CHAPTER 2

BUSINESS ETHICS, CORPORATE SOCIAL RESPONSIBILITY, AND SUSTAINABILITY

CHAPTER OBJECTIVES

2.1 Discuss what ethics means and the sources of ethical guidance
2.2 Explore human resource management's (HRM) role in creating an ethical culture and a code of ethics
2.3 Define human resource ethics
2.4 Explain the concepts and practices related to corporate social responsibility and corporate sustainability
2.5 Describe a social audit

KEY TERMS

Ethics: Discipline dealing with what is good and bad, or right and wrong, or with moral duty and obligation.
Code of ethics: Establishes the rules that the organization lives by.
Human resource ethics: Application of ethical principles to human resource relationships and activities.
Corporate social responsibility (CSR): Implied, enforced, or felt obligation of managers, acting in their official capacity, to serve or protect the interests of groups other than themselves.
Corporate sustainability: Concerns with possible future impact of an organization on society, including social welfare, the economy, and the environment.
Social audit: Systematic assessment of a company's activities in terms of its social impact.

LECTURE OUTLINE

DEFINING ETHICS AND THE SOURCES OF ETHICAL GUIDANCE

Ethics is the discipline dealing with what is good and bad, or right and wrong, or with moral duty and obligation. The concepts of corporate social responsibility (CSR) and corporate sustainability are related to ethics. CSR is the implied, enforced, or felt obligation of managers, acting in their official capacity, to serve or protect the interests of groups other than themselves. Corporate sustainability concerns with possible future impact of an organization on society, including social welfare, the economy, and the environment.

BUSINESS ETHICS

Well-publicized corrupt conduct of companies such as WorldCom and Enron and their senior managers provide many examples of unethical leadership. Even though most Fortune 500 companies have a written code of ethics, business ethics scandals continue to make headlines.

Compliance with the law sets the minimum standard for ethical behavior; however, ethics is much more. There are many dimensions to ethics, and leaders must be able and willing to instill ethics throughout the culture of an organization.

SOURCES OF ETHICAL GUIDANCE

The sources of ethical guidance should lead to our beliefs or a conviction about what is right or wrong. Most would agree that people have a responsibility to avail themselves to these sources of ethical guidance.

One might use a number of sources to determine what is right or wrong, good or bad, moral or immoral. These sources include the Bible and other holy books in addition to the still, small voice that many refer to as conscience. Another source of ethical guidance is the behavior and advice of the people psychologists call significant others—our parents, friends, role models, and members of our churches, clubs, and associations. For most professionals, there are codes of ethics that prescribe certain behaviors.

LEGISLATING ETHICS

Much of the current legislation was passed because of business ethics breakdowns. There have been four attempts to legislate business ethics since the late 1980s.

- **PROCUREMENT INTEGRITY ACT of 1988**—Prohibits the release of source selection and contractor bid or proposal information. Passed after reports of military contracts for $500 toilet seats.

- **FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS of 1992**—Outlined an effective ethics training program and explained the seven minimum requirements for an effective program to prevent and detect violations.

- **CORPORATE AND AUDITING ACCOUNTABILITY, RESPONSIBILITY AND TRANSPARENCY ACT of 2002**—Known as the Sarbanes-Oxley Act, the primary focus of the Act is to redress accounting and financial reporting abuses in light of recent corporate scandals. The Act has teeth, because in the 2003 *Bechtel v Competitive Technologies Inc.* Supreme Court case involving wrongful termination under Sarbanes-Oxley's whistleblower-protection rule, the Court ruled that the company violated the Act by firing two employees and ordered them reinstated.

- **WHISTLEBLOWER PROTECTION**—A *whistleblower* is someone who participates in an activity that is protected. The whistleblowing side of the Dodd-Frank is shaped after a successful IRS program. In passing the Act, Congress believed that award programs are an effective method to encourage people with information regarding violations of the law to come forward with the information to responsible law enforcement officials. The Act requires the SEC to provide an award to a qualifying whistleblower of no less than 10 percent, and no greater than 30 percent, of any sanction imposed against a violator of any securities laws as a result of "original information" from a whistleblower that is "voluntarily provided" to the SEC that leads to a successful enforcement or related action.

- **DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT**—Passed in 2010, the Act has provisions relating to executive compensation and corporate governance that directly and significantly impact the executives, directors, and shareholders of publicly traded companies and continue the increased federal regulation of corporate governance and executive compensation matters.

CREATING AN ETHICAL CULTURE AND A CODE OF ETHICS

Saying that a company has an ethical culture and actually having one may be two different things.

Ethical Culture

One way to create and sustain an ethical culture is to audit corporate ethics, much as corporate finances are audited each year. An ethics audit is simply a systematic, independent, and documented process for obtaining evidence regarding the status of an organization's ethical culture. It takes a closer look at a firm's ethical culture instead of just allowing it to remain unexamined.

To build and sustain an ethical culture, organizations must have a comprehensive framework that includes communication of behavior expectations, training on ethics and compliance issues, stakeholder input, resolution of reported matters, and analysis of the entire ethics program. A code of ethics helps employees know what to do when there is not a rule for something. Topics typically covered in a code of ethics might be business conduct, fair competition, and workplace and HR issues. Many employers appoint an ethics officer to support the code of ethics.

To make a code of ethics work, involvement by top management is necessary. There are five common ways that companies may lead good employees to make unethical choices:

1. It is psychologically unsafe to speak up
2. There is excessive pressure to reach unrealistic performance targets
3. Conflicting goals provoke a sense of unfairness
4. Ethical behavior is not part of the routine conversation

5. A positive example isn't being set

CODE OF ETHICS
A code of conduct should tell employees what the rules of conduct are. A code of ethics established the rules that the organization lives by. This is an important distinction.

Topics in a code of ethics might include business conduct, fair competition, and workplace and HR issues.

HUMAN RESOURCE ETHICS
Human resource ethics can be defined as the application of ethical principles to human resource relationships and activities. Integrity and ethical behavior are top competencies for senior HR leaders. HR professionals play a key role in helping to build an ethical culture at an organization. Through practices such as selection, orientation, performance management, etc., HR can help establish an environment in which employees throughout the organization work to reduce ethical lapses.

HR should review, develop, and enforce organizational policies to ensure a high level of ethics throughout the organization.

LINKING PAY TO ETHICAL BEHAVIOR
The importance of linking pay to performance is an appropriate topic when discussing ethics. It is well known in the compensation world that "what you reward is what you get." If the statement is correct, then a problem exists because most companies do not link pay to ethical behavior.

ETHICS TRAINING
The Federal Sentencing Guidelines for Organizations Act outlined an effective ethics-training program and explained the seven minimum requirements for an effective program to prevent and detect violations. Ethics training is not merely for top-level managers; it should be for everyone from the bottom to the top.

There are three fundamental factors in handling ethics issues: provide multiple channels for raising alarms, eliminate fear of retaliation for those who raise questions, and ensure consistent investigation and resolution of all matters reported.

CORPORATE SOCIAL RESPONSIBILITY AND SUSTAINABILITY
Corporate social responsibility is the implied, enforced, or felt obligation of managers, acting in their official capacity, to serve or protect the interests of groups other than themselves. CSR encompasses meeting economic, social, and environmental responsibilities concurrently. Many organizations have demonstrated the bottom line impact of CSR activities.

While these days more employers are publicly endorsing a culture of ethics and social responsibility, not all agree that CSR is important for companies. Milton Friedman was an American economist, statistician, academic, and author who taught at the University of Chicago for more than three decades and was a recipient of the Nobel Memorial Prize in Economic Sciences. He argued that here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud. Friedman disciples continue to condemn CSR as a hodgepodge of, "value-destroying nonsense."

CORPORATE SUSTAINABILITY

Corporate sustainability has evolved from the more traditional corporate social responsibility. According to the World Commission on Environment and Sustainability, the narrow definition of sustainability or sustainable development is, "meeting the needs of the present without compromising the ability of future generations to meet their own needs." In recent years, sustainability has been changed to encompass the social, economic, environmental, and cultural systems needed to sustain any organization. This type of organization is capable of surviving both now and in the future. Increasingly, environmentally sound and cost-cutting operating procedures are also expected for suppliers and trade partners of organizations.

CONDUCTING A SOCIAL AUDIT

A **social audit** is a systematic assessment of a company's activities in terms of its social impact. Some of the topics included in the audit focus on core values such as social responsibility, open communication, treatment of employees, confidentiality, and leadership. Firms are now acknowledging responsibilities to various stakeholder groups other than corporate owners.

ANSWERS TO CHAPTER 2 QUESTIONS FOR REVIEW

2-1. What are ethics and business ethics?

Ethics is a discipline dealing with what is good and bad, or right and wrong, or with moral duty and obligation. Compliance with the law sets the minimum standard for ethical behavior; ethics, however, is much more. There must be leaders who are able and willing to instill ethics throughout the culture of the organization. Ethics is about deciding whether an action is good or bad and what to do about it if it is bad. Ethics is a philosophical discipline that describes and directs moral conduct. Those in management make ethical (or unethical) decisions every day.

2-2. What are some sources of ethical guidance?

One might use numerous sources to determine what is right or wrong, good or bad, and moral or immoral, such as holy books or one's conscience. Another source of ethical guidance is the behavior and advice of people, including our parents, friends, and role models and members of our churches, clubs, and associations. For most professionals, there are codes of ethics that prescribe certain behavior.

What laws have been passed in an attempt to legislate ethics?

- **Procurement Integrity Act of 1988**: Passed after reports of military contracts for such things as $500 toilet seats. It prohibits the release of source selection and contractor bid or proposal information.

- **Federal Sentencing Guidelines for Organizations of 1992**: Outlined an effective ethics program.

- **Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002**: Criminalized many corporate acts that were previously relegated to various regulatory structures.

- **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010**: Has provisions relating to executive compensation and corporate governance that directly and significantly impact the executives, directors, and shareholders of publicly traded companies and continue the increased federal regulation of corporate governance and executive compensation matters.

2-3. Why is it important to have a code of ethics?

A distinction needs to be made between a code of conduct and a code of ethics; the former should tell employees what the rules of conduct are. The code of ethics helps employees know what to do when there is not a rule for something. A broad-based participation of those subject to the code is important. For a company to behave ethically, it must live and breathe its code of ethics, train its personnel, and communicate its code through its vision statements.

2-4. Regarding business ethics, what does the statement, "what you reward is what you get," mean?

In compensation circles it is well know that what you reward is what you get. If the statement is correct, then a problem exists with regard to compensation because most companies do not link pay to ethical behavior.

2-5. What are HR ethics?

The application of ethical principles to human resource relationships and activities is called human resource ethics.

2-6. What are the areas in which HR professionals can have a major impact on ethics?

HR professionals can help foster an ethical culture, but that means more than just hanging the ethics codes posters on walls. Instead, since the HR professionals' primary job is dealing with people, they must help to instill ethical practices into the corporate culture. Those values must be clearly communicated to all employees, early and often, beginning with the interview process, reinforced during employee orientation, and regularly recognized during performance reviews, public ceremonies, celebrations, and awards. They need to help establish an environment in which employees throughout the organization work to reduce ethical lapses. The ethical bearing of those in HR goes a long way toward establishing the credibility of the entire organization.

2-7. What is corporate social responsibility?

Corporate social responsibility is the implied, enforced, or felt obligation of managers, acting in their official capacity, to serve or protect the interests of groups other than themselves. It is how a company as a whole behaves toward society.

2-8. What does corporate sustainability mean?

Corporate sustainability has evolved from the more traditional corporate social responsibility. According to the World Commission on Environment and Sustainability, the narrow definition of sustainability or sustainable development is, "meeting the needs of the present without compromising the ability of future generations to meet their own needs." In recent years, sustainability has been changed to encompass the social, economic, environmental, and cultural systems needed to sustain any organization. This type of organization is capable of surviving both now and in the future.

2-9. What are some of the practices companies can use to promote sustainability?

Corporate sustainability may be thought of as being a business and investment approach that strives to use the best business practices to meet the needs of current and future shareholders. According to Louis D. Coppola, executive vice president of the Government & Accountability Institute, "Leaders increasingly understand the critical importance of adopting and implementing strategies, products, services, programs and initiatives that reflect the twenty-first century business environment, and the interest of investors and important stakeholders." HR professionals also play an important role in promoting corporate sustainability objectives.

Essentially it is about how a firm handles its business while understanding how these decisions may affect others. One could think of corporate sustainability in a business sense as providing long-term profitability. Thus, sustainability should be a fundamental part of business strategy, product development, talent development, and capital investment. Some organizations have emphasized the importance of corporate sustainability by establishing the position of chief sustainability office.

DISCUSSION OF CHAPTER 2 INCIDENTS

HRM Incident 1: An Ethical Flaw

Amber Davis had recently graduated from college with a degree in general business. Amber was quite bright, although her grades did not reflect this. She had thoroughly enjoyed school, dating, playing tennis, and swimming, but found few stimulating academic endeavors. When she graduated, she had not found a job. Her dad was extremely upset when he discovered this, and he took it upon himself to see that Amber became employed.

Amber's father, Allen Davis, was executive vice president of a medium-sized manufacturing firm. One of the people he contacted in seeking employment for Amber was Bill Garbo, the president of another firm in the area. Mr. Davis purchased many of his firm's supplies from Garbo's company. After telling Bill his problem, Allen was told to send Amber to Bill's office for an interview. Amber went, as instructed by her father, and before she left Bill's firm, she was surprised to learn that she had a job in the accounting department. Amber may have been lazy, but she certainly was not stupid. She realized that Bill had hired her because he hoped that his action would lead to future business from her father's company. Although Amber's work was not challenging, it paid better than the other jobs in the accounting department.

It did not take long for the employees in the department to discover the reason she had been hired; Amber told them. When a difficult job was assigned to Amber, she normally got one of the other employees to do it, implying that Mr. Garbo would be pleased with that person if he or she helped her out. She developed a pattern of coming in late, taking long lunch breaks, and leaving early. When the department manager attempted to reprimand her for these unorthodox activities, Amber would bring up the close relationship that her father had with the president of the firm. The department manager was at the end of his rope.

QUESTIONS

2-18. From an ethical standpoint, how would you evaluate the merits of Mr. Garbo's employing Amber? Discuss.

Mr. Garbo should not have been pressured by Mr. Davis to hire his daughter, Amber. The employment of a "friend's" son or daughter may or may not be a good business practice. If Amber had been competent, mature, ambitious, energetic, and wanted to learn the business, then Mr. Garbo would have made a good decision. However, Amber did not possess these characteristics, and so Mr. Garbo's decision was based solely on his business relationship with Mr. Davis. Obviously, employment decisions should be based on business or professional judgment and not on personal relationships. Finally, it was unethical of Mr. Davis to have pressured Mr. Garbo to hire Amber.

2-19. Now that she is employed, how would you suggest that the situation be resolved?

Amber should be encouraged to become a productive member of the accounting department, or she should be replaced. It should be made clear to her that her father's connections with Mr. Garbo may have gotten her *in the door*, but will not *keep her inside* unless she becomes an effective and efficient performer.

2-20. It may be that Mr. Garbo viewed the hiring of Amber as strictly a business decision that would ensure receiving continued business from Amber's father. What might be some negative results of this questionable ethical decision?

Other workers have noticed that Amber is taking advantage of the situation. Some may use her work performance as the standard to be achieved in the department. This would prove to be a problem for them since although the department manager cannot fire Amber, other employees are not as lucky. The morale in the department is sure to suffer and the only way for it to improve is to somehow get Amber's performance up to where it should be or to get rid of Amber.

HRM Incident 2: Illegal Hiring

The Foreign Corrupt Practices Act (FCPA) prohibits U.S. companies from bribing foreign officials; yet, the number of violations each year is staggering. Some violations center on the use of unethical HR practices. For example, the banking industry has been investigated for its internship and full-time employment hiring practices. The Bank of New York Mellon Corp. (BNY Mellon) gave internships to family members of foreign government officials. The bank's leadership intended to maintain or increase business with a Middle Eastern sovereign wealth fund. Internship programs are legal and BNY Mellon has a legitimate internship program, but these internships were awarded outside the accepted procedures and criteria used in its program. The U.S. SEC issued a cease and-desist order, stating that, "Delivering them [internships] 'was seen by certain relevant [bank] employees as a way to influence the officials' decisions." This is the first cease-and-desist order of which internship hiring was the subject. Phillip Bezanson, a Bracewell & Giuliani Law LLP (firm) partner stated that, "the concept of 'anything of value' under

the FCPA can be ‘really abstract.’. . .” In the end, the bank agreed to pay a $5 million penalty, give up $8.3 million, and pay $1.5 million in interest.

QUESTIONS

2-21. What would you have done in response to learning about these facts?

In the banking industry trust and ethical relationships are paramount. There is a strong argument as to the value of paying the fines, even though the FCPA was vague on this issue. By paying the penalty the bank may have minimized long-term damage to the relationships they have with customers

2-22. What factors in this situation might influence a company to make less-than-ethical decisions.

Large value customers might remove their assets from the bank if family members are not hired. This could have long-term financial repercussions both for the bank and the HR department. While the positions were real, the procedure in place for the hiring process was not followed.