Introduction

Back in 1993, when we sat down to write the first edition of this book, people wondered if business ethics was just a fad. At that point, companies were just beginning to introduce ethics into new-hire orientations and management training programs. In academia, business ethics was just beginning to gain traction as a subject for serious academic study, and some business schools were going so far as to require a business ethics course to graduate.

Back then there was still the feeling among many experts that business ethics—like time management, quality circles, and other management buzzwords of the day—would soon become a footnote in texts that described business fads of the late twentieth century. Despite multiple waves of scandal over the years, these have often been portrayed as temporary blips. For example, one prominent business writer for Fortune Magazine wrote an article in 2007 titled “Business is Back!” Here’s a choice excerpt: “It must be said: The shaming is over. The 5½ year humiliation of American business following the tech bubble’s burst and the Lay-Skilling-Fastow-Ebbers-Kozlowski-Scrushy perp walks that will forever define an era has run its course. After the pounding and the ridicule, penance has finally been done. No longer despised by the public, increasingly speaking up and taking stands, beloved again by investors, chastened and much changed—business is back.”! Could he have been more wrong? Business managed to outdo itself on the shame index yet again just about a year later with the collapse of the financial markets. We’ve seen these ethical debacles occur regularly for the past 30 years. As a result, we’re convinced that business ethics is far from a fad. It’s an ongoing phenomenon that must be better understood and managed and for which business professionals must be better prepared.

We tell our students that serious ethical scandals often result from multiple parties contributing in their own small or large ways to the creation of a catastrophe. As you’ll read later on in this book, Enron’s collapse in 2001 was not just the failure of Enron executives and employees, but also the failure of Enron’s auditors, the bankers who loaned the company money, and the lawyers who never blew the whistle on Enron’s shenanigans. However, no scandal of recent
years—not even Enron—matches the financial industry debacle in 2008. Like Enron, many players contributed to this colossal failure. But the financial crisis was unparalleled in its scope and has fueled public outrage like no other business disaster in our lifetime. The aftermath had people around the world angry and mistrustful of companies, governments, regulators, rating agencies, and the people who work in them. If there was ever a crisis of trust and confidence, this is it. It is also a textbook-perfect example of how numerous people’s actions (and inactions) can conspire to spawn an almost unimaginable calamity.

Recent business history has proven beyond any doubt that divorcing business from ethics and values runs huge risks. Rushworth Kidder,² the highly regarded ethics writer and thinker who died in 2012, wrote about the financial debacle and the resulting public anger. He eloquently described how free marketers cite Adam Smith’s *Wealth of Nations* to justify a breed of capitalism that abhors regulation and focuses on short-term profits over long-term stewardship. Kidder wisely noted that 17 years before his more famous book, Smith wrote another one titled *The Theory of Moral Sentiments*. Smith’s first book deserves more attention because he always presumed that the messages from these two books would go hand in hand. Smith’s “moral sentiments” work rests on the assumption that human beings are empathetic; they care about others, and they derive the most joy from human love and friendship. His book opened with the following statement: “How selfish soever man might be supposed, there are evidently some principles in his nature, which interest him in the fortune of others. . . .”³ Smith believed that a good life derives from the expression of “beneficence,” not from material wealth. He proposed that self-love (which he also acknowledged) can spur the individual to better his own condition by besting competitors. But he argued that this must be done in a just manner and in the spirit of fair play as judged by an informed, ethical, and impartial spectator. We care what others think of us because we are first and foremost social beings. But we also are moral beings who want to do the right thing because it is the right thing to do (not just to win the praise of others). According to Smith, virtuous persons balance prudence (mature self-love), strict justice, and benevolence, and ideal societies are comprised of such persons. Finally, a flourishing and happy society is built upon a foundation of justice and rules of conduct that create social order. Smith was confident that humankind would progress toward this positive ethical state; he called on leaders to avoid the arrogance of power and, instead, to be virtuous statesmen. Kidder’s point was that capitalism will succeed only when firmly tethered to a moral base, and he reminds us that Adam Smith—that hero of free marketers—knew this better than anyone.

We completely agree. We began this book more than 20 years ago with the firm belief that business isn’t just “better” when companies and businesspeople are ethical, but rather that good ethics is *absolutely essential* for effective business practice. This is not just empty rhetoric. Work is essential to life, and most people work for a business of some kind. How we work and the standards we uphold while we are working affect much more than just commerce. Our business behavior also affects our personal and company reputations, politics, society at large, and even our national reputation. For example, the 2008 financial crisis,
while global in scope, had its roots in the United States, and the nation’s reputation has suffered because of the behavior of individuals and companies. Similarly, China’s reputation has suffered because of contaminants found in Chinese exports such as infant formula, drywall (used in construction), and children’s toys. So corporate misbehavior does not happen in a vacuum, and it’s not just corporate reputations that suffer as a result. These scandals cast long shadows, and they often affect entire industries and countries. In this complex and increasingly transparent world, where reputation influences everything from who wants to hire you or trade with you to who buys your products to who finances your debt—and much more—unethical behavior in business is a very big deal indeed. So let’s take a closer look at the elephant in the room: the near collapse of the financial markets in 2008 and what it has to do with business ethics.

The Financial Disaster of 2008

The implosion of the financial markets in 2008 was largely not the result of illegal behavior. For the most part, the activities that brought down the U.S. economy and others around the world were not against the law, at least not yet (government regulators and the legal system often play catch-up after ethical debacles in business). Many of those activities, however, were unethical in that they ultimately produced great harm and were contrary to a number of ethical principles such as responsibility, transparency, and fairness. Let’s start with some of the factors that laid the groundwork for the disaster in the United States.

Borrowing Was Cheap

First, borrowing money became really cheap. In 2000, stocks in high-technology companies had soared to unsustainable heights, and that bubble finally burst. To soften the effects on the U.S. financial markets, Alan Greenspan, who headed the Federal Reserve at that time, lowered the Federal Funds rate (the rate banks charge each other for overnight loans, which has a direct impact on short-term interest rates, including the prime rate) to almost zero. That move, seemingly innocent at the time, injected huge amounts of money into the U.S. financial system. It made the cost of borrowing so low that it fueled a glut of consumer borrowing. Suddenly, it was amazingly cheap to buy a new car, a wide-screen television, a backyard pool, a larger home, a second home, and all sorts of designer goodies. There was even encouragement to indulge. Following the terrorist attacks in September 2001, President George W. Bush told people that if they wanted to help the economy they should go shopping. And people did. Household debt levels rose to $13.9 billion in 2008, almost double what households owed in 2000, and savings dipped into negative territory. Responsible borrowers should have thought about what they could afford rather than what bankers would lend to them. And responsible lenders should have established that borrowers could actually afford to pay back the loans before lending them money.
Real Estate Became the Investment of Choice

Of course, people also want to invest in something safe, and what could be safer than real estate? There had been relatively few instances of real estate values declining, and when they did the declines were generally shallow and short-lived. A point of pride in the United States was the high percentage of Americans who owned their own homes. Investing in a home traditionally had been a very safe investment and one that was slow to appreciate in value. But suddenly in the early 2000s, real estate investing became a real moneymaker. With a backdrop of historically low interest rates, real estate became such a popular way to invest that demand soon outstripped supply and prices soared. The value of homes skyrocketed—homes that were selling for $300,000 in one year sold for $450,000 the next. Prices rose so fast that speculation grew tremendously. People bought houses with almost no down payment, remodeled them or waited a few months, and then resold the houses for a quick profit. A number of popular television programs showed viewers how to “flip” real estate properties for profit.

Because the cost of borrowing was so low and home equity had grown so quickly, many consumers borrowed on the equity in their homes and purchased additional real estate or a new car or financed a luxury vacation. For example, suppose someone purchased a house for $500,000 in 2003. By 2005, the home might have been worth $800,000. The home owner refinanced the mortgage—borrowing as much as the entire current worth of the house (because its value could only go up, right?), which resulted in a $300,000 cash infusion for the home owner. This practice was very popular, and it laid the groundwork for a huge disaster when the housing values fell off a cliff in 2008 and 2009. Imagine the home owner who refinanced the home just described. Imagine that he took the $300,000 and purchased a summer home and a sports car and paid for his children’s college educations. Suddenly, home values plummeted and his house lost 30 percent of its value, which was common in markets such as California, Florida, Nevada, and Arizona, where the real estate bubble was particularly inflated. After the real estate bubble burst, his house was worth $560,000. Now suppose he loses his job and needs to sell his house because he can’t afford the mortgage payments. He can’t get $800,000 for his home, which is what he owes on his mortgage. His only choice is to work with the mortgage holder (probably a bank) to refinance (unlikely) or declare bankruptcy and walk away from the house. This is what a lot of home owners have done, and it is one of the factors at the heart of the current financial crisis. Lots of folks were in on this bubble mentality, getting what they could in the short term and not thinking very much about the likelihood (or inevitability) that the bubble would burst.

Mortgage Originators Peddled “Liar Loans”

In the early 2000s, as housing investments increased in popularity, more and more people got involved. Congress urged lenders Freddie Mac and Fannie Mae to expand home ownership to lower-income Americans. Mortgage lenders began to rethink the old rules of financing home ownership. As recently as the
late 1990s, potential home owners not only had to provide solid proof of employment and income to qualify for a mortgage, but they also had to make a cash down payment of between 5 and 20 percent of the estimated value of the home. But real estate was so hot and returns on investment were growing so quickly that mortgage lenders decided to loosen those “old-fashioned” credit restrictions. In the early 2000s, the rules for obtaining a mortgage became way less restrictive. Suddenly, because real estate values were rising so quickly, borrowers didn’t have to put any money down on a house. They could borrow the entire estimated worth of the house; this is known as 100-percent financing. Also, borrowers no longer needed to provide proof of employment or income. These were popularly called “no doc” (no documentation) or “liar loans” because banks weren’t bothering to verify the “truth” of what borrowers were claiming on their mortgage applications.

This complete abandonment of lending standards opened the mortgage market to rampant fraud, and it was not exactly a secret. The FBI warned of an “epidemic” of mortgage fraud back in 2004, four years before that epidemic torpedoed the financial industry.

Banks Securitized the Poison and Spread It Around

At about the same time liar loans were becoming popular, another new practice was introduced to mortgage markets. Investors in developing countries were looking to the United States and its seemingly “safe” markets for investment opportunities. Cash poured into the country from abroad—especially from countries like China and Russia, which were awash in cash from manufacturing and oil, respectively. Wall Street bankers developed new products to provide investment vehicles for this new cash. One new product involved the securitization of mortgages. (Note: structured finance began in 1984, when a large number of GMAC auto receivables were bundled into a single security by First Boston Corporation, now part of Credit Suisse.) Here’s how it worked: Instead of your bank keeping your mortgage until it matured, as had traditionally been the case, your bank would sell your mortgage—usually to a larger bank that would then combine your mortgage with many others (reducing the bank’s incentive to be sure you would pay it back). Then the bankers sold these mortgage-backed securities to investors, which seemed like a great idea at the time. Real estate was traditionally safe, and “slicing and dicing” mortgages divided the risk into small pieces with different credit ratings and spread the risk around.

Of course, the reverse was also true, as the bankers learned to their horror. This method of dividing mortgages into little pieces and spreading them around could also spread the contagion of poor risk. However, starting in 2002 and for several years thereafter, people couldn’t imagine housing values falling. So much money poured into the system, and the demand for these mortgage-backed security products was so great, that bankers demanded more and more mortgages from mortgage originators. That situation encouraged the traditional barriers to getting a home mortgage to fall even farther. These investment vehicles were also based upon extremely complex mathematical formulas.
(and old numbers) that everyone took on faith and few attempted to understand. It looks like more people should have followed Warren Buffett’s sage advice not to invest in anything you don’t understand!

Add to that toxic mix the relatively new idea of credit-default swaps (CDS). These complex financial instruments were created to mitigate the risk financial firms took when peddling products such as securitized mortgages. CDS are insurance contracts that protect the holder against an event of default on the part of a debtor. One need not own the loan or debt instrument to own the protection, and the amount of capital tied up in trading CDS is very small compared to trading other debt instruments. That is a very significant part in the increase in the popularity of CDS at sell-side and buy-side trading desks. The insurance company AIG was a huge player in this market, and so were the large banks. The firms that were counterparties to CDS never stepped back from the trading frenzy to imagine what would happen if both the structured finance market and the real estate bubble burst (as all bubbles eventually do) at the same time. Both underwriters and investors would be left holding the bag when the music stopped playing—and the U.S. taxpayer has had to bail out most of the financially stressed firms to save the entire financial system from collapse. Please note that all of this happened in a part of the market that was virtually unregulated.

**Those Who Were Supposed to Protect Us Didn’t**

One protection against financial calamity was thought to be the rating agencies, including Standard and Poor’s, Fitch Group, and Moody’s. They rate the safety or soundness of securities, including those securitized mortgage products. A credit opinion is defined as one which rates the timeliness and ultimate repayment of principal and interest. But, like everyone else, the rating agencies say they didn’t foresee a decline in housing prices; and consequently, they rated the mortgage securities as being AAA—the highest rating possible, which meant that the rating agencies considered these securities to be highly safe with little risk.

The agencies are the subject of much criticism for their role in the crisis. If they had done a better job analyzing the risk (their responsibility), much of the crisis might have been avoided. But note that these rating agencies are hired and paid by the companies whose products they rate, thus causing a conflict of interest that many believe biased their ratings in a positive direction. So people who thought they were making responsible investments because they checked the ratings were misled.

Another protection that failed was the network of risk managers and boards of directors of the financial community. How is it that one 400-person business that was part of the formerly successful insurance behemoth, AIG, could invest in such a way that it brought the world’s largest insurance company to its knees? The risk was underestimated all around by those professionals charged with anticipating such problems and by the board of directors that didn’t see the problem coming. The U.S. government (actually taxpayers) ended up bailing
out AIG to the tune of $170 billion. The risk managers and boards of other financial firms such as Citigroup, Merrill Lynch, Lehman Brothers, Bear Stearns, and Wachovia were similarly blind.

On Wall Street, there were other contributing factors. First, bank CEOs and other executives were paid huge salaries to keep the price of their firms’ stocks at high levels. If their institutions lost money, their personal payouts would shrink. As a result, bank executives focused on short-term financial results often to the exclusion of long-term planning or organizational strategy. Because their compensation packages were directly tied to the company stock price, they were paid handsomely for their efforts to bolster short-term profits. The Wall Street traders were similarly compensated—they were paid multimillion-dollar bonuses for taking outsized risks in the market. What seemed to matter most were the short-term profits of the firm and the short-term compensation of those making risky decisions. The traders took risks, the bets were at least temporarily successful, and the bankers walked off with multimillion-dollar bonuses. It didn’t matter that the risk taking was foolish and completely irresponsible in the long run. The bonus had already been paid. Consequently, a short-term mentality took firm root among the nation’s bankers, CEOs, and boards of directors.

In addition, most of the big investment banks went public in the 1990s. Before becoming public companies, these firms were mostly partnerships. If the partners wanted to make a bet on the markets, they were risking their own money. If they won the bet, they reaped the rewards as individuals. If they lost the bet, the loss came out of their personal assets. In other words, they had “skin in the game.” After these firms went public, the money used to make bets no longer came from the partners; it came from shareholders. The profits and losses from these bets enriched the company directly, not the individuals who ran it (who would benefit only indirectly). These executives no longer had “skin in the game” to anywhere near the degree that they had when these firms were partnerships. It’s much easier to get careless with other people’s money than it is your own.\(^5\)

If you thought that bankers’ behavior would change as a result of the financial debacle, think again. In 2012, JPMorgan Chase—which in the wake of the financial crisis was described by many experts as being the best managed U.S. bank—suffered a huge loss at the hands of a rogue trader in its London office. The initial losses were estimated to be $2 billion, but later revised to be perhaps as high as $9 billion—in the same exact type of investments that created the financial catastrophe just a few years earlier.\(^6\) Between 2008 and 2014, JPMorgan Chase has paid more than $70 billion in fines for a variety of questionable activities. They are not alone. Bank of America has paid fines of $120 billion over the same period and Citigroup has paid more than $38 billion in fines.\(^7\)

Finally, we cannot examine the financial crisis without questioning the role of regulatory agencies and legislators. For example, for a decade, investor Harry Markopolos tried on numerous occasions to spur the Securities and Exchange Commission to investigate Bernard L. Madoff. The SEC never did uncover the
largest Ponzi scheme in the history of finance. The $65 billion swindle unravelled only when Madoff admitted the fraud to his sons, who alerted the SEC and the U.S. attorney’s office in New York in December 2008.

Others who are culpable in the financial crisis are members of the U.S. Congress, who deregulated the financial industry, the source of some of their largest campaign contributions. Among other things, they repealed the Glass-Steagall Act, which had been passed after the U.S. stock market crash in 1929 to protect commercial banking customers from the aggression and extreme risk taking of investment bank cultures. The act created separate institutions for commercial and investment banks, and they stayed separate until Citicorp and Travelers merged to form Citigroup in 1998. The two companies petitioned Congress to eliminate Glass-Steagall, claiming that it was an old, restrictive law and that today’s markets were too modern and sophisticated to need such protection. And Congress listened.

Those 1930s congressmen knew that if the two banking cultures tried to exist in the same company—the staid, conservative culture of commercial banking (our savings and checking accounts) and the razzle-dazzle, high-risk culture of investment banking—the “eat what you kill” investment bank culture would win out. Some said that staid old commercial banks turned into “casinos.” But, interestingly, casinos are highly regulated and are required to keep funds on hand to pay winners. In the coming years, we expect to learn more about the behavior that led to this crisis. As we noted earlier, much if not most of it was probably legal because of the lack of regulation in the mortgage and investment banking industries. But look at the outcome! If only ethical antennae had been more sensitive, more people might have questioned products they didn’t understand, or spoken out or refused to participate in practices that were clearly questionable. As just one tiny example, could anyone have thought it was ethical to sell a product they called a liar loan, knowing that the customer surely would be unable to repay (even if it was legal to do so)?

In 2010, the U.S. Congress passed the Dodd-Frank Financial Regulation Legislation—an attempt to rein in the most egregious practices in the financial industry. Financial institution lobbyists continue trying to water down the effects of this bill as regulators work to implement its complex regulations. Several European countries might be ahead of the U.S. when it comes to comprehensive financial regulation reform. Although many experts felt that Dodd-Frank was a failure in the years immediately following the crisis, the view is more nuanced now, going on ten years after the crisis. While more than a few banks remain “too big to fail,” bank profits are down, capitalization is up, and some experts theorize that the banks are indeed shrinking as a result of the regulation.

What’s increasingly clear is that corruption exists among the world’s leading financial institutions and that sometimes they collude in that corruption. If you think that is an exaggeration, please read about the LIBOR scandal that broke during the summer of 2012. LIBOR, which stands for the London Interbank Offered Rate, is the interest rate by which banks can borrow from one another. LIBOR is important because so many of the loans around the world—mortgage
rates, car loans, corporate debt, etc., are pegged to those LIBOR rates. Experts estimate that hundreds of trillions of dollars’ worth of financial contracts and derivatives are tied to LIBOR.

Regulators in several countries have accused a number of global financial institutions with cooperating with one another to rig LIBOR rates to make themselves appear healthier in the wake of the financial collapse of 2008–2009. Several of the large banks have received huge fines: Deutsche Bank (Germany) paid $2.5 billion in fines, USB (Switzerland) paid $1.5 billion, and Rabobank (Netherlands) paid $1 billion. Other banks including Citigroup, JPMorgan Chase, Royal Bank of Scotland, and Barclays Bank have paid hundreds of millions of dollars in fines stemming from the scandals and individual traders have been criminally convicted of manipulating the LIBOR and will be serving jail sentences. This crisis was particularly shocking because the UBS settlement not only charges that UBS manipulated rates to make itself look healthier, but also that it colluded with other global banks to make money from the manipulated rates. This is the equivalent of the big players admitting that the game is fixed. One Wall Street veteran described the scandal this way: “It’s like finding out that the whole world is on quicksand.”

Let’s delve into the cynicism that this and previous scandals have created and then try to move beyond it so that you can do things differently in the future.

Moving Beyond Cynicism

After multiple waves of business scandals, some cynicism (a general distrust) about business and its role in society is probably healthy. However, cynicism about business has truly become an epidemic in the United States. To be fair, we should note that although the financial industry screwed up royally, at the same time most other mainstream American companies were “running their companies with strong balance sheets and sensible business models.” Most companies were responsible, profitable, and prudent. Because they had serious cash reserves, many of them have actually managed to weather the recent crises reasonably well. But the attention has not been on these responsible companies. It’s been on the financial sector and its irresponsibility.

How bad is the cynicism? According to the 2016 Edelman Trust Barometer—a survey of almost 30,000 college-educated people around the world—it’s bad almost everywhere around the globe. (Edelman is the world’s largest independent public relations firm with 53 offices around the world. Its business is helping companies build and maintain reputations.) Edelman’s study shows that only 49 percent of consumers trust institutions in general. As for business, globally about half of the general public and about 60 percent of the informed public trust companies.

The Edelman study also highlights the importance of consumer trust—the degree to which consumers trust organizations has a direct impact on their buying patterns and much more. Over a one-year period, 91 percent of consumers
stated that they purchased a product of service from a company they trust, and 77 percent of consumers refused to purchase a product or service from a company that they mistrusted. These figures suggest that corporate reputations affect consumer buying patterns, and companies risk harming their bottom line when they do not act to protect their good name.

However, consistent with our idea that business ethics is not a fad, neither is public cynicism about business ethics new. We have written about it in every edition of our book (since 1995). Surely, the factor that has contributed the most to cynicism in recent years is the highly visible behavior of some of the nation’s leading corporations and executives, whose activities have garnered so much space in the business press and on the evening news. How do you watch hour after hour of such reporting and not walk away jaded? In the last few years, all you had to do was read about or watch the news to feel cynical, and business school students are no exception. We also note that business is not alone in its scandalous behavior. In recent years, we’ve learned about government employees who stole or misused funds, academics who falsified their research results, ministers who stole from their congregations, priests who abused children, and athletes who took bribes or used performance-enhancing drugs. It seems that no societal sector is immune.

Many of our readers are business school students, the current or future managers of business enterprises. Surveys suggest that many business students are themselves surprisingly cynical about business (given that they’ve chosen it as their future profession). They might believe that they’ll be expected to check their ethics at the corporate door or that they will be pressured to compromise their own ethical standards in order to succeed. Consider this scenario that took place at a large university: A professor asked his class to name management behaviors that are morally repugnant. His class struggled to name one! In another of his classes, the professor asked if the students would dump carcinogens in a river. This time the class agreed that they would do so because if they didn’t, someone else would. When the professor asked if they really wanted to live in such a cynical environment, the class insisted that they already did. The dismayed professor believed that the attitudes of his students were formed long before they landed in his classroom. He agreed with other observers that the problem goes way beyond business and business schools and that our society, with its emphasis on money and material success, is rearing young people who strive for achievement at any cost. One symptom: cheating is pervasive in many high schools and colleges.14

This scenario is enough to make anyone wonder about today’s business students. But at the same time, we know that students at many colleges and universities, including business schools, are encouraging their own faculty and administrators to establish newly invigorated academic integrity policies and honor codes. In an honor code community, students take responsibility for implementing the academic integrity policy and for holding each other accountable to it. They manage study-run judiciaries that mete out serious discipline to their fellow students who tarnish the community by cheating. These efforts,
which are gaining real traction at many schools, suggest that at least some students have had enough and are willing to turn from cynicism toward a proactive approach to change things.

A 2008 Aspen Institute study of nearly 2,000 MBA students from 15 leading international business schools provides some insight into MBA students’ attitudes, which appear to be moving in a less cynical direction. Similar to the findings they obtained in a 2002 survey, the results of Aspen’s 2008 survey of MBA students indicate that the students anticipate facing difficult conflicts regarding values in their jobs, and they suggest some cynicism about ethics in the workplace. However, about 40 percent of these students believe that their business education is preparing them to manage values conflicts “a lot,” and another 50 percent believe that they’re being prepared “somewhat.” Also, more than a quarter of the respondents said they are interested in finding a job that gives them the opportunity to contribute to society (compared to only 15 percent in 2002). More than half believe that safe, high-quality products and responsible governance and transparent business practices are very important in a potential employer. In addition, more than half said they would advocate alternative values or approaches in response to values conflicts at work (many more than in 2002).

The media might be largely responsible for students’ cynical attitudes. Think about the depiction of business and its leaders in movies and on television. The Media Research Center conducted a survey of 863 network TV sitcoms, dramas, and movies in the mid-1990s. Nearly 30 percent of the criminal characters in these programs were business owners or corporate executives. Entrepreneurs were represented as drug dealers, kidnappers, or sellers of defective gear to the military. Fortune magazine called this “the rise of corporate villainy in prime time.” Movies have abounded with negative messages about corporate America. Think The Big Short, The Wolf of Wall Street, Arbitrage, Avatar, Inside Job, Up in the Air, The Constant Gardner, Gasland, Wall Street, Boiler Room, Civil Action, Glengarry Glen Ross, The Insider, Erin Brockovich, Supersize Me, The Corporation, Enron: The Smartest Guys in the Room, Michael Clayton, The International, Quiz Show, The Insider, and Bowling for Columbine. And there are more such movies every year; we’re sure you can add to the list. A much tougher exercise is to generate a list of movies and television shows that actually create a positive ethical impression of business. Can you think of any? The consistent negative representation of business in the media has its effects. Academic research suggests that cynicism toward American business increased after study participants viewed the film Roger & Me, which depicted ruthless plant closings and layoffs at General Motors. Imagine the cumulative, daunting effect of viewing countless movies and television programs that portray business as corrupt and business leaders as ruthless and unethical.

To counter that media-fueled cynicism at least somewhat, we encourage you to think about your own life and the hundreds of reliable products and services you trust and depend on every day as well as the people and businesses that produce them. These good folks are businesspeople too, but it isn’t nearly as
exciting or sexy for the media to portray businesspeople who do the right thing every day. We also encourage you to talk with businesspeople you know, perhaps people in your own family who work for businesses. Do they feel pressured to compromise their ethical standards, or do they see their employer in a more positive light?

Interestingly, the Ethics & Compliance Initiative’s 2013 National Business Ethics Survey (see ethics.org) found that only 9 percent of employees of for-profit enterprises report feeling pressured to compromise their ethical standards. That means that more than 91 percent say that they’re not feeling such pressure. Also, two-thirds of these employees said that their own company has a strong or strong-leaning ethical culture. What do these numbers mean? To us, it means that most Americans who work in business think that their own company and coworkers are pretty ethical. Still, they read the same media accounts and see the same movies and TV programs as everyone else, and these offerings influence cynicism about American business in general.19

Finally, we won’t leave a discussion of cynicism without talking about the events of September 11, 2001. While the business scandals of 2001–02 left many cynical, the events of September 11, 2001, showed us some of the best in many individuals and businesses. We have read about the care, compassion, and assistance that countless American firms gave to those who were harmed by the terrorist attacks. Few firms were hit as hard as Sandler O’Neill & Partners, a small but profitable Wall Street investment bank that lost 66 of its 171 employees—including two of the firm’s leading partners—on September 11. The firm’s offices were on the 104th floor of the World Trade Center. Despite its dire financial straits, the firm sent every deceased employee’s family a check in the amount of the employee’s salary through the end of the year and extended health-care benefits for five years. Bank of America quickly donated office space for the firm to use. Competitors sent commissions their way and freely gave the company essential information that was lost with the traders who had died. Larger Wall Street firms took it upon themselves to include Sandler in their deals. The goal was simply to help Sandler earn some money and get back on its feet.20 This is only one of the many stories that point to the good that exists in the heart of American business. In this book, we offer a number of positive stories to counterbalance the mostly negative stories portrayed in the media.

The bottom line is this. We’re as frustrated as you are about the media portrayal of business and the very real, unethical behavior that regularly occurs in the business community. But we also know that the business landscape is a varied one that is actually dominated by good, solid businesses and people who are even heroic and extraordinarily giving at times. So, for our cynical readers, we want to help by doing two things in this book: (1) empowering managers with the tools they need to address ethical problems and manage for ethical behavior, and (2) providing positive examples of people and organizations who are “doing things right” to offset some of the media-fueled negativity.
In May 2009, something notable and quite positive happened. A group of 20 second-year students at Harvard Business School created *The MBA Oath* in an attempt to articulate the values they felt their MBA degree ought to stand for:

**THE MBA OATH**

As a business leader I recognize my role in society.

- My purpose is to lead people and manage resources to create value that no single individual can create alone.
- My decisions affect the well-being of individuals inside and outside my enterprise, today and tomorrow.

Therefore I promise:

- I will manage my enterprise with loyalty and care, and will not advance my personal interests at the expense of my enterprise or society.
- I will understand and uphold, in letter and spirit, the laws and contracts governing my conduct and that of my enterprise.
- I will refrain from corruption, unfair competition, or business practices harmful to society.
- I will protect the human rights and dignity of all people affected by my enterprise, and I will oppose discrimination and exploitation.
- I will protect the right of future generations to advance their standard of living and enjoy a healthy planet.
- I will report the performance and risks of my enterprise accurately and honestly.
- I will invest in developing myself and others, helping the management profession continue to advance and create sustainable and inclusive prosperity.

In exercising my professional duties according to these principles, I recognize that my behavior must set an example of integrity, eliciting trust and esteem from those I serve. I will remain accountable to my peers and to society for my actions and for upholding these standards.

This oath I make freely, and upon my honor.

This focus on positive values among business students and business in general received significant publicity and turned into something of a movement. More than 400 graduates of Harvard Business School signed the oath, and they were joined by more than 6,000 business students from 300 other colleges and universities globally. For more information, go to www.mbaoath.org.

**Can Business Ethics Be Taught?**

Given all that has happened, you might be wondering whether business ethics can be taught. Perhaps all of the bad behavior we outlined earlier results from a relatively few “bad apples” who never learned ethics from their families, clergy, previous schools, or employers. If this were so, ethics education would be a
Can Business Ethics Be Taught? waste of time and money, and resources should be devoted to identifying and discarding bad apples, not trying to educate them. We strongly disagree, and the evidence is on our side.

Aren’t Bad Apples the Cause of Ethical Problems in Organizations?

According to the bad apple theory, people are good or bad and organizations are powerless to change these folks. This bad apple idea is appealing in part because unethical behavior can then be blamed on a few individuals with poor character. Although it’s unpleasant to fire people, it’s relatively easier for organizations to search for and discard a few bad apples than to search for some organizational problem that caused the apple to rot.

Despite the appeal of the bad apple idea, “character” is a poorly defined concept, and when people talk about it, they rarely define what they mean. They’re probably referring to a complex combination of traits that are thought to guide individual behavior in ethical dilemmas. If character guides ethical conduct, training shouldn’t make much difference because character is thought to be relatively stable: it’s difficult to change, persists over time, and guides behavior across different contexts. Character develops slowly as a result of upbringing and the accumulation of values that are transmitted by schools, families, friends, and religious organizations. Therefore, people come to educational institutions or work organizations with an already defined good or poor character. Good apples will be good and bad apples will be bad.

In fact, people do have predispositions to behave ethically or unethically (we talk about this in Chapter 3). And sociopaths can certainly slip into organizations with the sole intent of helping themselves to the organization’s resources, cheating customers, and feathering their own nests at the expense of others. Famous scoundrels like Bernie Madoff definitely come to mind. Such individuals have little interest in “doing the right thing,” and when this type of individual shows up in your organization, the best thing to do is discard the bad apple and make an example of the incident to those who remain.

But discarding bad apples generally won’t solve an organization’s problem with unethical behavior. The organization must scrutinize itself to determine whether something rotten inside the organization is spoiling the apples. For example, Enron encouraged a kind of devil-may-care, unethical culture that is captured in the film Enron: The Smartest Guys in the Room. Arthur Andersen’s culture morphed from a focus on the integrity of audits to a consulting culture that focused almost exclusively on feeding the bottom line (you’ll read more about that in Chapter 5). In this book you’ll learn that most people are not guided by a strict internal moral compass. Rather, they look outside themselves—to their environment—for cues about how to think and behave. This was certainly true in the financial crisis when the mantra became “everyone is doing it” (and making a lot of money besides). At work, managers and the organizational culture transmit many cues about how employees should think and act. For example, reward systems play a huge role by rewarding short-term thinking and profits, as they did in the recent financial crisis. In this book, you’ll learn about
the importance of these organizational influences and how to harness them to support ethical behavior and avoid unethical behavior.

So apples often turn bad because they’re spoiled by “bad barrels”—bad work environments that not only condone, but might even expect unethical behavior. Most employees are not bad to begin with, but their behavior can easily turn bad if they believe that their boss or their organization expects them to behave unethically or if everyone else appears to be engaging in a particular practice. In this view, an organization that’s serious about supporting ethical behavior and preventing misconduct must delve deeply into its own management systems and cultural norms and practices to search for systemic causes of unethical behavior. Management must take responsibility for the messages it sends or fails to send about what’s expected. If ethics problems are rooted in the organization’s culture, discarding a few bad apples without changing that culture isn’t going to solve the problem. An effective and lasting solution will rely on management’s systematic attention to all aspects of the organization’s culture and what it is explicitly or implicitly “teaching” organizational members (see Chapter 5).

This question about the source of ethical and unethical behavior reflects the broader “nature/nurture” debate in psychology. Are we more the result of our genes (nature) or our environment (nurture)? Most studies find that behavior results from both nature and nurture. So when it comes to ethical conduct, the answer is not either/or, but and. Individuals do come to work with predispositions that influence their behavior, and they should take responsibility for their own actions—but the work environment can also have a large impact. In this book, you’ll learn a lot about how that work environment can be managed to produce ethical rather than unethical conduct.

**Shouldn’t Employees Already Know the Difference between Right and Wrong?**

A belief associated with the good/bad apple idea is that any individual of good character should already know right from wrong and can be ethical without special training—that a lifetime of socialization from parents, school, and religious institutions should prepare people to be ethical at work. You probably think of yourself as an individual of good character, but does your life experience to date prepare you to make a complex business ethics decision? Did your parents, coaches, and other influential people in your life ever discuss situations like the one that follows? Think about this real dilemma.

You’re the VP of a medium-sized organization that uses chemicals in its production processes. In good faith, you’ve hired a highly competent scientist to ensure that your company complies with all environmental laws and safety regulations. This individual informs you that a chemical the company now uses in some quantity is not yet on the approved Environmental Protection Agency (EPA) list. However, it has been found to be safe and is scheduled to be placed on the list in about three months. You can’t produce your product without this chemical, yet regulations say that you’re not supposed to use the chemical until it’s officially approved. Waiting for approval would require shutting down the
plant for three months, putting hundreds of people out of work, and threatening the company’s very survival. What should you do?

The solution isn’t clear, and good character isn’t enough to guide decision making in this case. As with all ethical dilemmas, values are in conflict here—obeying the letter of the law versus keeping the plant open and saving jobs. The decision is complicated because the chemical has been found to be safe and is expected to be approved in a matter of months. As in many of today’s business decisions, this complex issue requires the development of occupation-specific skills and abilities. For example, some knowledge in the area of chemistry, worker safety, and environmental laws and regulations would be essential. Basic good intentions and a good upbringing aren’t enough.

James Rest, a scholar in the areas of professional ethics and ethics education, argued convincingly that “to assume that any 20-year-old of good general character can function ethically in professional situations is no more warranted than assuming that any logical 20-year-old can function as a lawyer without special education.” Good general character (whatever that means) doesn’t prepare an individual to deal with the special ethical problems that are likely to arise in a career. Individuals must be trained to recognize and solve the unique ethical problems of their particular occupation. That’s why many professional schools (business, law, medicine, and others) have added ethics courses to their curricula, and it’s why most large business organizations now conduct ethics training for their employees.

So although individual characteristics are a factor in determining ethical behavior, good character alone simply doesn’t prepare people for the special ethical problems they’re likely to face in their jobs or professions. Special training can prepare them to anticipate these problems, recognize ethical dilemmas when they see them, and provide them with frameworks for thinking about ethical issues in the context of their unique jobs and organizations.

**Aren’t Adults’ Ethics Fully Formed and Unchangeable?**

Another false assumption guiding the view that business ethics can’t be taught is the belief that one’s ethics are fully formed and unchangeable by the time one is old enough to enter college or a job. However, this is definitely not the case. Research has found that through a complex process of social interaction with peers, parents, and other significant persons, children and young adults develop in their ability to make ethical judgments. This development continues at least through young adulthood. In fact, young adults in their twenties and thirties who attend moral development educational programs have been found to advance in moral reasoning even more than younger individuals do. Given that most people enter professional education programs and corporations as young adults, the opportunity to influence their moral reasoning clearly exists.

Business school students might need ethics training more than most because research has shown they have ranked lower in moral reasoning than students in philosophy, political science, law, medicine, and dentistry. Also, undergraduate business students and those aiming for a business career were found to be more likely to engage in academic cheating (test cheating, plagiarism, etc.)
than were students in other majors or those headed toward other careers. At a minimum, professional ethics education can direct attention to the ambiguities and ethical gray areas that are easily overlooked without it. Consider this comment from a 27-year-old Harvard student after a required nine-session module in decision making and ethical values at the beginning of the Harvard MBA program.

Before, [when] I looked at a problem in the business world, I never consciously examined the ethical issues in play. It was always sub-conscious and I hope that I somewhat got it. But that [ethics] was never even a consideration. But now, when I look at a problem, I have to look at the impact. I’m going to put in this new ten-million-dollar project. What’s going to be the impact on the people that live in the area and the environment. . . . It’s opened my mind up on those things. It’s also made me more aware of situations where I might be walking down the wrong path and getting in deeper and deeper, to where I can’t pull back.

In 2004, Harvard’s MBA class of 1979 met for its 25-year reunion. The alumni gave the dean a standing ovation when he stated that a new required course on values and leadership was his highest priority and then pledged to “live my life and lead the school in a way that will earn your trust.”

It should be clear from the above arguments that ethics can indeed be taught. Ethical behavior relies on more than good character. Although a good upbringing might provide a kind of moral compass that can help the individual determine the right direction and then follow through on a decision to do the right thing, it’s certainly not the only factor determining ethical conduct. In today’s highly complex organizations, individuals need additional guidance. They can be trained to recognize the ethical dilemmas that are likely to arise in their jobs; the rules, laws, and norms that apply in that context; reasoning strategies that can be used to arrive at the best ethical decision; and the complexities of organizational life that can conflict with one’s desire to do the right thing. For example, businesses that do defense-related work are expected to comply with a multitude of laws and regulations that go far beyond what the average person can be expected to know.

The question of whether ethics should be taught remains. Many still believe that ethics is a personal issue best left to individuals. They believe that much like proselytizing about religion, teaching ethics involves inappropriate efforts to impose certain values and control behavior. But we believe that employers have a real responsibility to teach employees what they need to know to recognize and deal with ethical issues they are likely to face at work. Failing to help employees recognize the risks in their jobs is like failing to teach a machinist how to operate a machine safely. Both situations can result in harm, and that’s just poor management. Similarly, we believe that, as business educators, we have a responsibility to prepare you for the complex ethical issues you’re going to face and to help you think about what you can do to lead others in an ethical direction.

Defining ethics Some of the controversy about whether ethics can or should be taught might stem from disagreements about what we mean by ethics. Ethics can be defined as “a set of moral principles or values”—a definition that
Can Business Ethics Be Taught?

portrays ethics as highly personal and relative. I have my moral principles, you have yours, and neither of us should try to impose our ethics on the other. But our definition of ethics—“the principles, norms, and standards of conduct governing an individual or group”—focuses on conduct. We expect employers to establish guidelines for work-related conduct, including such basic matters as what time to arrive and leave the workplace, whether smoking is allowed on the premises, how customers are to be treated, and how quickly work should be done. Guidelines about ethical conduct aren’t much different. Many employers spend a lot of time and money developing policies for employee activities that range from how to fill out expense reports to what kinds of client gifts are acceptable to what constitutes a conflict of interest or bribe. If we focus on conduct, ethics becomes an extension of good management. Leaders identify appropriate and inappropriate conduct, and they communicate their expectations to employees through ethics codes, training programs, and other communication channels.

In most cases, individual employees agree with their company’s expectations and policies. For example, who would disagree that it’s wrong to steal company property, lie to customers, dump cancerous chemicals in the local stream, or not comply with regulations on defense contracts? At times, however, an employee might find the organization’s standards inconsistent with his or her own moral values or principles. For example, a highly religious employee of a health maintenance organization might object to offering abortion as an alternative when providing genetic counseling to pregnant women. Or a highly devoted environmentalist might believe that his or her organization should go beyond the minimum standards of environmental law when making decisions about how much to spend on new technology or on environmental cleanup efforts. These individuals might be able to influence their employers’ policies. Otherwise, the person’s only recourse might be to leave the organization for one that is a better values match.

**Good control or bad control?** Whether or not we like to admit it, our ethical conduct is influenced (and to a large degree controlled) by our environment.

In work settings, leaders, managers, and the entire cultural context are an important source of this influence and guidance. If, as managers, we allow employees to drift along without our guidance, we’re unintentionally allowing them to be “controlled” by others. If this happens, we’re contributing to the creation of “loose cannons” who can put the entire organization at risk. Guidance regarding ethical conduct is an important aspect of controlling employee behavior. It can provide essential information about organizational rules and policies, and it can provide explanations and examples of behavior that is considered appropriate or inappropriate in a variety of situations.

But should organizations be “controlling” their employees in this way? B. F. Skinner, the renowned psychologist, argued that it’s all right, even preferable, to intentionally control behavior. He believed that all behavior is controlled, either intentionally or unintentionally. Therefore, what was needed was more intentional control, not less. Similarly, ethical and unethical behavior in organizations is already being controlled explicitly or implicitly by the existing
organizational culture (see Chapter 5). Thus, organizations that neglect to teach their members “ethical” behavior might be tacitly encouraging “unethical behavior” through benign neglect. It’s management’s responsibility to provide explicit guidance through direct management and through the organization’s culture. The supervisor who attempts to influence the ethical behavior of subordinates should be viewed not as a meddler but as a part of the natural management process.

To summarize, we believe that educational institutions and work organizations should teach people about ethics and guide them in an ethical direction. Adults are open to, and generally welcome, this type of guidance. Ethical problems are not caused entirely by bad apples. They’re also the product of bad barrels—work environments that either encourage unethical behavior or merely allow it to occur. Making ethical decisions in today’s complex organizations isn’t easy. Good intentions and a good upbringing aren’t enough. The special knowledge and skill required to make good ethical decisions in a particular job and organizational setting might be different from what’s needed to resolve personal ethical dilemmas, and this knowledge and skill must be taught and cultivated.

This Book is About Managing Ethics in Business

This book offers a somewhat unique approach to teaching business ethics. Instead of the traditional philosophical or legalistic approach, we take a managerial approach. Between us, we have many years of experience in management, in consulting, and in management teaching and research. Based on this experience, we begin with the assumption that business ethics is essentially about human behavior. We believe that by understanding human behavior in an organizational context, we can better understand and manage our own and others’ ethical conduct. Kent Druyvesteyn was vice president for ethics at General Dynamics from 1985 to 1993 and one of the first “ethics officers” in an American company. He made a clear distinction between philosophy and management in his many talks with students and executives over the years. As he put it, “I am not a philosopher and I am not here to talk about philosophy. Ethics is about conduct.”

We agree. After years of study and experience, we’re convinced that a management approach to organizational ethics is needed. As with any other management problem, managers need to understand why people behave the way they do so that they can influence this behavior. Most managers want the people they work with to be productive, to produce high-quality products, to treat customers well, and to do all of this in a highly ethical manner. They also want and need help accomplishing these goals.

Therefore, we rely on a managerial approach to understanding business ethics. We introduce concepts that can be used to guide managers who want to understand their own ethical behavior and the behavior of others in the organization. And we provide practical guidance to those who wish to lead their department or organization in an ethical direction.
We define ethical behavior in business as “behavior that is consistent with the principles, norms, and standards of business practice that have been agreed upon by society.” Although some disagreement exists about what these principles, norms, and standards should be, we believe there is more agreement than disagreement. Many of the standards have been codified into law. Others can be found in company and industry codes of conduct and international trade agreements.

Importantly, we treat the decisions of people in work organizations as being influenced by characteristics of both individuals and organizations. We also recognize that work organizations operate within a broad and complex global business context. We will cover individual decision making, group and organizational influences, and the social and global environment of business. The first part of this perspective, the influences on individual decision making, is represented in Figure 1.1.

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Ethics and the Law

It’s important to think about the relationship between the law and business ethics because if one could just follow the law, a business ethics book wouldn’t be necessary. Perhaps the easiest way to visualize the relationship between business ethics and the law is in terms of a Venn diagram (Figure 1.2). If we think of the law as reflecting society’s minimum norms and standards of business conduct, we can see a great deal of overlap between what’s legal and what’s ethical. Therefore, most people believe that law-abiding behavior is also ethical behavior. However, many standards of conduct are agreed upon by society and not codified in law. For example, some conflicts of interest might be legal but are generally considered unethical in our society and are commonly prohibited in codes of ethics. For example, having an affair with someone who reports to you might be legal, but it is considered unethical in most corporate contexts.
As we said earlier, much of the behavior leading to the 2008 financial crisis was legal, but unethical. So the domain of ethics includes the law but extends well beyond it to include ethical standards and issues that the law does not address. Finally, there are times when you might encounter a law that you believe is unethical. For example, racial discrimination was legal in the United States for a long time. But racial discrimination was, and is, highly unethical. Similarly, many companies do business in developing countries with few, if any, laws regulating environmental pollution or labor conditions. They can “legally” pollute the air and water in these countries. Such companies have to choose between adhering to ethical standards that are higher than the legal standards in those countries and deciding that it’s okay to harm the well-being of the people and communities there. The legal and ethical domains certainly overlap, but the overlap is far from complete.

**Why Be Ethical? Why Bother? Who Cares?**

Assuming that you accept the notion that business ethics can be taught, and that as current or future managers you have a role to play in creating an environment supportive of ethical conduct, you might still wonder why you should care about being ethical. As workers, we should care about ethics because most of us prefer to work for ethical organizations. We want to feel good about ourselves and the work we do. As responsible citizens, we must care about the millions of people who lost retirement savings because of the greed of those at AIG, Citigroup, Lehman Brothers, Merrill Lynch, and other financial firms that brought down the global economy in 2008. These people are our parents, spouses, siblings, children, and friends—they’re us! We live in a world community, and we’re all inextricably connected to each other and to the environment that surrounds us. Our future depends on our caring enough.

Most important, it is the right thing to do.
Individuals Care about Ethics: The Motivation to Be Ethical

Classical economists assume that practically all human behavior, including altruism, is motivated solely by self-interest—that humans are purely rational economic actors who make choices solely on the basis of cold cost-benefit analyses. However, a new group of economists who call themselves behavioral economists have found that people are not only less rational than classical economists assumed, but more moral. Much evidence suggests that people act for altruistic or moral purposes that seemingly have little to do with cost-benefit analyses. For example, people will mail back lost wallets to strangers, cash and all; help strangers in distress; and donate blood marrow for strangers or a kidney to a family member. Also, a large majority of people will refrain from stealing even if it’s easy to do so.

In his book *The Moral Dimension*, Amitai Etzioni cited many more examples and research evidence to document his claim that human action has two distinct sources: the pursuit of self-interest and moral commitments. Accordingly, most human decisions are based on ethical and emotional considerations as well as rational economic self-interest. People are motivated by both economic and moral concerns.

In a typical behavioral economics experiment, subject A in the experiment receives 10 one-dollar bills and can give subject B any number of them. Subject B can choose to accept or reject A’s offer. They are told that if B accepts, they each get what was offered. If B rejects the offer, each gets nothing. From a pure economics perspective, A would do best offering B one dollar and keeping the rest. B should accept that offer because, in economic terms, getting one dollar is better than nothing. But most A subjects offer B close to half the total, an average of about four dollars. B subjects who are offered one or two dollars generally reject the offer.

Economists can’t explain this result based upon rational self-interest. People’s sense of fairness seems to be driving both subjects’ behavior. Interestingly, when people play the game with a machine, they are more likely to play as classical economics would predict because they don’t expect a machine to be “fair.” Autistic A players (whose autism means that they don’t take others’ feelings into account) also play as the theory would predict. So most people expect fair play in their interactions with other human beings, and the experiments demonstrate they will even forgo economic benefits in order to maintain a fair system.

Neuroscience is also beginning to substantiate the moral sense that develops in humans. New imaging technologies have allowed scientists to locate a unique type of neuron in the brain—spindle cells—that light up when people perceive unfairness or deception. Only humans and African apes have these cells. An adult human has more than 82,000 of them, whereas a gorilla has around 16,000 (perhaps explaining why a gorilla might save a human child). A chimpanzee has less than 2,000. In humans, these cells appear at around four months of age and gradually increase with moral development.
In 2003, neuroscientists used functional magnetic resonance imaging (fMRI) to look inside the brains of people playing the ultimatum game, and they found that unfair offers were associated with heightened activity in parts of the brain associated with strong negative emotions, as well as in other parts of the brain associated with long-term planning. The subjects who rejected the unfair offers had more activity in the emotional part of the brain, which is the part that usually wins out.34

Given these research findings, we begin this book with an important assumption—that, as human beings and members of society, all of us are hardwired with a moral and ethical dimension as well as self-interested concerns. People care about ethics for reasons that stem from both of these sources.

Beyond being hardwired for fairness and altruism, employees are also concerned about their personal reputations. In today’s work environment, success depends on an individual’s ability to work effectively with others. Trust greases the wheels of working relationships with peers across departments and on project teams. We disagree with the old adage that “nice guys (or gals) finish last.” If it looks like bad guys (or gals) come out ahead, this is generally a short-run result. A reputation for being difficult to work with, dishonest, or mean often catches up with you as coworkers withhold important information and promotions go to others. Given the importance of relationships to effectiveness in business today, your reputation for integrity is an essential ingredient for success and personal satisfaction. This is even truer in an age of social networking that can send news of bad behavior to a broad audience in seconds.

### Employees Care about Ethics: Employee Attraction and Commitment

Organizations are concerned about their ability to hire and retain the best workers. The evidence suggests that employees are more attracted to and more committed to ethical organizations. “People who know that they are working for something larger with a more noble purpose can be expected to be loyal and dependable, and, at a minimum, more inspired.”35

As this book goes to press, graduating students at more than 80 colleges and universities now sign or recite the “Graduation Pledge,” in which they promise to “take into account the social and environmental consequences of any job” they consider. They also pledge to “try to improve these aspects of any organizations” where they work. Prospective employers should be very interested in these graduates and their concerns, which go beyond just making a living.36 (Go to www.graduationpledge.org for more information.)

Recent surveys confirm that it might be important to consider how potential and current employees are affected by an organization’s ethics. In a survey of millennial employees in the UK, 44 percent felt that meaningful work that helped others was more important than a high salary and 62 percent wanted to work for a company that makes a positive impact.37
Managers Care about Ethics

Managers care about ethics in part because they face the thorny problem of how to prevent and manage unethical behavior in their ranks. Ask any manager for examples, and be prepared to spend the day listening. More than their jobs depend on this concern—managers can be held legally liable for the criminal activities of their subordinates. For example, the estimates around employee theft are shocking. The U.S. Chamber of Commerce estimates that employee theft costs U.S. businesses $40 billion each year. Employee theft in the banking industry—estimated to be more than $1 billion annually—is more than the amount taken in bank robberies each year.\(^38\) In addition to such self-interested behavior, employees might engage in unethical behavior because they think (rightly or wrongly) that it’s expected or that their behavior is justified because they’ve been treated unfairly. Or they simply might not know they are doing something that’s considered to be unethical.\(^39\)

Whatever its source, subordinates’ unethical behavior is a management problem that won’t go away. It becomes even more of a challenge as restructuring continues to reduce management layers, thus leaving fewer managers to supervise more workers. With more workers to supervise, the manager can’t directly observe behavior. Restructuring also increases the number of part-time or contingency workers. These workers are likely to feel less loyalty to the organization and might be more prone to engage in unethical behaviors such as theft.

In addition, more workers might cross the line between ethical and unethical behavior in response to fierce business competition and a strict focus on the bottom line. Employees might believe that they can help the company succeed (at least in the short term) by fudging sales figures, abusing competitors, or shortchanging customers. Those who are potential layoff candidates are also more likely to flirt with impropriety.\(^40\) Many perceive the message to be: “reaching objectives is what matters and how you get there isn’t that important.”\(^41\) Therefore, today’s managers might have to work even harder to communicate the idea that ethical conduct is expected, even in the midst of aggressive competition.

Moreover, many managers understand the positive long-term benefit a reputation for ethics can bring to business dealings. Carl Skooglund, former ethics officer at Texas Instruments, had this to say:

There are very positive, even competitive, reasons to be ethical. If you walk into a relationship and somebody says, “I know you, I know your track record, I can trust you,” that’s important. Two years ago, in a survey that we sent out to employees, I received an anonymous comment from somebody who said, “A reputation for ethics which is beyond reproach is a silent partner in all business negotiations.” I agree and it works in all personal and business relationships. An unethical company is very difficult to do business with. You can’t trust them. You’re never sure if a commitment’s a commitment. At TI, our customers have told us that they can be sure of one thing: Once TI commits, we’re going to break our tail to make it happen. That’s an easy company to do business with.”\(^42\)
Executive Leaders Care about Ethics

Some of us are understandably cynical about CEO ethics after the widely publicized scandals, huge compensation packages, and CEO “perp walks” of recent years. But many business executives do care about ethics in their own organizations and about business’s image in society.

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

Jeffrey Immelt, the CEO of General Electric, spoke powerfully about ethics at Columbia University (available for viewing on YouTube). Immelt described how, above all else, leaders had to consider their organizations and protect—their organizations for shareholders, employees, and the greater good. “I believe that ethical behavior in 2008 starts first and foremost, as always, with a real sense of permanence, excellence, accountability, and safety, making sure that the enterprise endures no matter how tough the situation becomes.”

Warren Buffett, the legendary investor and CEO of Berkshire Hathaway, had perhaps the best idea about ethics and integrity when he said, “Somebody once said that in looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if they don’t have the first, the other two will kill you. You think about it; it’s true. If you hire somebody without the first, you really want them to be dumb and lazy.”

We believe that organizational ethics is a distinct managerial concern that must be addressed by management at all levels of the organization.

Industries Care about Ethics

When companies get bad publicity for ethical scandals, whole industries suffer. So, in some industries, companies have joined together in voluntary efforts to promote ethical conduct among organizations in the industry. Prominent among these efforts is the Defense Industry Initiative. A cynic might say that these initiatives are aimed solely at preventing more intrusive government regulation and that companies in these industries don’t truly “care” about ethics. Certainly, these types of initiatives have generally begun in response to a scandal or crisis. But over the years, they tend to take on a life of their own. Members internalize beliefs about appropriate conduct, hire support staff, and develop structures for enforcement that become institutionalized among member organizations.

The Defense Industry Initiative on Business Conduct and Ethics (DII) is a major voluntary industry initiative. It is described on the organization’s website (www.dii.org) as “a consortium of U.S. defense industry contractors which
subscribes to a set of principles for achieving high standards of business ethics and conduct.” It developed out of the President’s Blue Ribbon Commission on Defense Management (the Packard Commission), which was convened after a number of defense-industry scandals in the early 1980s. In 1986, the commission concluded that the industry could be improved by focusing on corporate self-governance. A number of companies voluntarily joined forces to “embrace and promote ethical business conduct,” and their work together continues today. As of 2016, 77 companies were signatories; as such, they have agreed to live according to the following principles:

- We shall act honestly in all business dealings with the U.S. government, protect taxpayer resources, and provide high-quality products and services for the men and women of the U.S. Armed Forces.
- We shall promote the highest ethical values as expressed in our written codes of business conduct, nurture and ethical culture through communications, training, and other means, and comply with and honor all governing laws and regulations.
- We shall establish and sustain effective business ethics and compliance programs that reflect our commitment to self-governance, and shall encourage employees to report suspected misconduct, forbid retaliation for such reporting, and ensure the existence of a process for mandatory and voluntary disclosures of violations of relevant laws and regulations.
- We shall share best practices with respect to business ethics and compliance, and participate in the annual DII Best Practices Initiative.
- We shall be accountable to the public, through regular sharing and reporting of signatory activities in public fora, including [www.dii.org](http://www.dii.org). These reports will describe members’ efforts to build and sustain a strong culture of business ethics and compliance.

The organization hosts a two-day Best Practices Forum each year, in which the industry’s prime customer, the Department of Defense, participates. It also hosts workshops on specific topics, including an annual two-day workshop to train ethics professionals, and publishes an annual report to the public and government summarizing DII activities.

### Society Cares about Ethics: Business and Social Responsibility

Business ethics also matters because society cares. From an economic perspective, businesses are powerful. Wal-Mart’s size and profits make it a more powerful economic force than most countries. Business is learning that it must use its power responsibly or risk losing it. Using power responsibly means being concerned for the interests of multiple stakeholders—parties who are affected by the business and its actions and who have an interest in what the business does and how it performs.  

These stakeholders include many constituencies: shareholders, employees, suppliers, the government, the media, activists, and many more. Stakeholders have the power to interfere with a firm’s activities.
For example, employees can strike, customers can stop buying products, protesters can bring bad publicity, and the government can act to regulate a firm’s activities. Consequently, it’s a matter of paramount importance for organizations to consider all of their various stakeholders and what those stakeholders expect and require before they make decisions that will affect those various audiences. Increased regulation is an almost certain societal response to business scandal, and with new regulations comes increased costs and reduced power for business. In addition, organizations that do not act responsibly risk criminal liability and the resulting financial damage. Even without criminal liability, businesses that don’t act responsibly risk their reputations, and a lost reputation is tough to rebuild. As business becomes more global and business practices more transparent, it’s almost impossible to hide bad behavior. There is a growing emphasis worldwide on corporate social responsibility (CSR), and this emphasis and the reasons for it are covered in much more detail in Chapter 9.

The Importance of Trust

A more elusive benefit of ethics is trust. Although it’s difficult to document, trust has both economic and moral value. Scientists are beginning to understand the “biology of trust.” In trusting relationships, neuroscientists have found that the brain releases a hormone, oxytocin, that makes cooperating feel good.

Trust is essential in a service economy, where all a firm has is its reputation for dependability and good service. Individuals and organizations build trust accounts that work something like a bank account. You make deposits and build your trust reserve by being honest and by keeping commitments. You can draw on this account and even make mistakes as long as the reserve is maintained. Having a trust reserve allows the individual or organization the flexibility and freedom to act without scrutiny, thus saving a great deal of time and energy in all types of relationships. Think of a marriage that is based on trust; the partners go about their daily business without feeling any need to check up on each other or to hire private detectives to confirm the other’s whereabouts. The same is true of trust-based business relationships, where a handshake seals a deal and a business partner’s word is considered to be a contract. Corporations also build trust with their customers.

Johnson & Johnson made a huge contribution to its trust account when it recalled all Tylenol from store shelves after the poisoning crisis in 1982 (a situation discussed in more detail in Chapter 10). Despite no recall requirement and huge recall costs, the company put its customers first. Trust might be even more important in efforts at global collaboration and alliances, and in cross-cultural management teams. Trust encourages the open exchange of ideas and information, reduces the need for costly controls, allows for rapid adjustment to change, and is associated with willingness to work through cultural differences and difficulties.
The Importance of Trust

Trust accounts are easily overdrawn, however. And when they are, all flexibility disappears. Every word and action is carefully checked and double-checked for signs of dishonesty. In organizations, lawyers are hired, contracts are drawn up and signed, and CYA (cover your you-know-what) memos fly. Recent corporate ethics scandals have created a huge gap in the public’s trust. The entire global business system relies on the public’s faith and trust. That trust has been shattered in a manner that could be extremely costly to society. A decade or more ago, the public considered the debacles at companies such as Enron, Arthur Andersen, WorldCom, Tyco, and Adelphia not as an anomaly, but as an example of the workings of a business culture that has lost its way. Although some strides were made to correct that not-very-flattering image of business, the financial crisis of 2008 was truly devastating to public trust in business, government, finance, and the economy. In Barron’s annual survey of the world’s 100 most respected companies, some of the financial firms still flounder—eight years after the financial crisis. For example, Bank of America and Citigroup still languish toward the bottom of the heap—at number 94 and 95, respectively. Still evolving as this book goes to press: Wells Fargo, after its huge trust scandals in 2016, will likely fall from its 2015 perch at number 7. According to this survey, Apple, Walt Disney, and Berkshire Hathaway top the list.

Unfortunately, all companies have been tainted by the scandals. Blue-chip companies now face even closer scrutiny and the skepticism of shareholders as they are being asked to open their books and reveal much more information than has been recent practice. Meeting profit projections or beating them by a penny is being viewed suspiciously as evidence of accounting chicanery rather than reliability. Confidence and trust in the system must be restored, or access to capital (the engine of the entire system) could be cut off.

The good news is that many corporations are responding. Boards of directors are replacing inside members with outsiders who are seen as more independent. Stock options are being expensed. CEO compensation packages that are seen as excessive are being cut. And executives are asking their people whether they are living by the “spirit of the law” as well as the letter of the law.

The idea of trust, however, is bigger than business. One reason why so much of our society appears to be in disarray is that people have so little trust in institutions. Recent Gallup polls that measure such confidence show that institutional trust has eroded significantly over the last 25 years. For example, in 1987, 51 percent of those polled expressed “a great deal or quite a lot of” trust in banks. In 2015, that number had declined to 28 percent. In 1986, 41 percent of those polled in the United States expressed “a great deal or a lot of trust” in Congress. By 2015, that number had fallen to 8 percent. Similar drops were reported for the Presidency, public schools, newspapers, and other institutions that form the basis for our society. This lack of trust is not a good thing, and the ethical debacles that have occurred over the last few decades have proven to be a blight on our civic landscape because so many people trust no one. It has also become increasingly difficult for people to engage in civil discourse. If people find it difficult to even talk to one another in civil tones, trust will become even more elusive.
The Importance of Values

As a theme even broader than trust, you can think of values as a kind of “glue” that guides our thinking across the book. Values are relevant to individuals, to organizations, and to societies. For individuals, values can be defined as “one’s core beliefs about what is important, what is valued, and how one should behave across a wide variety of situations.” For example, most of us agree that honesty, fairness, and respect for others are important values. Where individuals differ is in how they prioritize their values. For example, some people may believe that ambition is more important than other values. Others may feel that helpfulness predominates. Strongly held values influence important decisions such as career choices as well as decisions in particular situations. For example, someone for whom helpfulness is most important is more likely to choose a “helping” profession such as social work, while someone for whom ambition is most important may be more likely to choose a business career. In Chapter 2, you have the opportunity to think about your own values and how they influence your ethical decision making.

Values are also relevant at the organizational level. Many of you have seen organizational values statements that aim to create a shared sense of purpose among employees and to convey something about the organization’s identity to outsiders. If you haven’t, just look at company websites and you’ll see that most of them include values statements. Values lists often include respect, integrity, diversity, innovation, teamwork, and the like. Just as individual values guide individual thinking and action, organizational values guide organizational thinking and action. And, just as with individuals, the key question is how the organization prioritizes its values. For example, at 3M Corporation, no value is more important and more ingrained in the culture than innovation. Innovation is encouraged in myriad ways and has been “baked” into the culture through the commitment of senior executives, thus creating a culture that rewards collaboration and teamwork and that views mistakes as opportunities to learn.

In Chapter 5, you see that organizational values undergird the ethical culture of an organization and influence how its managers and employees behave. Thus, an organization that highly values diversity and respect is more likely to make efforts to hire and retain a diverse workforce and to take diversity into consideration when making supplier choices and other decisions. We know of an organization with a strong value for diversity that walked away from business when a customer insisted on dealing only with white males.

However, organizations don’t always “really” value what they say they value. That’s why values statements are often the butt of Dilbert jokes. For example, in Enron’s values statement, the verbiage described an organization where excellence and respect and integrity were key values. The scandal at Enron showed that what Enron really cared about—maximizing profits at any cost—was a far cry from what appeared in print on its values statement. For organizational values to work in a positive way, the organization must live those values every day.
Societies and cultures also have shared values, and these are an important part of the business environment and expectations of business and businesspeople. When we talk about cross-cultural values, we often focus on the differences. But, as you see in Chapter 11, values across cultures are often more similar than different. Even in corrupt cultures, if you ask people what they value, they’ll tell you that they would prefer to live in an environment where everyone can be trusted to do business honestly and fairly. We’ll return to a discussion of values again and again as a touchstone for ethical business practice.

How This Book Is Structured

Section II of this book deals with ethics and the individual. Chapter 2 presents the reader with an overview of some basic philosophical theories that have formed the underpinning for the traditional study of individual ethical decision making from a prescriptive viewpoint. Chapter 3 presents a more psychological approach to individual ethical decision making. It provides a “reality check” for Chapter 2 by suggesting that managers need to understand the individual characteristics that can influence employees’ ethical decision making and the human cognitive biases that can interfere with the ideal decision-making process (see Figure 1.1). Chapter 4 categorizes the common ethical problems individuals face at work and provides an opportunity for you to apply what you’ve learned. Chapter 4 is also about finding your moral voice to raise or report ethical issues or to stand up for what you value. Despite the best of intentions and the most carefully reasoned ethical judgments, doing the right thing can be difficult.

Section III of the book focuses on the internal life of organizations, how they develop ethical (or unethical) cultures, and how culture influences employee behavior. Chapter 5 focuses on business ethics as a phenomenon of organizational culture. It provides a comprehensive overview of how an organization can build a culture that reflects a concern for ethics, and how it can change its culture to be more supportive of ethical conduct. This chapter also emphasizes the importance of executive ethical leadership in creating a strong ethical culture. Chapter 6 follows with more practical and specific advice on how organizations can design an ethics infrastructure as well as effective communications and training programs. It also includes examples of the programs various companies have implemented to encourage ethical conduct among their employees. Many of these examples resulted from interviews we conducted with top managers in these companies.

Chapter 7, “Managing for Ethical Conduct,” introduces management concepts that can help explain the group and organizational pressures that influence people to behave ethically or unethically. We also provide practical advice for managers about how to use these management concepts to encourage ethical conduct and discourage unethical conduct in their employees. Finally, Chapter 8 explores how culture plays out at the manager’s level and features a series of cases to test your knowledge of ethics and management skills.
After considering individuals and organizations, Section IV of this book looks at organizations in the broader social environment (see Figure 1.3). Chapter 9 focuses on corporate social responsibility and discusses the environment that organizations are part of—and what they must do to be considered “good citizens” of the broader world. Chapter 10 examines some of the classical organizational ethics cases using a stakeholder framework. Finally, Chapter 11 extends our discussion of business ethics to the global business environment. Although global examples appear throughout the book, this issue is important enough to warrant its own chapter.

Conclusion

This chapter was designed to pique your interest in business ethics. We hope we have done that. We also hope that reading this book gives you a better understanding of ethics from a managerial perspective, and of how you can encourage ethical business behavior in yourself and others. We aim to help you understand how this aspect of the organizational world actually works and what you can do to manage it. We also provide practical decision-making guidance for facing your own ethical decisions and for helping others do the same.
It’s critically important that we all understand ethics because good ethics represents the very essence of a civilized society. Each of us must understand that ethics is the bedrock for all of our relationships; it’s about how we relate to our employers, our employees, our coworkers, our customers, our communities, our suppliers, and one another. Ethics is not just about the connection we have to other beings—we are all connected; rather, it’s about the quality of that connection. That’s the real bottom line and our society is threatened when we ignore it.

Discussion Questions

1. Before reading this chapter, did you think of ethics as “just a fad”? Why or why not? What do you think now? Why?

2. Have you been cynical about business and its leaders? Why or why not? (See the following cynicism exercise.) How does cynicism affect you, as a business student or as a manager?

3. Can you think of something that is legal but unethical, or something that is ethical but illegal?

4. Do you think business ethics is important? Why or why not?

5. Identify reasons why a person would be interested in being ethical, and classify those reasons in terms of whether they represent moral motivation or economic motivation.

6. Think about the television programs and films you’ve seen recently that depicted business in some way. How were business and businesspeople portrayed? Is there anything business could or should do to improve its media image? Some businesses try to stay out of the limelight. Why might that be? What do you think of that strategy?

7. Do you believe that employees are more attracted and committed to ethical organizations? Are you? Why or why not? Make a list of the companies you would prefer to work for, and state the reasons why. Are there also companies that you would refuse to work for? Why? Are there ethically “neutral” companies that don’t belong on either list? Are there industries where you would not want to work? What are they and why?

8. Discuss the importance of trust in business. Can you cite examples? What happens when trust is lost?

9. What effect do you think the Barron’s survey on the most respected companies has on the companies involved? Do you think the companies on the top of the list benefit? How? What do you think about the companies on the bottom of the list? (Search for “Barron’s Most Respected Companies” for the complete list.)

10. What can we learn about business ethics from the recent financial crisis?

11. How does a lack of trust in institutions affect us? Do you trust institutions? If not, what effect does that have on you?
Exercise

**Your Cynicism Quotient**

Answer the following questions as honestly as you can. Circle the number between 1 and 5 that best represents your own beliefs about business.

<table>
<thead>
<tr>
<th></th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neither Agree nor Disagree</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Financial gain is all that counts in business.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2. Ethical standards must be compromised in business practice.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3. The more financially successful the businessperson, the more unethical the behavior.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4. Moral values are irrelevant in business.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5. The business world has its own rules.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>6. Businesspeople care only about making profit.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>7. Business is like a game one plays to win.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>8. In business, people will do anything to further their own interest.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>9. Competition forces business managers to resort to shady practices.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>10. The profit motive pressures managers to compromise their ethical concerns.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Add the total number of points. The maximum is 50 points. Total_________.

The higher your score, the more cynical you are about ethical business practice. Think about the reasons for your responses. Be prepared to discuss them in class.
Notes


22. Ibid.

23. J. R. Rest and S. J. Thoma, “Educational Programs and Interventions,” In *Moral Development: Advances in Research and...


