer term of employment.

Joe also thought he had to consider the well being of his family in any decision he made. He would not find it easy to secure another good position in his town, as it was small and isolated. Joe and his family were now living about 1,000 miles from their relatives. He had accepted a transfer to his present location, Grovetown, when he was working for Ace Printing. The layoff caused by downsizing had left Joe and his family stranded in Grovetown. The proximity of a university offering a night program in accounting coupled with his wife’s position as a clerk in the business office of a local physician’s group had led to the decision to stay. Now his two older children were very active in their schools and with extracurricular activities. They had many friends, and Joe believed the children would suffer a difficult adjustment period if they were to leave Grovetown at this time. His wife, too, seemed content with life as it was. She had found satisfaction in her job, as well as with the community.

Although Joe had not worked in one of the branch offices dealing directly with customers, he had heard plenty of stories around the office about what it was like on the front line. Based on what he had heard, he was glad to be working with people behind the scenes, even though the environment in the office was far from ideal.

Even Acme’s home office seemed to be fraught with problems, most of which Joe thought were caused by the caliber of Acme’s personnel. In the year that Joe had been there, he had seen a number of employees go over their supervisors’ heads taking problems to higher levels than necessary and undermining the authority of their supervisors. This seemed to be an accepted way of solving problems and making decisions. There also seemed to be a degree of backstabbing with which Joe was unfamiliar in other positions. Additionally, there had been recurring incidents of executives charging personal items on company credit cards. The company continued to pay for such charges in spite of Joe’s calling those incidents to the attention of the accounting manager. Sums of money were also borrowed from company accounts with no apparent attempt to secure repayment. Joe had also seen several seemingly inappropriate personal relationships develop on the job. The entire office was gossiping about the relationship that had developed between the CFO and one of his direct reports, the office manager. The subordinate, a female, was subsequently transferred to one of the branch offices.

**QUESTIONS FOR DISCUSSION**

1. What decisions need to be made when an individual discovers that he/she is working in a company and industry with many ethical issues?

2. If the organizational culture at Acme Title Pawn cannot be changed, can Joe continue to work there and avoid involvement in activities that are ethically questionable or possibly illegal?
3. How could Acme create an ethical organizational culture and still be in the title pawn business?

ANSWERS TO QUESTIONS FOR DISCUSSION

1. This case should encourage the class to develop a rich discussion about the decisions and involvement of an individual in an ethically questionable company and industry. Joe has to consider whether to stay in such a company and deal with many ethical problems or leave the company and pursue a new career. Students should be able to generate several alternatives for Joe. This should provide a good starting point for discussing the case. Whether or not to leave an ethically questionable company is a decision that many employees have to make. It can be difficult to find an organizational culture that matches one’s personal values.

2. Joe must make a personal decision as to whether he can stay out of trouble and feel good about himself if he continues to work at Acme. If he stays, it is possible he could be a positive force to encourage others to comply with the law and develop more ethical treatment of customers. However, if Joe stays, he will face much ethical conflict. There is a possibility that his career advancement may suffer if he becomes overly focused on unethical behavior within the company.

3. Acme could develop an ethical compliance program to make sure that consumers and employees are treated properly. But the nature of the industry and competition might prevent Acme from achieving current profit levels if it operates in a more ethical manner. If Acme takes a long-run perspective, it could establish an ethical reputation and increase the level of business at a lower profit margin. Finally, a discussion on the appropriateness of the title pawn industry in general could be developed, including whether states should ban this type of operation using existing interest rates and repossession tactics.
PART A

Sanfred Koltun sat in his office in the Chicago headquarters of his company, Kolcraft Enterprises, reading a letter. Addressed to Bernard Greenberg, president of Kolcraft, the February 1, 1993, letter had been passed around to the company’s handful of top executives. He would get their perspectives on the situation. But Koltun knew that, as owner and CEO, he would be the one to determine the company’s actions. It had been that way since his father started the company in 1942.

The three-and-a-half page letter was from Marc J. Schoem, director of the division of corrective actions for the United States Consumer Product Safety Commission (CPSC). Schoem’s office, his letter explained, was responsible for making a preliminary determination about “whether a defect is present in a product and, if so, whether that defect rises to the level of a substantial risk of injury to children.”

“The CPSC has received reports of two infant fatalities resulting from the collapse of ‘Playskool’ brand portable cribs manufactured and distributed by Kolcraft,” Schoem wrote. “In both cases it appears the infant was entrapped when the crib collapsed while the infant was in the crib.” Schoem then requested a “Full Report:” Kolcraft would have to provide, among other materials, “copies of all test reports, analyses, and evaluations, including premarket tests and reports of tests and any analyses related to the locking mechanism and/or potential for collapse of product.” The CPSC also requested copies of all engineering drawings, any consumer or dealer complaints, lawsuits, assembly instructions in all their forms, and two samples of the Travel-Lite crib. Finally, Schoem noted, Kolcraft had a “continuing obligation to supplement or correct its ‘full report’” as new information about the product or incidents related to it became known.1

Schoem closed his letter with the request that Kolcraft respond within ten working days.

History of Kolcraft

Kolcraft Enterprises was started in Chicago in 1942 as a manufacturer of baby pads, a foam product commonly used in high chairs, play pens, and bassinets. In 1950 Kolcraft began manufacturing mattresses for use in baby cribs. Sanfred Koltun, the founder’s son, graduated with a bachelor’s degree

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* Written by David Zivan, Senior Editor, Chicago Magazine. Funded by the James S. Kemper Ethics in Business Grant to the Graduate School of Business at the University of Chicago, under the direction of Professor Linda Ginzel.

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1Marc Schoem, letter to Bernard Greenberg, 2/1/93. From tab 7, Linda Ginzel, as independent administrator of the estate of Daniel Keysar, deceased, and on behalf of Boaz Keysar, Ely Keysar, and Linda Ginzel, next of kin, plaintiff, v. Kolcraft Enterprises, Inc., a Delaware Corporation, and Hasbro, Inc., a Rhode Island Corporation, defendants, #98L7063, pending in the Circuit Court of Cook County, County Department, Law Division.
from The University of Chicago in 1954 and an M.B.A. from the same school in 1955. He then joined the company, which at that time employed about 30 people.²

By the early 1980s, Kolcraft diversified into the manufacture of various juvenile seats, including car seats and booster seats. Koltun opened a 25,000-square-foot facility in North Carolina making what are generically known as play pens, a metal and masonite folding device typically measuring 36” by 36” with mesh sides. Children would nap and play in these common household products. Kolcraft eventually expanded to include operations in Pennsylvania, Georgia, and California.³ By the late 1980s, the company had hundreds of employees, with headquarters in Chicago and a separate manufacturing and engineering facility in Bedford Park, Illinois.⁴ Though dwarfed by major corporations like Mattel’s Fisher-Price and Hasbro’s Playskool, Kolcraft eventually grew to become the seventh largest juvenile products manufacturer, with revenues around $30 million.⁵

Kolcraft maintained a small executive suite with Sanfred Koltun as CEO. Kolcraft’s flow of information was informal, with meetings taking place frequently in a centrally located conference room at the headquarters.⁶ Although the managers of various divisions controlled the day-to-day operations of their projects, Sanfred Koltun had the final word in all important decisions of the company.

In 1979, Kolcraft hired Edward Johnson, a graduate of a technical high school where he received training in draft work. Johnson had worked as a design draftsman for a lighting company, served four years in the Air Force, and worked for seven years at J.E. Industrial Molding as a designer in custom blow molding, a process that made plastic products with a cushion of air inside. He designed Kolcraft’s first car seat, which was sold in the Sears retailing chain, and by 1987 he had been named engineering head of Kolcraft. Johnson worked mainly on car seats and other seat products like high chairs until his first design of a portable crib, in 1989.⁷

In 1987, Kolcraft hired Bernard Greenberg as a vice president. A graduate of New York University, Greenberg had worked at Macy’s for six years as a buyer, then spent a number of years with various manufacturers of juvenile products, eventually serving as president of Century, a juvenile product manufacturer which was a division of Gerber baby products. Greenberg became president of Kolcraft around 1990.

**Development of the Playskool Travel-Lite**

In the mid-1980s, the U.S. juvenile product market saw a substantial influx of imported goods, primarily from Asia, including a new product—portable play yards, or portable cribs as they came to be known. Rectangular in shape, the traveling cribs often folded into a carrying bag. Sanfred Koltun believed that Kolcraft could manufacture a similar, better product.

In the first half of 1989, Edward Johnson drew up some preliminary sketches for a portable, collapsible crib. Johnson’s design featured two hollow plastic sides that would serve as the exterior shell of the crib when it was folded for transport. The other two sides would be made of mesh supported by two collapsible top rails with a hinge in the middle. The solid floor would also fold at the center.

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² Deposition of Sanfred Koltun, 4/19/2000, pp. 6–8.
³ Deposition of Bernard Greenberg, 9/30/99, pp. 8, 20.
⁷ Johnson, pp. 3–9, 29.
That spring, Sanfred Koltun gave the go-ahead to create a mock-up of the portable crib. “His comment from the very beginning was like it was the best thing he’d ever seen,” Johnson remembered later. “It was unique because there was nothing out there with a carrying case. Nothing that was that structurally sound. Nothing that looked as nice as that.” Johnson’s painted wood model of the crib was well received by Kolcraft’s marketing department, and the company decided to try to get the portable crib ready for the annual Juvenile Products Manufacturers Association (JPMA) trade show, scheduled for mid-September in Dallas.

Initial prototype models of the crib were heavier than Johnson had hoped—close to 19 pounds, as opposed to the 10 or 11 he had originally planned. Nevertheless, the company’s optimism for the product continued. According to Johnson, the engineering department generated an “unbelievably thick” file on the Travel-Lite while trying to make the product achieve the portability that had been a major selling point of its competitors.

A Travel-Lite prototype was made and sat in the break room across from Johnson’s office in Bedford Park. Soon Johnson found himself demonstrating the crib to other Kolcraft employees. “We constantly were taking this thing down and putting it back up, kicking it around, because it was a unique product and everybody was . . . excited about it,” Johnson remembered. “Whenever someone walked into the room, they’d come in to me and say, ‘what is this?’ and I’d have to go through and explain it. And every time they asked, I’d tear it down and put it back up again. This thing [was] going up and down all the time.”

A prototype model of the portable crib received a generally favorable reception from retail buyers at Sears, K-Mart, JC Penney, Wal-Mart, Montgomery Ward’s, Service Merchandise, and Target. Several buyers noted that they would like to see the crib be a little lighter. Some also noted that they had difficulty turning the crib’s locking mechanism, which consisted of round plastic knobs or dials located at the end of each top rail. “Some of the buyers told us they just could not turn the lock,” said Greenberg, who visited the engineering offices once a week to check on the project’s progress. “And [Johnson] kept on working on it.”

The final design featured a nub on the outside portion of the dial that would slide into an indent on the inside portion. Once the crib was standing up, users would turn the knobs to the “lock” position (eventually designated by decals), and then hear a small “click” (Exhibit 1). “When we put it back to the buyers, they liked it a lot,” Greenberg said. “They thought it was a very good idea.”

The crib would be ready for the trade show in Dallas.

**Licensing the Travel-Lite**

Sanfred Koltun believed that affiliating with a recognized brand name would be beneficial for Kolcraft. “I thought in terms of customers,” he said. “I wanted to get [our product] on the floor of juvenile departments in retail stores.” In 1989, as Bernard Greenberg would later put it, Sanfred Koltun “went after the Playskool name,” and by that summer Koltun had negotiated a licensing deal with Hasbro.

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9. Ibid., p. 20.
11. Greenberg, p. 82.
13. S. Koltun, pp. 73–75.
Koltun hired Ernst Kaufmann, a 32-year veteran of Sears, to handle the merchandising of the new line, which Kolcraft would license under the Playskool brand name.

Playskool, well known in the juvenile products market for its reputation as a maker of high quality toys, was a property of the Hasbro company. Founded in the 1920s by Polish immigrant Henry Hassenfeld and publicly traded since 1968, Hasbro was in the 1980s one of the fastest growing companies in the nation, with successful brands such as Raggedy Ann and G.I. Joe, and revenues surpassing $2 billion. In 1983, Hasbro had hired John Gildea to be its director of licensing. Gildea had been employed by the owners of Hanna Barbera, where he had negotiated licensing contracts for such properties as the Flintstones, Scooby Doo, and Huckleberry Hound. Prior to 1983, licensing had not been a separate department at Hasbro, and top management at the company had directed the new department to find high-quality manufacturing partners who would uphold Playskool’s reputation in the marketplace. Through the mid-1980s, Gildea hired account executives to handle such properties as G.I. Joe, My Little Pony, and Mr. Potato Head.

By the end of the decade, Hasbro had begun licensing the Playskool name—a brand associated, as Gildea put it, with “quality, fun products.” In an interview with *Children’s Business*, Gildea outlined the emerging benefits of the company’s licensing business:

> The non-toy products are Playskool line extensions that we don’t happen to make. Our strategy is twofold. We gain incremental exposure of the Playskool name, [creating] brand awareness at a very early age that will pay dividends down the line. Secondly, and not insignificantly, it brings income. Licensing allows us to concentrate on our core business and also take advantage of the corporate name in appropriate products.

Both benefits looked relatively easy to achieve, and may have seemed necessary, as one of Hasbro’s main competitors, Fisher-Price, had already begun making products outside its traditional lines.

In the original agreement, Kolcraft would manufacture and distribute mattresses, play pens, and car seats with Hasbro’s Playskool name attached. The agreement stipulated, among other provisions, that:

> [T]he licensee shall, prior to the date of the first distribution of the licensed articles, submit to the licensor a test plan which lists all the applicable acts and standards and contains a certification by the licensee that no other acts or standards apply to the licensed articles. . . . Test plan shall describe in detail the procedures used to test the licensed articles, and licensee shall submit certificates in writing that the licensed articles conform to the applicable acts and standards. Upon request by the licensor, licensee shall provide licensor with specific test data or laboratory reports.

Kaufmann helped with the final terms of the licensing agreement, and came up with one amendment: adding the new portable crib to the deal. “When you develop your company into new products, the competition is way ahead of you,” said Greenberg. “If you develop a product that is similar to the competition, especially in price, you need something to put on it to give more flavor to it, so to speak.”

15. Deposition of John Gildea, 8/26/99, p. 11.
17. Details of this expansion also included in *Children’s Business*, February 1991.
20. Greenberg, p. 27.
Going to the Show

Kolcraft’s display at the JPMA trade show in Dallas featured a separate area for its Playskool products, staffed by Kaufmann. The Travel-Lite received a warm reception, and a press release by the JPMA, dated September 15, 1989, named the Travel-Lite one of the top new products at the trade show:

> At a press conference today, the Juvenile Products Manufacturers Association (JPMA) announced the winners of the “Ten Most Innovative Products Contest.”

A panel of independent judges . . . were instructed to judge on: creativity, originality, function, convenience, safety, innovative design, fashion, style, and overall appearance and use of the product.

Later, the crib even got some national press attention in the “What’s New in Design” section of the December 4, 1989, edition of *Adweek* magazine (Exhibit 2).

Final Preparations

On September 28, 1989, Hasbro’s David Schwartz, who handled the Kolcraft account for the company, wrote a letter to Ernst Kaufmann, reminding him of Kolcraft’s obligations under the licensing agreement. “Pursuant to the terms of the contract between Hasbro and Kolcraft Enterprises, please be aware that Kolcraft must adhere to the terms set forth in Paragraph 7 (quality of merchandise), stating that: ‘The licensee warrants that the licensed articles will be designed, produced, sold, and distributed in accordance with all applicable U.S. laws.’”21 Schwartz then specifically asked for documents he had not yet received: “I would also request test plans and results for the Playskool travel crib . . . when they have been obtained.”22 While Hasbro had its own quality assurance department, it did not perform tests on the Travel-Lite.23

On December 1, 1989, Kaufmann answered Schwartz with a letter, noting various government and industry testing standards that had been applied to the other juvenile products about to come to market under the Playskool name. For the portable crib, he noted only that the product would come with a one-year limited warranty. “My intention was to show that we had a quality product,” Kaufmann said later. “[One] that we were willing to put a warranty behind.”24

In subsequent conversations with Kaufmann, Schwartz again requested test plans for the Travel-Lite.25 Kaufmann answered with a December 21, 1989, letter,26 which in its entirety read as follows:

Dear Mr. Schwartz:

Please be advised that there are no government or industry test standards applicable to the Playskool portable crib.

We have therefore taken all reasonable measures to assure that this portable crib is an acceptable consumer product.

Very truly yours,

[signed] Ernst Kaufmann

Schwartz filed the letter.

24. Kaufmann, p. 76.
26. From appendix to #98L7063, tab 17.


Going to Market

Kolcraft began producing and shipping the Travel-Lite in January 1990. Both the crib and its packaging featured prominent placement of the Playskool name, and it was available in retail chains such as Toys ‘R’ Us, K-Mart, JC Penney, and Wal-Mart. An instruction sheet for setting up the crib was affixed to the floor of the crib, underneath the mattress—“a standard production step,” Johnson noted. “It’s in the specifications for [conventional] play yards. . . . All the other play yards have them.”

Sanfred Koltun was by now a proud grandfather. On family visits, his grandson would spend time in a Travel-Lite. “I was very happy with it,” Koltun said.

In June 1991, Edward Johnson received a patent for the Travel-Lite design. His petition noted that “the present invention relates to collapsible or foldable structures; and more particularly, to a collapsible structure suitable for use as a portable play yard.” Other play yards, the patent application contended, were difficult to fold, whereas Johnson’s design for the Travel-Lite was “easy to fold and transport.”

Sanfred Koltun would later attribute the poor sales of the Travel-Lite to the fact that the crib was more expensive than similar imported items, causing discount retailers like K-Mart and Wal-Mart to shy away from the product. “As far as the buyers go, [the] unit [was] too heavy,” Johnson said. “I don’t think it was the consumer. The buyers kept asking for more and more--more padding, things like that. And eventually, enough buyers said, ‘no.’”

Kolcraft ended up selling only about 11,600 of the cribs, models 77101 and 77103, and shipments stopped in April 1992.

The First Deaths

On July 3, 1991, an 11-month-old boy in California died of strangulation while in a Travel-Lite crib. The child’s neck was caught in the “V” created when the crib’s top rails collapsed (Exhibit 3). The CPSC investigated the incident, and produced a report by the end of the year.

That spring, the report was mailed to Hasbro, which forwarded it to Kolcraft. In June 1992, Kolcraft responded with a letter to the CPSC which stated in part:

The CPSC report on the July 3, 1991 incident involving a small child notes that the travel crib is subject to the voluntary standards of the juvenile products manufacturing industry. We note that there is no such standard applicable to travel cribs. The ASTM standard for play yards, ASTM F 406 does not apply to this product, which is a wholly different structural entity. Nor does the CPSC standard for non-full-size cribs, 16 CFR Part 1509, apply to travel cribs of this design.

The letter also noted that nothing in the report “suggests at this point that the Travel-Lite portable crib is defective in any way or presents a substantial hazard.”

27. Johnson, p. 94.
30. Johnson, pp. 43–44.
33. Ibid.
On November 30, 1992, a nine-month-old girl in Arkansas died when her Travel-Lite collapsed, strangling her in the “V.” A ten-month-old girl in California was killed in the same manner in another Travel-Lite on January 5, 1993.

The CPSC had only heard about two of the deaths when Marc J. Schoem wrote his February 1, 1993, letter to Kolcraft, requesting a full report on the Travel-Lite. Sanfred Koltun was shocked at the news. “I was appalled when I heard about the deaths,” he said. “I just couldn’t believe people were so careless.”

Exhibit 1  Travel-Lite crib with view of two side knobs

Exhibit 2  Travel-Lite crib in *Adweek* magazine

In the always-hot market for portable everything, Kolcraft Enterprises Inc. of Chicago is testing the offspring of mobile cellular-phone users and other travelers with a portable crib. The No. 5 juvenile-products manufacturer, under a licensing agreement with Playskool, has designed a 19-pound all-in-one unit that folds up into its own carrying case.

The crib’s nylon walls unfold and the frame locks in place to hold an infant up to 24 months old. In the closed position, the crib case measures 29-by-5½-inches—the size of a large typewriter. Transparent walls made out of mosquito netting let guardians keep an eye on the baby, and vice versa. The $89 travel crib is expected to hit the market in March.

The Trav’l Light is one of three products that Kolcraft licensed from Playskool this year. The company is also making a Playskool car seat and stationary-crib mattress that will ship to major retailers during the winter.

Designer Nolan Miller—whose fashions graced the primetime soap queens on *Dynasty*—has created a signature gown for The Black Velvet Lady. The spokeswoman for the No. 3 brand of Canadian whiskey will wear the plush dress in ads and promotions.

For years Heublein Inc. used professional models as the Back Velvet Lady. But three years ago it launched annual beauty contests to boost brand awareness with younger women. This year’s regional contests had more than 5,000 participants. And in these markets, sales jumped 10% during the promotion.
PART B

Starting the Recall

The Travel-Lite had been off store shelves for almost a year when Kolcraft received the February 1, 1993, letter from the CPSC. And although the crib carried a limited one-year warranty, the product had not included a mail-in warranty registration card for consumers. By February 1993, the earliest users of the crib would have long outgrown it, and in many cases the original purchasers would have discarded, stored, sold, or given away their cribs.

Sanfred Koltun met with Bernard Greenberg and John Staas, an attorney and Kolcraft’s vice president of operations, to discuss the situation. Kolcraft retained a law firm in Washington, D.C., and on February 12 drafted a response to the CPSC. In it, they proposed notification procedures, including contacting retailers with a letter and a poster informing them of a potential problem with the Travel-Lite, and providing a toll free number for consumers to call. A copy of the poster Kolcraft designed for display in retail locations was passed to Hasbro, and on February 18, staff at Hasbro approved the poster.35 On Friday the 19th, Kolcraft sent retailers a letter and an accompanying 8-1/2” x 11” poster, which included a drawing of the Travel-Lite.

35. Denniss, p. 64.
Also on February 19, Kolcraft’s lawyers in Washington received notice that the compliance staff at the CPSC had made a preliminary determination that the Playskool Travel-Lite crib presented “a substantial risk of injury to children as defined by section 15 (a) of the Federal Hazardous Substances Act (FHSA), 15 U.S.C. § 2064 (a). Specifically, there have been three reports to the Commission of infant fatalities resulting from the product folding up during use.” On February 22, 1993, the CPSC received from Kolcraft a copy of the letter and poster the company had mailed to retailers the previous Friday. On February 24, 1993, William J. Moore, Jr., an attorney in the office of compliance and enforcement of the CPSC, wrote a letter to Kolcraft’s attorneys in Washington, D.C. His letter stated, in part:

We take serious exception with your proposal to print the pediatrician poster in black and white. The poster will be competing with many other pieces of information. . . . The staff was very troubled to learn that the retailer letter and accompanying poster you provided to us on Monday, February 22, 1993, had already been sent to the retailers the previous Friday. The staff had been asking to review the proposed retailer notice for several days. Your February 12 letter promised to provide these documents to us by February 16. We stood willing and able to give quick guidance for producing effective notice documents. . . .

The 8-1/2 x 11 inch, black and white, thin stock “poster” sent to retailers had many serious shortcomings, in our view. It did not even have the Playskool name on the crib.

Moore added that his staff “wishes to work with Kolcraft to make this an effective . . . recall and to prevent further tragedy.”

In a conference call on March 1, Kolcraft’s attorneys in Washington tried to reassure the CPSC that Kolcraft and their firm were responding quickly and responsibly. Kolcraft had by then agreed to send a notice to approximately 26,000 pediatricians on a list maintained by the American Academy of Pediatrics. In addition, it would send a revised letter to Sears and to smaller retailers. The JC Penney’s chain would be able to notify its catalog customers directly from its database. Kolcraft’s attorneys expressed concern with the tone of Moore’s letter and asked that it be purged from the case file, a suggestion that the CPSC rejected.

After confidential negotiations between Kolcraft attorneys and the CPSC, the CPSC on March 10 issued a press release announcing the product recall (Exhibit 4). Hasbro was not involved.

Six weeks after its request for a full report, the CPSC was still attempting to acquire testing data on the Travel-Lite and status reports on the progression of the recall. On March 19, 1993, John Staas wrote a memo to Kolcraft’s file, with the subject line, “Testing information requested by CPSC.” It read in part:

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36. Linda Ginzel, as independent administrator of the estate of Daniel Keysar, deceased, and on behalf of Boaz Keysar, Ely Keysar, and Linda Ginzel, next of kin, plaintiff, v. Kolcraft Enterprises, Inc., a Delaware Corporation, and Hasbro, Inc., a Rhode Island Corporation, defendants, #98L7063, pending in the Circuit Court of Cook County, County Department, Law Division. From appendix, tab 7.
37. From appendix to #98L7063, tab 7.
38. From telephone notes in appendix to #98L7063, tab 7.
40. From appendix to #98L7063, tab 6.
Using the ASTM play yard standard as a model Kolcraft measured and maintained the following performance features on the Travel-Lite crib:

1. Caps, sleeves, etc. secured to stay on with 15 lbf force or more.
2. Uniformly spaced components.
4. Side strength and deflection of top rails and supporting methods to withstand 50 lbf static load.
5. Floor strength to withstand 50 cycle 30 ft. load.
6. Holes sized to avoid finger entrapment.
7. Mesh openings to avoid finger and toe entrapment and snaring of buttons.
8. Twelve-gauge vinyl used on the top rails.

Staas mentioned reaching compliance with regulations on sharp points and edges, and flame-retardant standards, and added that:

Kolcraft designers conducted use and abuse tests on these cribs, consisting of repeated cycles of leaning, pushing, sitting on and throwing the crib, and turning it on its sides. Kolcraft also tested the folding mechanism to determine if it could be inadvertently folded or lowered by a child while the crib was in use. Kolcraft used CPSC 16 CFR § 1500.53 (e) (3) as its standard to test the folding mechanisms.

CPSC use and abuse standard 16 CFR § 1500.53 (e) (3) prescribes a standard of 4 inch-pound torque to measure the susceptibility of a product to the twisting motion of a child 36 to 96 months of age. The Travel-Lite top rails were designed and measured to require four times the force of the CPSC regulation. Kolcraft’s measurements using a torque wrench indicated that 15-20 inch-pounds was approximately the range needed to activate the folding mechanism.

Kolcraft was able to produce no records on the testing of such a twisting motion. Later, Edward Johnson said he could not recall which of the tests his department performed had received written notations, and which had been informal. In addition to simply turning the dials at either end of the crib, as intended, the crib could also fold closed if the collapsible top rails were turned firmly enough (i.e., 15-20 inch-pounds, as noted by Kolcraft) to dislodge the nub holding them in place.

On July 12, 1995, a ten-month-old boy in Indianapolis was strangled in the “V” of his collapsed Travel-Lite. He was the fourth known victim of the crib.

By June 1996, of the 11,600 sold, 2,736 Travel-Lites could be accounted for. Noting that the returns had stopped, and that there had been no recent injury or death reports, the CPSC closed its case. The status of 76 percent of the cribs remained unknown.

42. Mitch Lipka, “Deaths of Six Babies Expose Fatal Flaws of System.”
After the Recall

On May 12, 1998, during naptime at his childcare provider, 16-month-old Danny Keysar was found unconscious in the “V” of a Travel-Lite. He was rushed to the emergency room but could not be revived. He was the fifth reported death in a Travel-Lite (Exhibit 5).

On August 19, 1998, a ten-month-old New Jersey boy was found dead, strangled in the “V” of his Travel-Lite. He was the sixth victim (Exhibit 6).
Exhibit 4

NEWS FROM CPSC
S. Consumer Product Safety Commission

Office of Information and Public Affairs Washington, DC 20207

FOR IMMEDIATE RELEASE CONTACT:
March 10, 1993 (301) 504-7908
Release # 93-043

PLAYSKOOL TRAVEL-LITE PORTABLE CRIBS RECALLED BY KOLCRAFT—SUCCOSSION RISK CITED

PRODUCT: 11,638 Playskool Travel-Lite Portable Cribs, models 77101 and 77103 manufactured by Kolcraft Enterprises, Inc.

PROBLEM: If the side rails of the portable crib fold during use, an infant can become entrapped and suffocate. Three deaths have been reported.

WHAT TO DO: Stop using and call Kolcraft at 1-800-453-7673 for instructions on how to obtain a refund.

WASHINGTON, DC—Kolcraft Enterprises, Inc., Chicago, IL, is voluntarily recalling 11,638 Playskool Travel-Lite portable cribs, models 77101 and 77103. The cribs were manufactured by Kolcraft under license from Playskool and sold nationally from 1990 to 1992. This recall is being conducted in cooperation with the U.S. Consumer Product Safety Commission (CPSC). The Commission has received three reports of infant deaths due to suffocation in these cribs. In each case an infant allegedly was found entrapped in a folded crib.

The incidents reported to CPSC suggest that if the side rails of the crib fold during use, an infant may become entrapped in the “V” where the side rails fold. While it is still unclear exactly why the crib side rails folded, Kolcraft is recalling all Travel-Lite cribs in an effort to prevent any further risk of injury to infants using these cribs.

The Playskool Travel-Lite portable crib has two nylon mesh sides and two blue solid plastic ends. “Playskool” appears in white letters on a red background on each end. The crib folds in the center for storage and handling.

Consumers who have a Playskool Travel-Lite portable crib should immediately stop using it and call Kolcraft toll-free at 1-800-453-7673 for instructions on how to obtain a refund. The toll-free line is open between 9:00 a.m. and 4:00 p.m. Eastern time.

Send the link for this page to a friend! The U.S. Consumer Product Safety Commission is charged with protecting the public from unreasonable risks of serious injury or death from more than 15,000 types of consumer products under the agency’s jurisdiction. Deaths, injuries and property damage from consumer product incidents cost the nation more than $700 billion annually. The CPSC is committed to protecting consumers and families from products that pose a fire, electrical, chemical, or mechanical danger.
hazard or can injure children. The CPSC’s work to ensure the safety of consumer products - such as toys, cribs, power tools, cigarette lighters, and household chemicals - contributed significantly to the 30 percent decline in the rate of deaths and injuries associated with consumer products over the past 30 years.

To report a dangerous product or a product-related injury, call CPSC’s hotline at (800) 638-2772 or CPSC’s teletypewriter at (800) 638-8270, or visit CPSC’s web site at www.cpsc.gov/talk.html. Consumers can obtain this release and recall information at CPSC’s Web site at www.cpsc.gov.
NEWS FROM CPSC
U.S. Consumer Product Safety Commission

Office of Information and Public Affairs
Washington, DC 20207

FOR IMMEDIATE RELEASE
June 18, 1998
Release # 98-128

CPSC Consumer Hotline: (800) 638-2772
CPSC Media Contact: Nychelle Fleming,
(301) 504-7063

CPSC URGES SEARCH FOR PREVIOUSLY RECALLED PORTABLE CRIBS AND PLAY YARDS

WASHINGTON, D.C. - The U.S. Consumer Product Safety Commission (CPSC) is urging consumers to search for and stop using previously recalled child products, in particular the “Playskool Travel-Lite” portable crib, which was manufactured by Kolcraft from 1990 through 1992 and recalled in 1993. In May of 1998, a Chicago toddler died after a Playskool Travel-Lite portable crib collapsed.

Manufacturers of portable cribs and play yards are joining in the effort to warn consumers and childcare providers to stop using the more than 1.5 million portable cribs and play yards that have been recalled in past years. Top rail hinges must be turned to set up the cribs and play yards. These top rails can collapse, entrapping children and suffocating them. Twelve children have died from suffocation in collapsed play yards and portable cribs manufactured by various firms. Current production play yards have top rails that automatically lock into place when the play yards are fully set up.

“A death caused by a previously recalled product is a tragedy,” said CPSC Chairman Ann Brown. “We urge consumers to make an all out effort to search their homes and daycare centers for these portable cribs and play yards and stop using them.”

The Playskool Travel-Lite portable cribs have two nylon mesh sides and two blue solid plastic ends. “Playskool” appears in white letters on a red background on each end. The portable crib folds in the center for storage and handling. Stores nationwide sold 11,600 of the products from 1990 through 1992. Kolcraft has gone to great lengths to renew their recall efforts. Kolcraft is offering a $60 refund to consumers for the return of the Travel-Lite portable cribs. They also are notifying pediatricians and childcare providers about the recall. Consumers should call Kolcraft at (800) 453-7673 for instructions on disposing of the products and receiving the refund.

A number of portable cribs and play yards manufactured by other companies also have been recalled because of the risk of suffocation posed by collapsing top rails. Consumers and childcare providers should check for the following recalled play yards and portable cribs. If these products are found, consumers should call the company.
<table>
<thead>
<tr>
<th>Date Recalled</th>
<th>Product and Firm</th>
<th>Numbers/Dates Sold</th>
<th>Remedy</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/21/96</td>
<td>Century “Fold-N-Go Models 10-710 and 10-810” Portable Play Yards</td>
<td>212,000 units sold between 1993 and 1996</td>
<td>Free repair. Call firm 800-541-0264</td>
</tr>
<tr>
<td>11/21/96</td>
<td>Draco “All Our Kids” (models 742 and 762) Portable Cribs/Play Yards</td>
<td>13,000 units sold between 1992 and 1995</td>
<td>Stop use and destroy (Firm out of business)</td>
</tr>
<tr>
<td>1/1/95</td>
<td>Baby Trend “Home and Roam” and “Baby Express,” Portable Cribs/PlayPens, manufactured before 1995</td>
<td>100,000 units sold between 1992 and 1994</td>
<td>Free repair. Call firm. 800-328-7363</td>
</tr>
</tbody>
</table>

CPSC is asking the help of consumers, childcare providers and child welfare associations to help spread the word about the search for these portable cribs and play yards in an effort to avoid another tragic incident. “CPSC gets recalled products off store shelves, but we can’t go into consumers’ homes and remove the products,” said Brown. “That’s why we want to get this message out and have consumers act immediately to prevent another tragedy.” Before using used nursery equipment, even if it has been used for a sibling, consumers should check the recalled product lists, available 24-hours-a-day, through the CPSC hotline at (800) 638-2772 or through the CPSC web site at www.cpsc.gov.

Send the link for this page to a friend! The U.S. Consumer Product Safety Commission is charged with protecting the public from unreasonable risks of serious injury or death from more than 15,000 types of consumer products under the agency’s jurisdiction. Deaths, injuries and property damage from consumer product incidents cost the nation more than $700 billion annually. The CPSC is committed to protecting consumers and families from products that pose a fire, electrical, chemical, or mechanical hazard or can injure children. The CPSC’s work to ensure the safety of consumer products - such as toys, cribs, power tools, cigarette lighters, and household chemicals - contributed significantly to the 30 percent decline in the rate of deaths and injuries associated with consumer products over the past 30 years.

To report a dangerous product or a product-related injury, call CPSC’s hotline at (800) 638-2772 or CPSC’s teletypewriter at (800) 638-8270, or visit CPSC’s web site at www.cpsc.gov/talk.html. Consumers can obtain this release and recall information at CPSC’s Web site at www.cpsc.gov.
Exhibit 6

NEWS FROM CPSC
S. Consumer Product Safety Commission

FOR IMMEDIATE RELEASE
August 21, 1998
Release # 98-156

IN WAKE OF ANOTHER DEATH, CPSC AGAIN URGES SEARCH FOR PREVIOUSLY RECALLED PORTABLE CRIBS AND PLAY YARDS

WASHINGTON, D.C. - The U.S. Consumer Product Safety Commission (CPSC) again is urging consumers to immediately search for and stop using previously recalled child products, in particular the “Playskool Travel-Lite” portable crib, which was manufactured by Kolcraft from 1990 through 1992 and recalled in 1993. According to the Asbury Park Press newspaper, a 10-month-old New Jersey infant died on Wednesday after becoming trapped in a collapsed Playskool Travel-Lite portable crib. CPSC issued this same warning in June, following the death of a 17-month-old Chicago toddler in the Playskool Travel-Lite portable crib. A $60 bounty is being offered for the return of each Travel-Lite crib.

Manufacturers of portable cribs and play yards have joined in the effort to warn consumers and childcare providers to stop using the more than 1.5 million portable cribs and play yards that have been recalled in past years. Top rail hinges must be turned to set up the cribs and play yards. These top rails can collapse, entrapping children and suffocating them. Thirteen children have died from suffocation in collapsed play yards and portable cribs manufactured by various firms. Current production play yards have top rails that automatically lock into place when the play yards are fully set up.

CPSC has been actively publicizing these previous recalls. Each recall has been distributed to media outlets nationwide and state and local health organizations. CPSC has included these products in the past two years’ national recall roundup campaigns. The Commission has held multiple press conferences and broadcast video news releases by satellite so that local television stations can report these stories by showing the product and demonstrating the collapsing side rails. Chairman Brown has announced these play yard recalls on network morning shows, which reach millions of viewers.

“Once again, we urge consumers to immediately search their homes and daycare centers for these portable cribs and play yards and stop using them,” said CPSC Chairman Ann Brown. “We are asking the news media to help us get word of these dangerous products out to consumers so that another tragedy is prevented. The media plays a critical role in reaching consumers. We can’t go into everyone’s home, but newspapers, and radio and television stations can. I ask every newspaper and every radio and television station to run weekly recall announcements so that consumers can find out if products in their home are being recalled. The news media should be their reliable source for product recall information.”
The Playskool Travel-Lite portable cribs have two nylon mesh sides and two blue solid plastic ends. “Playskool” appears in white letters on a red background on each end. The portable crib folds in the center for storage and handling. Stores nationwide sold 11,600 of the products from 1990 through 1992.

Kolcraft has gone to great lengths to renew their recall efforts. Kolcraft is offering $60 to consumers for the return of each Travel-Lite portable crib. They also sent new recall notices to pediatricians, childcare providers and consumer magazines. Consumers with Playskool Travel-Lite cribs should call Kolcraft at (800) 453-7673 for instructions on receiving the refund and disposing of the products.

The following table lists the portable cribs and play yards, manufactured by various companies, that have been recalled because of similar hazards. Consumers and childcare providers should check for the following recalled play yards and portable cribs. If these products are found, consumers should call the company listed below.

<table>
<thead>
<tr>
<th>Date Recalled</th>
<th>Product and Firm</th>
<th>Number/Dates Sold</th>
<th>Remedy</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/25/97</td>
<td>Evenflo “Happy Camper,” “Happy Cabana,” and “Kiddie Camper” Portable Play Yards</td>
<td>1.2 million units sold between 1990 and 1997</td>
<td>Free hinge covers Call firm 800-447-9178</td>
</tr>
<tr>
<td>11/21/96</td>
<td>Century “Fold-N-Go Models 10-710 and 10-810” Portable Play Yards</td>
<td>212,000 units sold between 1993 and 1996</td>
<td>Free repair Call firm 800-541-0264</td>
</tr>
<tr>
<td>11/21/96</td>
<td>Draco “All Our Kids” (models 742 and 762) Portable Cribs/Play Yards</td>
<td>13,000 units sold between 1992 and 1995</td>
<td>Stop use and destroy (Firm out of business)</td>
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<td>1/1/95</td>
<td>Baby Trend “Home and Roam” and “Baby Express,” Portable Cribs/Play Pens, manufactured before 1995</td>
<td>100,000 units sold between 1992 and 1994</td>
<td>Free repair Call firm 800-328-7363</td>
</tr>
<tr>
<td>2/17/93</td>
<td>Kolcraft “Playskool Travel-Lite” Portable Cribs</td>
<td>11,600 units sold between 1990 and 1992</td>
<td>$60 refund Call firm 800-453-7673</td>
</tr>
</tbody>
</table>

Consumers can also view video clips showing how the top rails of some of these recalled portable cribs and play yards can collapse.

Before using used nursery equipment, even if it has been used for a sibling, consumers should check the recalled product lists. Consumers can get information about recalled products in the following ways:

- Call the CPSC hotline, available 24-hours-a-day, at (800) 638-2772.
- Check the CPSC web site at www.cpsc.gov.
- Receive recall notices automatically by FAX, e-mail or regular mail free of charge by calling the CPSC hotline or writing to CPSC, Washington, DC 20207.
- Return product registration or warranty cards so manufacturers can reach you directly if there is a recall.
consumer product incidents cost the nation more than $700 billion annually. The CPSC is committed to protecting consumers and families from products that pose a fire, electrical, chemical, or mechanical hazard or can injure children. The CPSC’s work to ensure the safety of consumer products - such as toys, cribs, power tools, cigarette lighters, and household chemicals - contributed significantly to the 30 percent decline in the rate of deaths and injuries associated with consumer products over the past 30 years.

To report a dangerous product or a product-related injury, call CPSC’s hotline at (800) 638-2772 or CPSC’s teletypewriter at (800) 638-8270, or visit CPSC’s web site at www.cpsc.gov/talk.html. Consumers can obtain this release and recall information at CPSC’s Web site at www.cpsc.gov.
PART C

In the early 1990s, Thomas Koltun was being groomed to take over Kolcraft Enterprises, his father’s Chicago-based company. A manufacturer of juvenile products, Kolcraft had been started by Thomas’ grandfather in 1942, and had grown to become the seventh largest company in the industry, with several hundred employees and annual revenues above $30 million. After completing his M.B.A. at the Kellogg School of Management at Northwestern University, Thomas had worked for three years in New York as a product manager with Colgate-Palmolive. He joined Kolcraft in 1990 as director of marketing, and in 1994 was named vice president of marketing.

When Koltun joined the company, his father Sanfred, CEO of Kolcraft, had recently entered into a licensing agreement with Rhode Island-based Hasbro, which would allow Kolcraft the use of Hasbro’s Playskool brand name. Under the agreement, Kolcraft would manufacture and distribute mattresses, play pens, car seats, and a new product, a portable crib, which came to be called the Playskool Travel-Lite.

Kolcraft had initially been optimistic about the crib, introduced in January 1990. The company believed that the well-known Playskool name would bring consumer attention to the product. They also believed that the portability of the crib—it could fit into the trunk of a car—would provide a useful solution for various situations parents would encounter. But the crib did not sell well, and by April 1992, when it stopped shipping, only about 11,600 of the cribs, models 77101 and 77103, had been sold.

In March 1993, the Travel-Lite was recalled by the Consumer Product Safety Commission (CPSC). Three infants had been strangled in the cribs when its top rails collapsed, and the agency determined that the crib posed “a substantial risk of injury to children as defined by section 15 (a) of the Federal Hazardous Substances Act (FHSA), 15 U.S.C. § 2064 (a).” Kolcraft conducted a recall by sending posters to pediatricians and retailers, and the CPSC issued press releases to the media. The company offered a $60 bounty to consumers who returned the cribs, which had been sold at retail usually for $89.

Thomas Koltun had assisted with the company’s trade catalog presentation of the Travel-Lite in 1991, but had otherwise not been much involved in its marketing or licensing. He believed that the failure of the Travel-Lite in the marketplace arose from strong competition from other manufacturers’ cribs, which were several pounds lighter. Regardless, by the time the decision came to stop making the Travel-Lite, he was already looking past the product toward the company’s future. “I was involved somewhat,” he put it simply. “The product wasn’t selling, so it was time to move on to another product.”

Further Travel-Lite History

On July 12, 1995, while the recall of the Travel-Lite was still active, a ten-month-old boy in Indianapolis was strangled in the “V” of his collapsed Travel-Lite. He was the fourth known victim of the crib.

44. Linda Ginzel, as independent administrator of the estate of Daniel Keysar, deceased, and on behalf of Boaz Keysar, Ely Keysar, and Linda Ginzel, next of kin, plaintiff, v. Kolcraft Enterprises, Inc., a Delaware Corporation, and Hasbro, Inc., a Rhode Island Corporation, defendants, #98L7063, pending in the Circuit Court of Cook County, County Department, Law Division. From appendix, tab 7.
By June 1996, of the 11,600 sold, 2,736 Travel-Lites could be accounted for. Noting that the returns had stopped, and that there had been no recent injury or death reports, the CPSC closed its case. The status of 76 percent of the cribs remained unknown.46

**Kids in Danger—And a Lawsuit**

In mid-1995, a Travel-Lite crib found its way into a childcare home in Chicago—the third owner of that particular Travel-Lite. The provider set up, used, and took down the crib each day she was open for business, from the time she received it until May 1998. During naptime on May 12, 1998, 16-month-old Danny Keysar was found unconscious in the “V” of his Travel-Lite. He was rushed to the emergency room but could not be revived. He was the fifth reported death in a Travel-Lite.

Danny Keysar was the son of Linda Ginzel and Boaz Keysar, professors at The University of Chicago. At first, Danny’s death seemed to his parents to be a freak accident, a cruel tragedy with no explanation. But through news reports and the investigations of friends, Linda and Boaz learned that four children had previously been killed in Travel-Lite cribs. They also learned that the crib had been recalled five years earlier.

Ginzel and Keysar felt they had to take action, and created a nonprofit organization, Kids In Danger (KID), whose mission would be to promote the development of safer children’s products, advocate for legislative and regulatory strategy for children’s product safety, and educate the public, especially parents and caregivers, about dangerous children’s products. The organization started a Web site, www.KidsInDanger.org, and their efforts to bring the tragedy into the open resulted in substantial press attention.

On May 14, 1998, Thomas Koltun—now president of Kolcraft—drafted his company’s public response to the death of Danny Keysar, noting that he was “deeply saddened” by the tragedy. Kolcraft, he wrote, had “always been concerned with the safety of children.”47

Later that month, Koltun received a phone call from Malcolm Denniss,48 a Hasbro executive who has been called the company’s “safety czar.” Though the licensing agreement was no longer in effect, Kolcraft and Hasbro still communicated on matters related to the Travel-Lite. Denniss inquired about Kolcraft’s activities in relation to the recent events, and Koltun described the press release he was drafting, with help from a public relations firm. Koltun agreed that he would keep Denniss informed of Kolcraft’s actions.49

On June 18, 1998—the same day the CPSC issued a press release headlined, “CPSC Urges Search for Previously Recalled Portable Cribs and Play Yards”—Linda Ginzel and Boaz Keysar filed suit against Kolcraft and Hasbro, seeking damages for their negligence in bringing the Travel-Lite to market. The suit alleged that not only was the product unreasonably dangerous, but that Kolcraft and Hasbro had failed to properly warn the public about its danger. Hasbro was also responsible, Ginzel and Keysar contended, because by receiving licensing fees and allowing its Playskool brand name to be used prominently on the product, it was, to the public, the “apparent manufacturer” of the product.50

News of the lawsuit was featured on the Reuters and UPI newswires, and received national press coverage. The *Chicago Tribune* ran a short feature story, including a photo of the Travel-Lite that had

46. Lipka, “Deaths of Six Babies Expose Fatal Flaws of System.”
47. T. Koltun, p. 56.
49. Ibid., pp. 47-48.
50. Case materials from #98L7063.
killed Danny Keysar, shown in the collapsed position by Dan Webb, one of the plaintiff’s co-counsels and a former U.S. attorney.51

Hasbro filed a motion to have itself removed from the lawsuit, contending that the responsibility was solely Kolcraft’s, and referred calls regarding the Travel-Lite case to Kolcraft.52

On August 19, 1998, a ten-month-old New Jersey boy was found dead, strangled in the “V” of his Travel-Lite. He was the sixth victim.

ACKNOWLEDGEMENTS

The author wishes to thank a number of individuals who gave generously of their time and expertise during the creation of this case.

Numerous faculty members, Ph.D. candidates, and MBA students from the Graduate School of Business at the University of Chicago attended several brown bag seminars to critique drafts of the case study. Their input was extremely helpful, as was the help of various experts from around the nation. I thank all those listed here and apologize to those whose names do not appear: Robert Adler, Holly Burt, Jonathan Eig, Howard Haas, Josh Klayman, Richard Larrick, Harold J. Leavitt, Carmen Marti, Cade Massey, David Messick, Sharon Peck, Megan Rostan, Caroline Schoenberger, George Wu, and Jeff Zivan.

Mary Abowd provided extensive research and expert fact-checking on the entire case, Patricia LaMalfa served as a tireless editor and proofreader, and Abhijit Bhalla helped to create the final version of the document.

Attorneys Stephen Senderowitz, Bradford Springer, Patrick Stanton, and Bryan Sup of Schwartz, Cooper, Greenberger & Krauss generously provided expert legal advice.

Marla Felcher’s *It’s No Accident: How Corporations Sell Dangerous Baby Products* is a tour de force of investigative reporting in the area of juvenile product safety, and her work was a valuable resource and an inspiration.

Tom Hellie, executive director of the Kemper Foundation, not only helped put this case in the public domain, but also provided insight and encouragement.

Finally, my heartfelt thanks to Linda Ginzel and Boaz Keysar, who have shown great patience during the case’s composition—and more courage than any of us should ever have to muster.

52. Mitch Lipka, ibid.