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2 THE EVOLUTION OF BUSINESS ETHICS

LEARNING OBJECTIVES

After reading this chapter, you should be able to

2.1 Describe salient business ethics issues in precapitalist civilizations.

2.2 Summarize the ethical foundation of capitalism as argued by Adam Smith in the 1700s.

2.3 Explain ethical issues experienced in the United States since adopting capitalism.

2.4 Appraise the historical shift back and forth between mandatory business regulations and voluntary ethical enhancements.

2.5 Apply the Ethical Systems Model to create a high-integrity work culture.

WHAT WOULD YOU DO? BEYOND LEGAL COMPLIANCE

After graduation, you obtain a job as staff assistant to the chief executive officer (CEO) of a large international manufacturing company that produces several products, including computer printers. The company is known for "B" level products at affordable price points. Your company's legal and regulatory department ensures full compliance with all related laws and mandatory regulations associated with the products it makes. The department also monitors compliance with environmental laws and regulations regarding the recycling of printer parts and disposal of hazardous materials. The company is in full compliance with all current mandatory regulations regarding recycling.

Recently a protest group has organized an extensive and public letter writing campaign demanding that your company comply with new voluntary computer printer recycling regulations. The protesters e-mail thousands of inflammatory letters each week to the media and key stakeholders, organize petitions, and stage dramatic protests at company headquarters.

The CEO is considering changing your company's compliance policies. But going beyond legal compliance by implementing the new voluntary, and costly, regulations would raise the price point of your computer printer products by a substantial 20%, making your "affordable" market niche less affordable to many customers. The CEO asks for your advice on the matter.

Critical Thinking Questions

1. What *could* you do?
2. What *would* you do?
   a. Continue to comply with only the legally required regulations to maintain your price advantage over competitors
   b. Implement the new voluntary regulations to end the protests, raise prices 20%, and risk losing a great deal of business
   c. Something else (if so, what?)
3. Why is this the right option to choose?
4. What are the ethics underlying your decision?

The previous chapter highlighted that organizations are composed of morally imperfect individuals who have a sense of right and wrong, are self-interested and other-regarding, seek to experience pleasure and avoid pain, and can be both kind and cruel. The media overflows with daily stories documenting the worst attributes of organizations and individuals by spotlighting business wrongdoings. Is business contributing to the world getting better or worse over time?

This chapter begins with a broad perspective of modern society's progress and then discusses the historical evolution of business ethics and social responsibility. It describes business ethics in precapitalist societies, within Adam Smith's conceptualization of capitalism, and under capitalism. With the maturation of democracy and the justice system during the second half of the 20th century, tension points between stakeholder rights and government regulation rose to prominence.

The federal government's movement toward deregulation has been complemented by voluntary ethical encouragements, or nudges, as exemplified by the Defense Industry Initiative and federal sentencing guidelines. The chapter concludes with the Ethical Systems Model, a conceptual framework for maximizing ethical behavior and reducing ethical risks in organizations, to be applied throughout the remainder of this book.

THE HISTORICAL FLOW OF CIVILIZATION AND BUSINESS ETHICS

Arnold Toynbee, the noted historian, said, "Civilization is a movement and not a condition, a voyage and not a harbor."[1] Since 1980, in what direction is global civilization moving? Is the quality of life worldwide getting better, about the same, or worse?

Your answer depends a great deal on how "quality of life" is measured. Four key common social indicators are poverty, health, education, and democracy. A "good society" would have low poverty rates, healthy and educated individuals, and political freedom.

Based on media impressions, it would not be surprising if you thought all four indicators had worsened or stayed the same over time. But they've all dramatically improved.[2]

- *Poverty.* In 1993, almost 2 billion people around the world lived in extreme poverty on less than $1.25 per day. By 2013, the number was cut in half to 1 billion and has continued downward.
- *Health.* In 1990, almost 13 million children died from preventable diseases. By 2013, the number was cut in half to 6.3 million children and has continued downward.
- *Education.* In 1980, only 50% of all girls in developing countries completed primary school. By 2013, the number had increased to 80% and has continued upward.
- *Democracy.* In 1983, 17 developing countries were democracies. By 2013, the number more than tripled to 56 countries and has generally stabilized.

Why has there been a positive movement? Harvard professor of psychology Steven Pinker attributes the worldwide decline in violence over the last few centuries to the humanitarian and rights revolutions born out of the Enlightenment's twin pillars of rationality and liberty.[3] Progress is being pushed and pulled by each generation trying to make the world better for its own children; new technologies enhancing scientific and medical discoveries; the Internet making previously unseen injustices visible; and democracy putting grievances on public display for politicians, interest groups, and individuals to address.

What about personal and business ethics? Are they getting better or worse? Is it a hopeless dream to create ethical businesses? Not at all, though continual effort is required by current and future business and political leaders. Michael Shermer, a historian of science, surmises that "we are living in the most moral period in our species' history"[4] where "liberal democracies with market economies are more prosperous, more peaceful, and fairer than any other form of governance and economic system."[5]

History is driven by individuals seeking to improve the quality of their lives. Martin Luther King Jr., influenced by the writings of Theodore Parker, maintained, "The arc of the moral universe is long, but it bends toward justice."[6] People aspire to experience "the good life," which means being treated with respect, and treating others as an ends in themselves, rather than just a means to an end.

Business ethics must be understood from an evolutionary perspective to appreciate how our conceptions of ethical and unethical behaviors at work have developed over time. The movement of history has been toward the creation of a wealthy *and* just society, which requires enhanced economic growth and respect for people. The current mix of ethical issues in a country's business sector is a function of its economic, social, and moral evolution.

Our conceptions of right and wrong have evolved over time, as have the laws governing our behaviors. Progress in business ethics and corporate social responsibility, along with well-entrenched problems, can be partly explained by Charles Darwin's theories of survival of the fittest and natural selection.[7] Businesses that fit the economic, political, and moral environment of their time survive by adapting to changing social and political norms.

During the 1600s, it was morally permissible for male Caucasians to steal land from Native Americans, enslave African Americans, and torture individuals for their heretical religious beliefs. During the 1700s and 1800s, it was morally permissible to hire young children and adults to work 16 hours a day, 6 days a week, in sweatshop conditions with hazardous chemicals, dangerous machinery, and suffocating fumes. Up until the early 1960s, it was morally permissible to deny an individual employment or promotion because of his or her gender, race, or ethnicity. During the 2000s, all of these previous morally acceptable behaviors in business were considered morally objectionable and illegal.

How did this happen?

Early Civilizations and Business Ethics

Some people tend to blame capitalism for unethical business practices.[8] But unethical business activities far predate the formation of capitalism in the late 1700s and have occurred in all ancient civilizations.

The Earth is approximately 4.5 billion years old.[9] The first beings with a brain and skeletal structure appeared around 2.5 million years ago and evolved into having an upright bipedal posture and hand-thumb capability. The extinct Homo erectus migrated out of Africa and across Eurasia 1.75 million years ago. Homo sapiens appeared about 200,000 years ago in Africa and migrated out of Africa about 70,000 years ago. They spread across Asia, Europe, and Australia by 40,000 BCE, and the Americas around 20,000 BCE.

We can only speculate about the nature of work and moral sentiments before 3000 BCE, when writing is believed to have begun, based on archeological findings and scientific analysis. Despite the lack of written record, one thing we know is that individuals organized themselves in kin-based groups and performed labor.[10] Social cooperation and self-sacrifice, though not always obtained, were essential in early societies for survival. Neanderthal bone findings strongly suggest that tribes lacking a necessary resource, and unable to trade for it, would unethically invade, steal from, and kill another tribe possessing the desired resource.[11]

Tribal members engaged in scavenging, hunting, digging, gathering plants, and fishing. Generally, **division of labor**, meaning how work tasks are segmented to improve efficiency, was based on gender. Men hunted for animal meat and made tools. Women collected grains, fruits, vegetables, and water; prepared food; and cared for children. Tools, weapons, and living accommodations were privately possessed yet communally shared for the well-being of the tribe. The needs of the collective had to be put above individual wants and desires. Essential virtues needed to maintain peace within this social structure included justice, group loyalty, and generosity. Courage was needed for dangerous hunts and to protect the tribe from hostile outsiders. Selfishness and laziness led to ostracism and banishment from the tribe.

Slavery existed in almost all ancient civilizations after the formation of agrarian societies. Enslaved people, usually people conquered and their offspring, were considered the landowner's property. Enslaved people were used as the owner desired and often performed the most menial tasks.

The Code of Hammurabi, the oldest written set of laws for maintaining civil relationships among a community of people, dates back to 1754 BCE Mesopotamia.[12] Unethical business practices can be deduced from laws that placed restrictions on landowners, herdsmen, tenants, and merchants, meaning these business practices had been done and needed to be prohibited. Contract violations included not delivering or paying for promised goods, selling unowned goods, wage agreement violations, land theft, fraud, theft, slander, and not paying an enslaved person's doctor fees.

European Settlement of America and Business Ethics

The arrival of Europeans in the modern-day United States was the result of several business ethics issues associated with conducting international business, tax payments, the search for gold, business commissions, and slavery. In 1453, Ottoman Turks conquered Constantinople and gained control of the overland spice route linking Europe and India. European traders passing through Constantinople had to pay exorbitant taxes or have their product confiscated.[13]

Division of labor How work tasks are segmented to improve efficiency.

Complicating matters, Christian rulers declared it unethical for European traders to enrich an Islamic military power that wanted to conquer Europe.

The Italian navigator Christopher Columbus proposed a solution: avoid the land route through Constantinople by sailing west to India. He obtained funding from King Ferdinand and Queen Isabella of Spain, a commercial leader at the time. King Ferdinand's instructions to Columbus were straightforward: "Get gold, humanely if possible, but at all hazards—get gold."[14] Columbus signed a lucrative business contract where he would receive 10% of the revenues generated by the new lands.[15]

After exploring Caribbean islands, Columbus concluded that the Indigenous people would be relatively easy to conquer, enslave, and Christianize. During his four business voyages across the Atlantic Ocean, Columbus shipped 500 enslaved people back to Spain. The 300 enslaved people who survived the trips were sold at European auctions.

England, France, the Netherlands, and Spain, often at war with each other, competed to find riches in "America." In the 1580s, Walter Raleigh and his business associates obtained a charter from Queen Elizabeth to establish an English colony in modern-day Virginia and North Carolina to trade, search for minerals, and plunder Spanish merchant ships.[16] **Charters** granted by the British government allowed several people to create an organization by pooling their financial resources. This enabled bigger and riskier business projects to be undertaken. Owners of chartered organizations were exempt from debtor's prison if the business venture failed.

Another charter was granted to the Virginia Company of London to search for gold and gems and trade in furs and spices.[17] The labor force at Jamestown consisted mostly of indentured servants who came from England's "excess population" of landless tenants, beggars, and criminals.[18] But many more laborers were needed for strenuous work on tobacco plantations. Colonists met this labor shortage by enslaving Indigenous men and women and purchasing enslaved persons from Africa.

The first slave ship arrived in Virginia in 1619. Portuguese forces captured 350 tribal members from the vicinity of present-day Angola. More than half of the human cargo died due to brutal treatment and disease while crossing the Atlantic Ocean. The Portuguese ship was attacked by Dutch privateers, who then sold the 20 to 30 enslaved Africans they stole to British settlers.[19] By the time U.S. Congress banned importing enslaved persons in 1807, about 400,000 enslaved persons had arrived on America's shores. Some slave shippers found the business risk acceptable and continued to illegally sell enslaved persons to U.S. businesses as late as 1860.

The Pilgrim settlement at modern-day Plymouth, Massachusetts, was also a business venture. The Plymouth Company, an association of merchants in England that included some Puritans, obtained a charter to establish a trading colony on the northeast coast of America.[20] Among the Puritans, a small group called Pilgrims was recruited to make the first ocean voyage and establish a settlement. The Plymouth Company offered Pilgrims shares of company stock and transportation to "New England" where they could create their God-centered Puritan

Charters Granted by the British government to allow several people to create an organization by pooling their financial resources; owners of chartered organizations were exempt from debtor's prison if the business venture failed.

community in the American wilderness.[21] In return, the Pilgrims had to work off their travel and relocation debts by exporting goods back to England.

By 1773, more than 2.3 million European colonists participated in highly regulated business activities along the eastern section of America, regulations they resisted. Business and tax policies imposed on colonists by Great Britain to fund rising administrative costs exacerbated anti-England sentiments.[22] Farmers and merchants protested that colonial taxation without elected representation in the British Parliament was unethical.

A group of agitated colonists dissented against the East India Company's monopolistic business practices by dumping into Boston Harbor what amounted to 8% of the tea consumed in colonial America annually.[23] Acts of civil disobedience intensified. Within 2 years, the colonists declared war against their English ancestors. On July 4, 1776, colonial leaders declared political independence from Britain, an act of treason punishable by death.

FREEDOM, RIGHTS, AND THE ETHICS OF CAPITALISM

The Declaration of Independence provides an extensive list of legislative, judicial, and military abuses imposed on colonists by King George III. The well-educated colonial leaders wanted a government based on the consent of the governed, a claim grounded in fundamental human rights and individual liberty. The declaration's second sentence declared, "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable rights, that among these are life, liberty, and the pursuit of happiness."

Approximately 25,000 colonists died for these rights during the Revolutionary War. Emboldened by defeating Europe's largest military power, the new nation's founders set out on a political and economic experiment to create a government and economy based on individual liberty. Such a government would have limited power, protect the rights of people, and be accountable to laws established by the people.

These rights, elaborated by James Madison in the **Bill of Rights**, took effect in 1791.[24] The rights included freedom of speech, press, and religion; freedom to petition the government; and freedom from unreasonable search and seizure. Property rights, a core value for conducting commerce, are contained in the Fifth Amendment to the U.S. Constitution: "[nor should any person] be deprived of life, liberty, or property, without due process of law." These rights and freedoms were to be disbursed more broadly through the population.

Adam Smith's Capitalism

James Madison, Benjamin Franklin, and Alexander Hamilton relied on the writings of Scottish philosopher **Adam Smith** to guide their thinking on how to conceptualize freedom within the business sector.[25] Adam Smith (1723–1790), one of the most influential systematic social

Bill of Rights Document protecting freedom of speech, press, and religion; freedom to petition the government; and freedom from unreasonable search and seizure.

Adam Smith (1723–1790) One of the most influential systematic social philosophers in the history of Western civilization, applied the concept of "liberty" to economic matters.

philosophers in the history of Western civilization, applied the concept of "liberty" to economic matters. Smith's conception of modern capitalism was a reaction to the evolution of economic systems and business ethics leading up to mercantilism, the dominant business system at the time. Mercantilist policies included sanctioning monopolies, putting quotas on imports, regulating tradesmen, and assigning management positions based on family and political connections rather than individual merit.

The lack of business competition, Smith argued, led to high prices, low-quality products, and shortages, which contributed to harsh living conditions among Scottish peasants. The famines of 1696–1699 and 1739–1740 resulted in the starvation of 5% to 10% of the Scottish population. Smith maintained that despite Great Britain's majestic empire, "No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable."[26]

As a prominent member of the Scottish enlightenment, Smith applied the philosophical concepts of "reason" and "liberty" to a wide range of endeavors, including politics, the law, and economics.[27] In *Wealth of Nations* (1776), Smith formulated **capitalism**, an economic system based on freedom and competition in both product and labor markets, as an economic system ethically superior to highly regulated mercantilism.[28] Individuals should have the freedom to naturally pursue their economic self-interests and flock to business markets where product demand was high and supply low, which is where they were needed most. A free and competitive market economy would enhance national wealth by generating more goods and services, lower prices, better-quality products, more efficiency, and greater labor flexibility.

But wouldn't all this freedom result in social chaos? Wouldn't capitalism result in greedy rich merchants exploiting the poor and then the rich would become lazy? And wouldn't capitalism result in the poor becoming lazy and stealing from the rich rather than work hard as productive members of society?

Smith was well aware of these concerns and had addressed them 17 years earlier in his first book, *Theory of Moral Sentiments* (1759). Smith maintained that individuals typically self-regulate their free will within the confines of morality. The book's opening sentence states, "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it."[29]

Smith's ethical defense of capitalism rests on the following beliefs:

1. Freedom and liberty are essential values.
2. Free people naturally pursue their self-interests and respect the interests of others.
3. People will choose to enter product and labor markets where there is the greatest need and opportunity.
4. People morally self-regulate their actions based on their
   a. conscience,
   b. belief in God,

Capitalism An economic system based on freedom and competition in both product and labor markets, as an economic system ethically superior to highly regulated mercantilism.

c. concern for the well-being of others, and/or
d. reason.

5. A strong system of justice is essential to punish those who do not appropriately self-regulate their behaviors and to enforce contracts.

Smith differentiated between selfishness (concern only for self) and self-interest (concern for self in relation to others). Some individuals might be tempted to behave selfishly, Smith argued, but most people tend to self-regulate their behavior based on moral sentiments originating from one's conscience, belief in God, natural concern for the well-being of others, and reason. When these self-regulating moral mechanisms fail, a system of justice funded by, but independent of, government must punish the wrongdoer to protect the public from egregious immoral actions. People engaged in business activities need to know that those who violate the law will be punished by the justice system.

Government intervention in the marketplace, Smith reasoned, would only be needed under three conditions: (1) when contracts were violated; (2) when merchants abuse their freedom by committing injustices against others; and (3) when the pursuit of self-interest does not generate highly desired social welfare benefits, such as national defense, and certain public works, such as roads.

Smith on Labor Issues

Labor issues matter a great deal because individuals need to earn income and deserve to be treated with respect and dignity. Smith cautioned that there was a natural friction between the interests of owners seeking to maximize their profits and laborers seeking higher wages and better working conditions. He highlighted three problems that could occur if owners, in pursuit of greater profits, did not rely on their moral sentiments when dealing with laborers.

First, when there is an overabundance of laborers, owners could drive wages below subsistence amounts because of their superior bargaining position and ability to "hold out much longer" economically during wage conflicts and strikes.[30] Smith warned owners, however, "that men in general should work better when they are ill fed than when they are well fed, when they are disheartened than when they are in good spirits, when they are frequently sick than when they are generally in good health, seems not very probable."[31] Thus, it was in the owner's self-interest to pay a livable wage.

Second, in the short-term excessive application of piece-rate incentives could increase productivity, but in the long-term doing so damages a worker's physical health. Laborers paid piece-rate, Smith argued, "are very apt to over-work themselves, and to ruin their health and constitution in a few years."[32] Thus, it was in the owner's self-interest to be reasonable in determining piece-rate incentives.

Third, in the short-term excessive application of division of labor could increase productivity, but in the long-term doing so damages a worker's intellectual abilities. Smith reasoned that "the man whose whole life is spent in performing a few simple operations . . . generally becomes as stupid and ignorant as it is possible for a human creature to become."[33] Creating a class of ignorant laborers was not in the owner's self-interest.

BUSINESS ETHICS UNDER CAPITALISM

The nation's founders adopted the basic guidelines of capitalism synthesized by Adam Smith. Between the late 1700s and 1900, the United States economy grew from family farms, merchants, and tradesmen into the world's largest economy. Industrial nations have doubled life expectancy, eliminated famine, and developed a nonending list of technological innovations that enhance the quality of life.[34] These accomplishments are morally admirable. Capitalism experienced in the United States, however, has not been an ethically smooth march of progress. Some people who benefitted the most from capitalism misused their dominant positions to the detriment of laborers and local communities. Capitalism's greatest moral challenges have included unfair competition, slavery, work conditions, and stakeholder rights, each of which is summarized next.

Unfair Competition

How did the economic evolution from local merchants and farmers to the world's largest economy and dominant multinational corporations happen? After the Revolutionary War, the newly formed government permitted citizens to independently form businesses and choose places of employment. The economy boomed when the **Industrial Revolution** spread from Britain to the United States in the early 1800s.[35] The Industrial Revolution refers to economic and social organization changes characterized by replacing hand tools with new manufacturing power-driven machines, such as the steam engine, and industry's concentration into large establishments.

These technological innovations and the division of labor significantly increased productivity and reduced the price of products. Westward expansion required the transportation of goods to new business markets and resulted in the creation of integrated industries, cheaper products, and job growth.[36] Accountants were needed to document revenues and expenses, lawyers to address legal issues, and managers to efficiently coordinate activities. Roadways, railroads, and automobiles provided faster ways to transport goods and services over greater distances to connect suppliers and buyers. Telegraphs, telephones, postal services, and, eventually, computers provided faster means of communication over greater distances. Businesses developed to address housing the growing population, schools and colleges to educate them, and movies and television to entertain them.

These massive projects required large amounts of capital, which contributed to the growth of chartered corporations, banks, and the financial industry. The birth of each new industry led to the creation of more jobs and attracted immigrants seeking an alternative to the poverty they had been experiencing in their own countries, who would then consume more products and services.

But capitalism has an inherent contradiction. Competition is ethical partly because it rewards companies for becoming more efficient and effective at providing quality goods at affordable prices. Successful companies increase market share over less successful companies.

Industrial Revolution A period in the late 1700s and 1800s when hand tools were replaced with new manufacturing power-driven machines, such as the steam engine, and manufacturing companies grew into large establishments.

As their market share increases, some successful small businesses evolve into medium-sized businesses, and then into large corporations. The organization that best fits the evolving business environment runs less efficient competitors out of business or acquires them. Eventually, the former highly competitive market becomes inhabited by oligarchies, a handful of large businesses who then compete against one another, each aspiring to monopolize a market.

Early movers in a new market may also develop formidable advantages that prevent new competitors from entering the market or succeeding. In modern times, Microsoft, a software early mover, was accused by the U.S. and European governments of establishing a monopoly in the computer industry by legally placing restrictions on computer manufacturers and users' abilities to install competitor software programs.[37] In addition, with its vast resources, Microsoft subsidized its products at price levels new competitors could not match and acquired potential successful competitors at prices hard for them to turn down.

By the late 1800s, over 50 industries were characterized by one corporation controlling at least 60% of market share.[38] The federal government attempted to counteract these anti-competitive trends by passing the **Sherman Antitrust Act of 1890**, legislation that outlawed monopolies to increase competition. Businesses can grow to a certain extent, and then any further growth is illegal. Large corporations seeking additional growth have to apply their skills and expertise in other industries.

Slavery

As noted earlier, slavery, the worst form of labor exploitation, predates capitalism. **Slavery** is a system in which individuals are owned by other people. The number of enslaved persons in the United States grew dramatically during the buildup to the Revolutionary War, from 120,000 in 1756 to 500,000 in 1776.[39]

The U.S. Constitution sidestepped the obvious contradiction between liberty and slavery to appease southern states, whose economies depended on enslaved persons, into signing the document. George Washington, a Virginian plantation owner who became the first president, brought nine enslaved persons with him to the Philadelphia President's House. Washington had owned enslaved persons for 56 years, and more than 300 enslaved persons lived on his Mount Vernon plantation.[40]

Southern dependency on slavery increased during the Industrial Revolution. Enslaved persons toiled under severe working conditions picking cotton, tobacco, and sugar cane, products upon which northern businesses and citizens relied. Eli Whitney's cotton gin made it easier to separate seeds from cotton fibers, and the number of bales of cotton from southern plantations increased from 100,000 in 1800 to 5.4 million in 1859.[41]

With the 1807 federal ban on importing enslaved persons, producing enslaved persons became a growing southern business. Enslaved family members, including children, were separately sold at auction to the highest bidder. Enslaved persons had no rights because they were property of their owners and could be used at their owner's discretion. Intolerant enslaved

Sherman Antitrust Act of 1890 Legislation that outlawed monopolies to increase competition.

Slavery A system in which individuals are owned by other people.

persons were whipped and hanged. Female enslaved persons were raped. In 1857, the Supreme Court ruled that all Blacks were not entitled to citizenship, whether enslaved or free.

The number of enslaved persons picking cotton and performing other tasks grew from 700,000 at the turn of the century to 4 million in 1859.[42] Shortly after the 1860 election of President Abraham Lincoln, 11 southern states, concerned about a potential federal ban on slavery, seceded from the United States under the banner of "states' rights." More than 620,000 soldiers, and thousands more civilians, lost their lives in the ensuing Civil War fought to preserve the nation.

Lincoln's 1863 Emancipation Proclamation, which freed enslaved persons in Confederate states as a war strategy, did not apply to nonrebellious states. Slavery was not abolished until passage of the Thirteenth Amendment to the U.S. Constitution in 1865, which was soon followed by the Fourteenth Amendment's (1868) granting of citizen rights, and the Fifteenth Amendment's (1870) granting of voting rights. In many ways the scars of slavery still haunt racial relations in the United States today.

Labor Unions

The failure of owners and managers to heed Smith's appeal to treat laborers with respect and dignity led to the formation of worker unions.[43] A **labor union** is an association of employees that advances its members' interests, such as wages, benefits, work rules, and other conditions of employment, through collective bargaining with an employer. Unions reduced power imbalances between owners and laborers by organizing employees to speak with a single voice against what they considered unethical treatment.

Philadelphia shoemakers formed the first local union in 1792, but 13 years later, a jury composed of merchants found eight members of the shoemakers' union guilty of engaging in a criminal conspiracy to raise wages.[44] Business owners claimed unions violated their property rights and put their companies at a competitive disadvantage because paying higher than market wage rates forced them to charge higher prices for their products. In 1840, Philadelphia strikers won the right to work only 10 hours a day. But 40 years later, approximately 80% of all laborers worked a minimum, rather than a maximum, of 10 hours a day, with many still working 12- to 14-hour days.

Battles between management and labor over union efforts to negotiate pay and work hours issues often turned violent during the late 1800s and early 1900s.[45] Emotions ran high as laborers and strike breakers, referred to as scabs, needed income to feed their families; owners protected their business property rights; and local, state, and federal militia tried to maintain peace in ways that favored property owners. The "Great Railroad Strikes of 1877" left an estimated 40 dead in Pittsburgh, 18 in St. Louis, 30 in Chicago, and 30 in Philadelphia; 40 sugar cane workers died in 1887 at the "Thibodaux Massacre" in Louisiana; 30 railroad workers died during the Pullman Strike of 1894; and 50 died during 1914 Colorado coal mining strikes. The 1921 Battle of Blair Mountain in West Virginia rose to the level of more than 10,000 armed coal

Labor union An association of employees that advances its members interests, such as wages, benefits, work rules, and other conditions of employment, through collective bargaining with an employer.

miners fighting several thousand lawmen and private armed forces.[46] About 30 militia and 75 miners were killed before federal troops arrived.

Advocates for an 8-hour workday maintained that a day should be subdivided into three equal parts: 8 hours for work, 8 hours for personal interests, and 8 hours for rest. In 1916, the first 8-hour workday federal law passed covered interstate railroad workers, with additional pay earned for overtime. A key pivot in labor relations occurred with the National Labor Relations Act of 1935. The federal government codified regulations for forming a union, and employers were legally obligated to negotiate with duly elected unions. Union membership rose to 36% of wage and salary workers by the end of World War II.

The union movement has been hampered by the stigmas of violence and corruption.[47] Violence became a union strategy in response to some business owners hiring thugs to beat up union organizers. The International Brotherhood of Teamsters, which organized workers in the transportation industry, became the most notoriously corrupt union in the United States. People with criminal records rose to union leadership positions and extorted money from businesses in exchange for either not striking or striking a competitor.[48] Managers resisting the extortion were threatened with physical violence and nondelivery of goods.

Many union organizers, however, have lived sacrificial lives for the well-being of others and emphasized nonviolence when threatened by abusive business owners and strike-breakers. For example, Cesar Chavez, inspired by Gandhi's message of nonviolence and by Catholic social justice teaching, unionized immigrant farm workers in California and led a 10-year nationwide boycott against grapes picked by nonunion workers, until his death in 1993.[49]

What was a union organizer's life like? Chavez was born in Arizona in 1927, the son of illiterate Mexican immigrant parents. The poverty-stricken family lived in a tent and traveled throughout California picking grapes, strawberries, tomatoes, and cotton. Migrant farm workers received below-poverty wages, were charged for transportation to the fields and ice water, and had no bathroom facilities.

Chavez became a union organizer after serving in the U.S. Navy. He started an underground newspaper, held secret meetings, and eventually founded the National Farm Workers Association in 1962, later renamed the United Farm Workers, to represent the rights of farm workers.

Filipino grape workers went out on strike in 1965 for better wages and unemployment insurance. Chavez persuaded Mexican and Latino workers, fearful of being deported for immigration violations, to join the strike. Landowners accused Chavez of being a communist and imported Mexicans to work the fields. Local police sided with the landowners, threatened strikers with attack dogs and deportation, beat them up, sprayed the strikers with pesticides, and arrested them.

Chavez raised public awareness about these events by speaking at churches and universities. He called for a nationwide boycott of Schenley Industries, which purchased the farm worker-picked grapes for its liquor products. Influenced by the tactics of Gandhi and Martin Luther King Jr., Chavez led a 300-mile march to Sacramento, the capital of California, demanding political action. In 1966, Schenley Industries capitulated and recognized the union as the farm workers' bargaining agent. Chavez spent the rest of his life expanding the union, participating in collective bargaining negotiations, and conducting strikes and boycotts.

Despite the efforts of union organizers, many business owners continued to fight against unionization on private property rights grounds. Because they owned the business, owners argued, they had private property rights claims on how to manage their workplace.

Union membership steadily declined to 10.3% in 2020, which accounted for 14.6 million wage and salary workers.[50] The highest unionization rates are in the public sector (33.6%), namely government employees, teachers, fire fighters, and police officers. In the private sector, 6.2% of employees are union members.

Stakeholder Rights and the Interpenetrating Systems Model

Expectations that businesses should undertake greater social responsibilities have significantly increased over the past 50 years.[51] In the early 1960s, Democrat president John Kennedy encouraged a new generation of leaders to create a fair and just society.[52] Later that decade, profit maximization and the rights of owners came under attack by social activists who believed American businesses were a detriment, rather than a contributor, to improving the quality of life. Corporate critics formed alliances to restrict business freedom through increased **government regulation**, a law or rule developed by government to regulate conduct.

Business activities previously considered unethical became illegal. In general, the more that owners and managers behave ethically, the more freedom they are granted. The more that owners and managers behave unethically, the more they are regulated to prevent harms and protect stakeholders.

In relatively rapid succession, Congress passed a slew of regulations protecting various stakeholders from unethical business practices.[53] New consumer protections included the Cigarette Labeling and Advertising Act (1966) and Fair Packaging and Labeling Act (1967). New employee protections included the Equal Pay Act (1963) and Equal Employment Opportunity Commission (1964). New community protections included the Air Pollution Control Act (1962). New regulations and regulatory bodies were established during the early 1970s under Republican president Richard Nixon's administration, such as the Environmental Protection Agency (1970), Occupational Safety and Health Administration (1970), and Consumer Product Safety Commission (1972). These new regulations challenged businesses to achieve economic growth and profits in a socially responsible manner that considered the dignity and well-being of all stakeholders, not just shareholders.

Regulatory readjustments are made when political leaders and the public become convinced that specific regulations damage the economy and contribute to substantial job losses. During the 1980s, Republican president Ronald Reagan argued that the high costs associated with the onslaught of government regulations resulted in an economic competitive disadvantage for American companies operating within a global economy.[54] The Reagan and Republican George H. W. Bush administrations began to deregulate the economy, a trend that continued under the administrations of Democratic president Bill Clinton and Republican president George W. Bush.

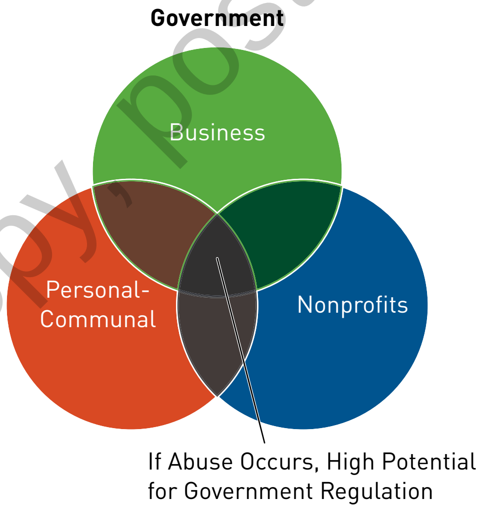
Government regulation A law or rule developed by government that regulates conduct.

A long-term perspective on these matters is helpful. Arthur Levitt, a Wall Street insider and former Securities and Exchange Commission (SEC) chairman under Clinton, noted, "The evolution of our markets is like the nine innings of a baseball game—and we're only in the top of the third inning."[55] Determining fair rules for all stakeholders, and preventing stakeholders from unfairly circumventing those rules, takes a great deal of trial and error.

Fraud continues to happen in all industries. It remains dangerous to engage in fraud because others in an industry do so. In the automobile industry, there had been a general sense that carmakers fudged tests for miles per gallon and emission calculations.

The Interpenetrating Systems Model is an illustrative tool for understanding the swinging of the pendulum between regulation and deregulation. As shown in Figure 2.1, the **Interpenetrating Systems Model** segments human activities into four major areas: government, business, nonprofits, and personal-communal, each with its own purpose.[56] Government is a broad system that contains the three other subsystems. Governments exercise control over populations by developing and enforcing rules and regulations. The business subsystem provides goods and services by generating wealth for owners, the nonprofit subsystem provides goods and services not met by governments and businesses, and the personal-communal subsystem refers to individuals behaving within the context of a family or neighborhood.

FIGURE 2.1 ■ Interpenetrating Systems Model



The government system and three subsystems can affect one another. During a business recession, more companies than usual go bankrupt (business subsystem), individuals have less discretionary income (personal-communal subsystem), nonprofits lose funding (nonprofit subsystem), and incumbent politicians lose elections (government system), which often results in regulatory changes.

Interpenetrating Systems Model An illustrative tool for understanding the interaction among businesses, nonprofits, individuals, and government.

Government is the most powerful system because it finalizes the rules for behaviors within its own system and has authority to impose them on the other three subsystems. The overlap of these systems is most apparent during a time of national crisis, such as the coronavirus pandemic. Government ordered businesses to close to minimize the virus's spread throughout a community. Business revenue streams quickly dried up, employees were furloughed or laid off, hospitals were overwhelmed, and nonprofits lost their funding when most needed. The government responded with a $2.2 trillion bailout to rescue the business sector.

Despite the bailout, bankruptcies soared. Unemployed workers and business owners pleaded for city and state government officials to reopen the economy as soon as possible. States that were reopening first-movers—such as Florida, Texas, and Arizona—experienced a second spike in coronavirus cases, and once again ordered businesses to close or significantly restrict how they operated.

No subsystem is monolithic. Multiple views and perspectives are evident within each subsystem. Health care legislation, for instance, affects government, businesses, nonprofits, and individuals. Some businesses, nonprofits, politicians, and individuals favor nationalized health care, and some do not.

The Interpenetrating Systems Model area in which all four subsystems overlap is typically one of regulatory interest. The request for regulation can come from any person or group in any subsystem.

In 2006, for example, Kate Hanni, her husband, and their two children (personal-communal subsystem) were stranded on a plane on the tarmac at the Austin, Texas, airport for 9 hours. Outraged at her lack of rights in this situation, Hanni created FlyersRights.org as a nonprofit consumer organization representing airline passengers (nonprofit subsystem) and lobbied political leaders and regulators to remedy the situation (government system).[57] Three years later, the U.S. secretary of transportation announced a "Passenger Bill of Rights" for domestic flights. The new regulation required an airline to provide passengers with food and water after waiting 2 hours on the tarmac and the opportunity to leave the plane after 3 hours.[58] The fine for not doing so: $27,500 per passenger.

Airlines (business subsystem) responded that they were being unfairly financially punished for factors beyond their control, such as bad weather and air traffic problems. For example, an airplane with 100 passengers experiencing unanticipated takeoff delays risked being fined $2.75 million. Airline representatives met with regulators (government system) to clarify the rules so that passenger rights are respected with reasonable accommodations made for airlines (the overlap of business, personal-communal, and nonprofit subsystems with the government system).

The new regulation went into effect in May 2010. The number of tarmac delays longer than 3 hours dramatically declined by 98%, from 463 during May to July 2009 to just 7 during the same 3-month period in 2010.[59] For the same 3-month period in 2019, the number of domestic flight tarmac delays over 3 hours had risen to 163, still significantly below the 2009 benchmark of 463.[60]

What other issues might airlines want to consider before they become regulatory matters? FlyersRights.org posts up-to-date videos of morally questionable behaviors passengers experience on airplanes, such as a passenger being physically abused after he did not cooperate with being forced to leave an airplane because of overbooking.[61]

FROM REGULATION TO ETHICAL ENCOURAGEMENTS

An initial swinging of the regulatory pendulum began with the Sherman Antitrust Act of 1890 to curtail monopolistic business behaviors. This section begins with the effort to regulate wages during the Great Depression and ends with the latest evolution toward voluntarily implementing business ethics best practices through pressure from industry associations, legal incentives, business ethics recognitions, and fear of negative Internet exposure.

Wages and Compensation

Adam Smith noted that a benefit of the free market system is that wages and other forms of compensation are determined in response to labor market supply and demand. He also maintained that the lowest paid full-time employee should earn enough income to afford the basic necessities of life.

Minimum and Living Wages

During the 1930s, the world economy collapsed, U.S. unemployment soared to 24%, and many people were unable to earn enough money to feed their families. In response to these conditions, Democratic president Franklin D. Roosevelt's administration regulated wages by establishing a minimum wage, the lowest wage an employer can legally pay an employee.[62]

An increase in the federal minimum wage requires congressional approval. Increases are not linked to inflation or a poverty threshold. The first federally mandated minimum wage was 25 cents an hour, or $11 a week ($151.20 modern equivalent adjusted for inflation). In 2009, the minimum wage increased to $7.25, which equates to a full-time annual income of about $15,000. Exemptions are made for tipped employees, who can be paid a minimum $2.13 an hour as long as tips earned raises their pay to at least $7.25 an hour.

In 2018, 1.7 million workers were paid at or below the federal minimum wage.[63] The highest percentage of people earning a minimum wage tend to be young, less educated, and employed in the leisure and restaurant industries. Generally, the more education a person receives, the higher his or her income, with a slight decline occurring at the doctorate level (see Table 2.1).

How does the minimum wage compare with poverty thresholds? The 2018 poverty rate in the United States was 11.8%, or about 38.1 million people.[64] A full-time employee living alone who earns a $7.25 minimum wage (about $15,000 annually) exceeds the poverty threshold for one person ($13,300), but it's not enough income to exceed the poverty threshold for a household consisting of one adult and one child ($17,622).[65]

States and other municipalities can establish their own minimum wage laws, as long as the wage is higher than the federal level. In 2020, 29 states and about two dozen cities had their own minimum wage. In 2018, San Francisco and New York City became the first cities to enact a $15 minimum wage. A full-time employee paid a $15 minimum hourly wage earns $31,200 annually.

TABLE 2.1 ■ Median Personal Income by Educational Attainment, 2018

Education Level	Percentage of Population Age 25 and Older*	Median Annual Salary Age 25 and Older**
Less than a high school degree	10.1%	$28,756
High school graduate	28.2%	$37,960
Some college, no degree	16.1%	$41,704
Associate degree	10.2%	$44,824
Bachelor's degree	21.9%	$62,296
Master's degree	9.6%	$74,568
Professional degree	1.4%	$97,968
Doctorate degree	2.0%	$94,900

* United States Census Bureau, *Educational Attainment in the United States: 2018*, "Population Characteristics," February 2019, Table 2, available at https://www.census.gov/data/tables/2018/demo/education-attainment/cps-detailed-tables.html, accessed 1/1/20.

** Bureau of Labor Statistics, "Earnings and Unemployment Rates by Educational Attainment, 2018," available at https://www.bls.gov/emp/ep_chart_001.htm, accessed 1/1/20.

Some free market advocates claim that minimum wage laws violate the constitutional right of employers and employees to freely enter into contracts.[66] They argue that wages should not be determined by politicians, government bureaucrats, or voters. Artificially raising wages above free market rates, they claim, hurts those it intends to benefit. Some business owners will hire fewer low-skilled employees because of the extra labor costs, which increases unemployment. The higher labor costs will also force some owners to increase their prices, which makes products less affordable for low-income individuals. Minimum wage advocates dispute these claims.[67]

A **living wage** refers to the amount of money a full-time employee needs to exceed the poverty threshold or afford the basic necessities of life.[68] It is based on the principle that people working full time should earn enough money to financially support their families.[69] Typically, living wage calculations cover costs for food, childcare, health care, housing, transportation, and other necessities within a specific geographic region. Most living wage initiatives are local municipal ordinances lobbied by unions and social justice activists. More than 50 counties and cities have legislated living wage ordinances, most of them in California.[70]

Living wage calculators for different geographic areas are available online.[71] For instance, a living wage for a family of two adults and two children in the metropolitan New York City area is $30.20 an hour and $24.04 in El Paso, Texas. The income gap between minimum and living wage levels raises ethical concerns regarding caring for others and human dignity.

Living wage The amount of money a full-time employee needs to exceed the poverty threshold or afford the basic necessities of life.

Employee Benefits

Companies can also reduce income inequality through their employee benefits packages. Glassdoor, founded in 2008 as a careers website for employees and former employees to anonymously review companies and their management, reviews and rates employee benefits.[72] Glassdoor notes that 57% of job seekers list employee benefits as among their most important considerations before taking a new job.[73] The top three employee perks and benefits that affect employee satisfaction were health insurance, vacation and paid time off, and pension plans.

As highlighted in "Ethics in Action," some companies reduce the income inequality gap by enhancing their employee benefits packages.[74]

ETHICS IN ACTION

EMPLOYEE BENEFITS AND PERKS

- *Netflix.* One paid year of maternity and paternity leave to new parents. After returning to work part-time or full-time, employees can take leave as needed throughout the year.
- *REI.* Two paid days off a year (called "Yay Days") to enjoy their favorite outside activity.
- *Salesforce.* Six days of paid volunteer time off a year and $1,000 a year to donate to a charity of their choice.
- *World Wildlife Fund.* Take Friday off every other week.
- *Airbnb.* An annual $2,000 stipend to travel and stay in an Airbnb listing anywhere in the world.
- *PricewaterhouseCoopers.* $1,200 per year for student loan debt reimbursement.
- *Twitter.* Three catered meals a day, on-site acupuncture, and improvisation classes.
- *Walt Disney Company.* Free admission to its parks and discounts on hotels and merchandise.
- *Epic Systems Corporation.* Paid 4-week sabbatical to pursue creative talents after 5 years at the company.
- *Asana.* Access to executive and life-coaching services outside the company.
- *Google.* Surviving spouse or partner receives 50% of the deceased employee's salary for the next 10 years.

Health insurance, the most desired employee benefit, is a major issue of contention among employers, employees, and government. The United States spent more than $3.6 trillion on health care in 2018, an average of about $11,000 per person.[75] As a result, employers became ever more concerned about the health and well-being of their employees and families. With health care expenses soaring, more employers and insurance companies offer employees incentives to exercise, eat healthier, and get regular health check-ups.

The 2019 Employer Health Benefits Survey found that annual premiums for employer-sponsored family health care coverage increased from $5,791 in 1999 to $20,576 in 2019, with the employee's share of that amount increasing from 26.6% in 1999 to 29.2% in 2019.[76] What is a "fair" distribution of health care and pension costs and benefits during this period of dramatic cost escalation, and how can they be constrained? These issues require dialogue and problem-solving between employers and employees, and if discussion results are inadequate, the government will likely get involved.

Defense Industry Initiative

In the mid-1980s, significant fraud and corruption were uncovered in the defense industry. Rather than waiting for additional regulations to be developed and imposed on them, defense industry leaders created the **Defense Industry Initiative (DII)** whereby companies voluntarily agree to implement self-regulatory conditions. Signatories are accountable to five guiding principles:[77]

1. 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.
2. We shall promote the highest ethical values as expressed in our written codes of business conduct, nurture an ethical culture through communications, training, and other means, and comply with and honor all governing laws and regulations.
3. 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.
4. We shall share best practices with respect to business ethics and compliance, and participate in the annual DII Best Practices Forum.
5. We shall be accountable to the public, through regular sharing and reporting of signatory activities in public fora, including www.dii.org. These reports will describe members' efforts to build and sustain a strong culture of business ethics and compliance.

As of 2020, 76 defense industry companies were DII participants. They commit their companies to establishing an ethics program that includes a written business ethics code, ethics training, and sharing best ethical practices with peer companies. DII offers free ethics training, videos, webinars, and best practices forums for the signatories.

Fraud continues to happen in all industries. It remains dangerous to engage in fraud because others in an industry do so. In the automobile industry, there had been a general sense that

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Defense Industry Initiative (DII) An initiative from the defense industry whereby companies voluntarily agree to implement self-regulatory conditions.

carmakers fudged tests for miles per gallon and emission calculations. Volkswagen took it one step further, and high-level executives faced criminal charges as a result.

Federal Sentencing Guidelines for Organizations

Organizations are held accountable for work-related crimes committed by their employees. For many decades, companies and other legal parties went "judge shopping," seeking to have their legal cases heard by judges who historically treated them favorably. In addition, judges in different courts assigned different fines for the same criminal behavior. Discussions about the need for cohesive and consistent judicial sentencing guidelines were initiated during President Jimmy Carter's administration and further developed during the Reagan presidency.

These efforts led to the **Federal Sentencing Guidelines for Organizations (FSG)** issued by President George H. W. Bush in 1991.[78] The FSG apply to felonies and serious misdemeanors committed by businesses, as well as nonprofits, unions, partnerships, trusts, and universities.

The FSG encourage, but do not require, companies to implement policies and procedures that reinforce ethical behavior. If an employee commits a federal crime, the number and authenticity of business ethics best practices implemented by the company affect the fine amount assessed against the organization. The judge refers to a standardized chart listing fines for specific types of crime and then adjusts the fine by a culpability multiplier of 0.05 to 4.0 based on the extent to which the organization has implemented business ethics best practices. The more best practices implemented, the lower the fine.

Assume an employee commits consumer fraud, and the corresponding fine listed in the judicial chart is $1.2 million. If an organization has not implemented any business ethics best practices, the initial fine is assessed a culpability multiplier of 4.0, increasing the fine to $4.8 million. The higher fine is the result of an organization not exhibiting "good faith" effort at applying the best practices in business ethics that would minimize unethical behaviors.

If, however, the organization has exhibited a good faith effort by implementing all the best practices, the initial $1.2 million fine is assessed a culpability multiplier of 0.05, reducing the fine to $60,000. If some, but not all, of the best practices have been implemented, the fine will be between these two amounts.

The judge should not let concern about organizational bankruptcy influence determining the fine amount. If companies choose not to implement any best practices, and a federal crime has been committed, then the organization is held accountable for having made that decision, independent of its financial viability.

In Table 2.2, the 16 best practices in business ethics suggested by the FSG are divided into six categories.[79]

In fiscal year 2018, 99 organizations were convicted of an applicable federal offense, and about half of them were for committing environmental crimes or fraud. Fifty-four of the organizations were subjected to sentencing under the guidelines.[80]

Federal Sentencing Guidelines for Organizations Federal guidelines that encourage, but do not require, companies to implement policies and procedures that reinforce ethical behaviors; if an employee commits a federal crime, the number and authenticity of business ethics best practices implemented by the company affect the fine assessed against the organization.

TABLE 2.2 ■ Best Practices for Compliance and Ethics Programs

Category	Best Practice
Organizational Personnel Issue	Substantial authority is not given to any employee known to have engaged in illegal activities.
Compliance/Ethics Program Personnel	A specific high-level manager oversees the program.
	A specific individual is accountable for the program's day-to-day operations.
Content of the Compliance/Ethics Program	A code of ethics is available.
	Procedures for preventing and detecting criminal misconduct or unethical behavior are documented.
	A mechanism is in place for employees to anonymously or confidentially seek guidance on, or report, criminal or unethical conduct without fear of retaliation.
Management of the Compliance/Ethics Program	Program training is available for all employees.
	Program content is communicated throughout the organization.
	The company periodically assesses criminal risks common to the profession or industry.
	The company periodically assesses the program's effectiveness.
Rewards and Punishments	Employees are provided incentives for performing in accordance with the program's provisions.
	Incentives for ethical behavior and legal compliance are consistently enforced.
	Employees violating the program's provisions, or who fail to take reasonable steps to prevent or detect criminal activity, are disciplined.
	Disciplinary measures for unethical behavior or criminal misconduct are consistently enforced.
After Criminal Conduct Detected	Reasonable steps are taken to respond appropriately to the criminal conduct.
	Reasonable steps are taken to prevent similar criminal misconduct in the future.

Other Incentives

A growing number of awards, recognitions, and benchmarks also encourage companies to be ethical and socially responsible.

Since 2007, Ethisphere Institute has been rating the "World's Most Ethical Companies" based on a weighted score covering five areas: ethics and compliance program (35%); corporate citizenship and responsibility (20%); culture of ethics (20%); governance (15%); and leadership, innovation, and reputation (10%).[81] In 2019, 128 companies earned the designation, eight of which have been honored all 12 years.

Many of the nation's most well-functioning and financially viable organizations benchmark themselves to the "Great Place to Work" criteria, which assesses employee engagement, empowerment, and pride.[82] The Better Business Bureau's business ethics Torch Award requires significant documentation on six criteria, including leadership commitment to ethical practices and organizational commitment to ethical human resource practices.[83] Media outlets award organizations "best places to work" for specific stakeholder groups, such as working mothers,[84] and lesbian, gay, bisexual, and transgender people.[85] Advice and examples on how to be an ethical and socially responsible organization abound in the popular business literature.[86]

Websites such as Glassdoor and Just Capital make a company's ethics more transparent. Glassdoor provides reviews of more than 600,000 companies written anonymously by present and former employees and determines a rating average for each company.[87]

Just Capital uses a more complex rating system.[88] Just Capital surveyed more than 50,000 Americans to determine what they consider the most important corporate traits and then evaluated about 1,000 of the largest publicly traded corporations based on these traits. Microsoft, Nvidia, and Apple were the top three corporations in 2019.

While incentives for ethical performance grow, the political pendulum continues to swing between regulation and deregulation. During Democratic president Barack Obama's administration, the political pendulum once again swung in the direction of regulation. Key legislative efforts included consumer protection under the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), new EPA regulations protecting communities from carbon emissions, regulations banning discrimination against workers because of sexual orientation or gender identity, and extensive health industry regulations under the Affordable Care Act (2010).[89]

The election of Republican president Donald Trump in 2016 immediately swung the pendulum back toward deregulation. The Trump administration claimed that overregulation was a $2 trillion drain on the economy and reduced household wealth by $15,000.[90] During his first days in office, Trump initiated rolling back the Affordable Care Act and financial sector regulations, among other regulations.[91] For every new regulatory rule enacted from 2016 to 2020, 8.5 were cut, reducing regulatory costs by $50 billion and saving households $3,100 a year.[92]

UP FOR DEBATE

THE ETHICS OF CAPITALISM

In the mid-1700s, Scottish philosopher Adam Smith recommended capitalism as an economic system. Smith grounded capitalism's ethical foundation based on freedom, improving the quality of life, moral sentiments people have toward others, and self-restraint. The United States has been experimenting and modifying capitalism on a trial-and-error basis for about 250 years. Some believe capitalism is ethical, and some insist it is unethical.

Critical Thinking Questions

Given your observations and personal experiences, which of the following evaluations best represents the extent to which *you* believe the U.S. version of free market capitalism is ethical:

1. Very ethical
2. Ethical
3. Slightly more ethical than unethical
4. Slightly more unethical than ethical
5. Unethical
6. Very unethical

Why? Provide reasons and examples that support your choice.

THE ETHICAL SYSTEMS MODEL

This section outlines how to use and implement the Ethical Systems Model to create a culture of high integrity and ethical mindedness.

A High-Integrity Work Culture

The evolution of business ethics, from before capitalism to modern times, highlights the importance of developing a high-integrity work culture. As Ben Franklin noted at the time of the 1787 Constitutional Convention, "There are two passions which have a powerful influence in the affairs of men. These are ambition and avarice; the love of power and the love of money . . . when united in view of the same object, they have in many minds the most violent effects."[93]

In the business arena, the pursuit of power and wealth needs to occur within ethical boundaries to avoid the business tragedies that appear daily in the media. A work culture narrowly focused on revenue and wealth generation often fosters behaviors that cut ethical corners and demonstrate a lack of concern about the feelings and welfare of others.

Greed is exemplified by the 30-year-old Wall Street broker who noted, "My bonus was $3.6 million—and I was angry because it wasn't big enough."[94] Such attitudes can corrupt an organization and industry. A survey of 250 Wall Street insiders reported that 52% "believed it was likely that their competitors have engaged in illegal or unethical activity to be successful," and 26% "believed the compensation plans or bonus structures in place at their companies incentivize employees to compromise ethical standards or violate the law."[95] This is further reflected in the Gallup poll results where only 14% of surveyed participants perceived stockbrokers as having high or very high ethical standards.[96]

The degree to which ethics matters during the pursuit of profits shapes and forms an organization's culture. An organization's culture can inspire and reinforce either ethical or unethical workplace behaviors. According to the Ethics & Compliance Initiative (ECI), an organization's "ethics culture drives employee conduct."[97]

What is organizational culture? Edgar Schein identified three distinct levels of organizational culture: (1) artifacts and behaviors, (2) espoused values, and (3) assumptions.[98] Assumptions about work and people generate values, which are then represented by artifacts, such as symbols and behaviors. An organization's culture signals to stakeholders what matters.

Some organizations place a strong emphasis on developing a work culture based on ethics, but others do not. The Ethics Resource Center obtained survey responses from 6,400 for-profit employees about whether the individual worked in a company with an ethics culture that was weak, weak-leaning, strong-leaning, or strong.[99] The strength of a work culture was measured by ethical leadership at the top of the organization, supervisor reinforcement of ethical behavior, and peer commitment to ethics by supporting one another in doing what is right.[100] For the entire survey sample, 22% of the companies reported a strong ethics culture, 44% a strong-leaning ethics culture, 24% a weak-leaning ethics culture, and 10% a weak ethics culture. The good news is that 66% of the companies had strong-leaning or strong ethical cultures. Conversely, 78% of respondents worked in organizations that did not have a strong ethics, or high-integrity, culture.

Researchers also analyzed the relationship between the strength of an organization's ethics culture and the extent of ethical misconduct at work. ECI researchers measured "leader commitment" as demonstrating that the organization had clear shared values and reflected employees' perception of the ethical leadership provided by direct supervisors. As shown in Table 2.3, among 18,000 global respondents from 18 nations, the incidents of pressure to "bend the rules" by engaging in misconduct and illegal behaviors were 3 times as high (49% compared to 13%) for employees with weak leader commitment to organizational values and ethical leadership compared with strong leader commitment.

TABLE 2.3 ■ Ethics Culture and Ethical Misconduct

	Weak Leader Commitment	Moderate Leader Commitment	Strong Leader Commitment
Pressured to engage in ethical misconduct during past year	49%	25%	13%

Source: Data from Ethics & Compliance Initiative, *2019 Global Business Ethics Survey: Pressure in the Workplace*, 2020, p. 8.

The same general findings occur with salespeople, whose industry ethics are rated among the lowest in annual Gallup polls. An ethical workplace climate drives a salesperson's performance success, teamwork, and job satisfaction.[101] A strong ethical culture works.

How do organizations signal to employees and other stakeholders that ethics matter? In a follow-up study, high-quality ethics and compliance (E&C) programs were found to exhibit the following key attributes and examples:[102]

1) *Strategy*: E&C is central to the organization's business strategy.
   - E&C objectives are included in the organization's strategy.
   - Senior leaders champion the importance of E&C throughout the organization.
   - Communications by senior leaders highlight E&C practices.
   - E&C best practices used within the organization are shared externally, positioning the organization as a thought leader.

2) *Risk management*: E&C risks are identified, owned, managed, and mitigated.
   - Senior leaders identify and mitigate risks related to E&C.
   - Senior leaders have a good understanding of key E&C risks.
   - There is a good understanding of key E&C risks across the organization.
   - Metrics are used to detect areas that may require intervention.

3) *Culture*: Leaders at all levels across the organization build and sustain a culture of integrity.
   - The organization has defined the ethical behavior expected from leaders.
   - Senior leaders set a good example of integrity ("walk the talk").
   - Performance reviews of senior leaders take into consideration their efforts to build and sustain a strong ethics culture.
   - All employees are expected to act in line with organization values and are held accountable if they do not.

4) *Speaking up*: The organization encourages, protects, and values the reporting of concerns and suspected wrongdoing.
   - There are multiple ways for employees to report misconduct.
   - All reporters are treated the same, with consistency and fairness, throughout the reporting process.
   - Leaders receive training to make them aware of the organization's policy on retaliation.
   - The organization openly communicates summary statistics with all employees about reported misconduct.

5) *Accountability*: The organization holds itself accountable when wrongdoing occurs.
   - The organization's code of conduct makes it clear that ethics violations will result in consequences.
   - The organization has a clear policy regarding response and escalation of significant ethics violations.
   - Senior leadership reinforces that consequences will occur for ethics violations.
   - Consistent disciplinary action is taken when ethics violations are substantiated.

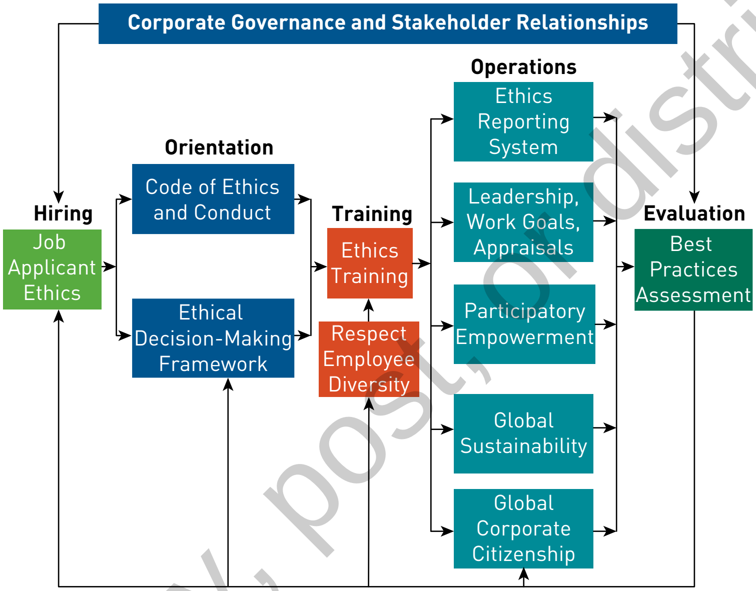
The Ethical Systems Model

Successful long-term organizational growth requires honesty, trust, integrity, and credibility. Current and future managers must learn how to design and manage a high-integrity work culture. Ethical behaviors are not just a matter of individual choice; they are associated with an organization's ethics culture and support system. The greater the number of ethics program components in place, the fewer unethical behaviors observed.[103]

Ethical Systems Model A model that synthesizes the various approaches of organizational ethics into a systematic best-practices framework for reinforcing ethical behaviors and reducing ethical risks throughout the workplace.

How can managers create a strong ethics culture that simultaneously enhances employee and organizational performance, profits, and ethics, rather than just respond to the latest ethical crisis? The **Ethical Systems Model**, presented in Figure 2.2, synthesizes the various best-practices approaches discussed in this chapter, such as the federal sentencing guidelines and E&C strong ethics culture, into a systematic best-practices framework for reinforcing ethical behaviors and reducing ethical risks throughout the workplace.

FIGURE 2.2 ■ Ethical Systems Model



Creating and sustaining a high-integrity work culture can be achieved through the multiple interdependent support systems in the Ethical Systems Model. The best practices for each dimension in the model are explained in Chapters 3 through 13:

- Corporate Governance and Stakeholder Relationships (Chapter 3)
- Hiring Ethical People (Chapter 4)
- Codes of Ethics and Codes of Conduct (Chapter 5)
- Ethical Decision-Making (Chapter 6)
- Ethics Training (Chapter 7)
- Respecting Employee Diversity (Chapter 8)
- Ethics Reporting Systems (Chapter 9)
- Managers as Ethical Leaders and Performance Assessments (Chapter 10)

- Ethically Engaging and Empowering Employees (Chapter 11)
- Global Sustainability (Chapter 12)
- Global Corporate Citizenship (Chapter 13)

Implementing the Ethical Systems Model can reduce unethical or illegal behaviors. Individuals, however, remain morally flawed, and ethical problems will still arise. When this happens, investigate the circumstances that led to the unethical or illegal behavior and, depending on the egregiousness of the unethical behavior, discipline or terminate the employee. Such short-term solutions, however, do not address the systematic root of the ethical problem. Why weren't the employee's unethical proclivities detected earlier? Is there a problem with the hiring process, the ethics training workshops, or the performance evaluations?

Similar to total quality management, the goal of the Ethical Systems Model is to reduce ethical risks to as close to zero defects as possible. The total quality management of ethics process in "Ethical Applications" provides a systematic approach for determining the root cause of an unethical behavior.

Ethical Applications: The Total Quality Management of Ethics

1. Focus on the particular unethical activity of the employee.
2. Instead of merely blaming the particular employee, determine the systematic source that allowed the problem to occur. Did the problem originate from a(n)
   a. *Corporate governance problem*: Do upper-level managers monitor this area of operations?
   b. *Hiring process problem*: Was an unethical person hired?
   c. *Code of ethics or conduct problem*: Do these codes inadequately address the issue?
   d. *Ethical decision-making framework problem*: Did the employee inadequately apply ethical reasoning to the situation?
   e. *Ethics training problem*: Does the training program inadequately address the issue?
   f. *Ethics reporting system problem*: Are the mechanisms for raising ethical issues and reporting unethical behaviors inadequate?
   g. *Manager role model problem*: Is the employee's manager an inadequate role model?
   h. *Unrealistic work goal problem*: Were the employee's work goals unattainable or misdirected?
   i. *Performance evaluation problem*: Are performance evaluation measures inadequate?
   j. *External stakeholder oversight problem*: Did the regulator or professional association inadequately address the issue?
3. Seek input from affected constituents about how to strategically address the problem.
4. Develop an action plan that includes
   a. Clearly stated problem
   b. Initial solution to the problem

  c. Major obstacles against implementing the solution
  d. Recommendations for overcoming the obstacles
  e. Development and monitoring metrics to measure success

5. Make managers accountable for the results. Senior leaders should set unambiguous objectives and provide the necessary resources and appropriate incentives.

SUMMARY

Unethical business practices are not new, nor are they limited to capitalism. Business owners and managers have always had the freedom to choose to behave ethically or unethically. Their choice depends on their own sense of ethics, the type of ethics expected by society, and the type of ethics reinforced by the organization's culture.

What is meant by the term *business ethics* has evolved over time. Business behaviors morally acceptable in the 1600s, such as slavery, child labor, and religious discrimination, are now illegal.

In the 1700s, Adam Smith outlined the ethical foundation of capitalism. He maintained that providing individuals with freedom and liberty to pursue their self-interests in the economic sector enhances the wealth of a nation. Minimal government intervention would be required, he argued, because people are naturally concerned about the well-being of others and possess a conscience. These psychological mechanisms restrain people from exercising their liberty in a manner that harms others. If these restraints fail, however, then a system of justice must develop, and enforce, laws that punish those whose unethical behaviors harm others.

The vitality of free market capitalism depends on ethics. The more that individuals in businesses behave ethically, the more freedom and liberty government can allow in the economic system. Unethical behaviors that reach a critical level result in new government regulations and oversight mechanisms. Historically, stakeholder rights have expanded significantly over time, and currently business behaviors are much more transparent because of technological innovations. The key to long-term business success is to create a high-integrity work culture that fits society's increased, and continually evolving, moral expectations.

The remainder of this textbook describes how managers can implement the Ethical Systems Model to maximize the likelihood of ethical behaviors and minimize the likelihood of unethical behaviors, as business ethics and organizations continue to evolve over time.

KEY WORDS

Adam Smith
Bill of Rights
Capitalism
Charters
Defense Industry Initiative (DII)
Division of labor
Ethical Systems Model
Federal Sentencing Guidelines for Organizations
Government regulation

Industrial Revolution
Interpenetrating Systems Model
Labor union
Living wage
Sherman Antitrust Act of 1890
Slavery

CHAPTER QUESTIONS

1. What are several salient business ethics issues in precapitalist civilizations?
2. How did Adam Smith justify the ethics of capitalism?
3. What prominent labor issues challenged the fairness of free market capitalism in the United States?
4. What have been some of the historical shifts since the 1930s Great Depression between mandatory business regulations and voluntary ethical enhancements?
5. What are the key dimensions of the Ethical Systems Model for creating a high-integrity work culture?