

CHAPTER 2: INTEGRITY AND ETHICS: FOUNDATIONS FOR SUCCESS IN SMALL BUSINESS

CHAPTER OUTLINE

Spotlight: PortionPac Chemicals
<http://www.portionpaccorp.com>

1) What is Integrity?

LO1: Define integrity, and understand its importance to small businesses.

- i) The general sense of honesty and reliability that is expressed in a strong commitment to doing the right thing, regardless of the circumstances.

2) Integrity and the Interests of Major Stakeholders

LO2: Explain how integrity applies to various stakeholder groups

a) Ethical Issues

- i) Questions of right and wrong. Frequently observed forms of workplace misconduct – Exhibit 2.1
 - (1) Category One – related to customers and competitors
 - (2) Category Two – the way a company treats its employees
 - (3) Category Three – obligations of employees to their employers
- ii) Stakeholders – those who either can affect or are affected by the performance of the company.
- iii) Four types of responsibilities for small businesses- Exhibit 2.2
 - (1) Economic- be profitable
 - (2) Legal- obey all laws, adhere to all regulations
 - (3) Ethical- avoid questionable practices
 - (4) Discretionary- be a good corporate citizen, give back

b) “Big Three” Stakeholders- Owners, Customers, and Employees

- i) Some say companies must follow the Golden Rule- that is those that hold the gold (owners) make the rules! Others lean on the philosophy that the customer is always right. The truth is that all of these groups (sometimes called primary stakeholders because they interact very directly with the company) pack the greatest punch when it comes to influence.

c) Promoting the Owner’s Interests

- i) Business owners have an obligation to make choices that protect the financial investment that others have in the company

d) Caring about Customers

- i) Customers are the most important stakeholder groups – without customers there is no business

e) Valuing Employees

- i) Fairness, honesty and impartiality inherent in decisions and practices
- ii) Fairness works both ways – FBI statistics indicate employees who steal supplies, merchandise, tools, or equipment from work may cost employers as much as \$150 billion each year (figure doesn’t include embezzlement)

f) Social Responsibility and Small Business

- i) Social Responsibilities – A company’s ethical obligations to the community
 - (1) Contribution starts with creating jobs and adding to local tax revenues causing goodwill in the community.
- g) **Governmental Laws and Regulations**
 - i) Entrepreneurs must comply with government laws and regulations
 - ii) Unethical behavior includes fraudulent reporting of income and expenses for income tax purposes
 - (1) Skimming
 - (2) Tax evasion
 - (3) Casual accounting systems
- 3) **The Challenges and Benefits of Acting With Integrity**
 - LO3: Identify some common challenges and benefits to integrity that arise in small businesses.*
 - a) **The Challenges and Benefits of Acting with Integrity**
 - i) Small companies face unique challenges to maintaining integrity, especially at critical states such as when getting started and establishing a name, launching online operations, or expanding internationally.
 - b) **Small Companies and the Legitimacy Lie**
 - i) Small, privately held firms may face greater pressures to act unethically and to rationalize situations and actions
 - ii) Most entrepreneurs exercise great integrity, but some are vulnerable when ethical issues directly affect profits
 - c) **Integrity and the Internet**
 - i) Legitimacy and trust are important to all small businesses, but those using the Internet face a host of ethical issues that are unique to the online marketplace.
 - (1) Personal privacy is an issue of great concern to users of the Internet.
 - (2) Protection of intellectual property has garnered increased attention.
 - d) **Integrity and Doing Business Abroad**
 - i) Sooner or later, small business owners operating abroad will run up against challenging ethical questions, and they could relate to just about any part of the company’s operations.
 - (1) Ethical imperialism- the belief that the ethical standards of one’s own country can be applied universally.
 - (a) Foreign Corrupt Practices Act – makes it illegal for U.S. businesses to use bribery elsewhere in the world
 - (2) Ethical relativism- the belief that ethical standards are subject to local interpretation.
 - (a) Training is necessary to ensure employees understand the firm’s commitment to integrity.
 - (b) One-time practices may set a pattern for future behavior.
 - e) **Trust and the Integrity Edge**
 - i) The entrepreneur who makes honorable decisions, even when it comes to the smallest of details, can take satisfaction in knowing that she or he did what was right, even if things do not turn out as planned.
 - ii) A growing body of research supports the notion that ethical business practices are good for business.

- iii) There are numerous long-term benefits to adopting ethical and responsible business practices including:
 - (1) Improved financial performance
 - (2) Enhanced brand image and reputation
 - (3) Increased sales and customer loyalty
 - (4) Improved productivity and quality
 - (5) Better recruitment and reduced employee turnover
 - (6) Fewer regulatory inspections and less paperwork
 - (7) Improved access to capital
- 4) **Building a Business with Integrity**- The goal of a small business owner with integrity should be to operate honorably in all areas of practice, which sets the entrepreneur on the path toward crafting the worthy legacy. The build a business with integrity, those at the top must provide the leadership, culture, and instruction that support appropriate ethical perspectives and proper behavior.

LO4: Suggest practical approaches for building a business with integrity.

a) The Foundations of Integrity

- i) Underlying values
 - (1) *Have students discuss a difficult ethical dilemma faced at work or at school*
 - (2) Unarticulated ethical beliefs that provide a foundation for ethical behavior in a firm
 - (3) “Actions speak louder than words” – behavior reflects the level of a person’s commitment to honesty, respect, truthfulness, etc.

b) Leading with Integrity

- i) Establishing high standards of integrity is more apparent in small firms than in large ones
- ii) Personal integrity of the founder or owner is the key to a firm’s ethical performance

c) An Ethical Organizational Culture

- i) Ideally the instinctive resolution of every ethical issue is doing what is right
- ii) Kenneth Blanchard and Norman Vincent Peale (*The Power of Ethical Management*) suggest five fundamental principles:
 - (1) Purpose – the vision for the company and your core values will guide business conduct
 - (2) Pride – when employees take pride in their work and their company, they are much more likely to be ethical in their dealings
 - (3) Patience – if you push too hard for short-term results, sooner or later acting unethically will seem to be the only way to achieve the outcomes you seek
 - (4) Persistence – stand by your work, which is the foundation of trust
 - (5) Perspective – stop from time to time to reflect on where the business is going, why it is going that way, and how to plan to get there to assure your are on the right track
- iii) Code of ethics – official standards of employee behavior formulated by a firm
 - (1) *Ask students about Codes of Ethics they have come into contact with and have them discuss what those Codes included*

d) Better Business Bureaus- encourages ethical business practices

- i) Ethical conduct is promoted by:

- (1) Providing consumers with free information to help them make informed decisions when dealing with a company.
 - (2) Creating an incentive for businesses to adhere to proper business practices and earnestly address customer complaints.
 - (3) Resolving questions or disputes concerning purchases through mediation or arbitration.
- e) **The Ethical Decision-Making Process**
- i) Step 1: Define the problem
 - ii) Step 2: Identify alternative solutions to the problem
 - iii) Step 3: Evaluate the identified alternatives
 - (1) Rotary Club International suggests
 - (a) Is it the truth?
 - (b) Is it fair to all concerned?
 - (c) Will it build goodwill and better friendships?
 - (d) Will it be beneficial to all concerned?
 - (2) Golden Rule
 - (a) Treat others as you would want to be treated
 - (3) Separate what you think is the case from what you know to be true
 - iv) Step 4: Make the decision
 - v) Step 5: Implement the decision
 - vi) Step 6: Evaluate the decision
- 5) **Small Business and the Natural Environment-** a sustainable enterprise must respond to customer needs while showing reasonable concern for the environment.
- LO5: Define sustainable small business, and describe the influence it has on small firms.*
- a) **Sustainability Matters**
- i) The effort to protect and preserve the environment
 - ii) Cost to business of environmentalism may be prohibitive to small business however win-win solutions are possible
- b) **Green Opportunities for Small Business**
- i) Adds to cost for some small companies, opens opportunities for others (may even create startups)

ANSWERS TO END-OF-CHAPTER DISCUSSION QUESTIONS

1. *Define the concept of integrity. What are the major features of integrity?*

Integrity is an uncompromising adherence to the lofty values, beliefs, and principles that an individual claims to hold. Integrity refers to a general sense of honesty and reliability that is expressed in a strong commitment to doing the right thing, regardless of the circumstances. A successful entrepreneur seeks financially rewarding opportunities while creating value, first and foremost. Relationships are critical and integrity is essential to success. Financial gain is important, but it should not be the only goal of interest. To act with integrity requires an individual to think differently by considering the welfare of others.

2. What are the major stakeholder groups that influence and are influenced by small companies? What are the primary interests of each of these groups? How can a small business owner manage potential conflicts between the demands of these groups?

The major stakeholder groups include owners, customers, employees, the community, and the government. There are four types of responsibility for small business:

- Economic- this is a required societal expectation where the general thrust is to be profitable.
- Legal- this is a required societal expectation where the general thrust is to obey all laws and adhere to all regulations.
- Ethical- this is an expected expectation where the general thrust is to avoid questionable practices
- Discretionary- this is a desired expectation where the general thrust is to be a good corporate citizen and give back to society.

The big three stakeholders are:

- Owners- Milton Friedman argues that businesses should be expected to earn profits honestly; any other use of the firm's resources is justified only if it enhances the firm's value. It is undeniable that owners have a clear and legitimate right to benefit from the financial performance of the company.
- Customers- obviously one of the most important stakeholder groups that a company must please. Entrepreneurs who take customers seriously and care about them as individuals are apt to have more of them.
- Employees-a firm's level of integrity is also expressed by the value it places on employees. Showing proper appreciation for subordinates as human beings and as valuable members of the team is an essential ingredient of managerial integrity.

The concerns of important stakeholders are fundamental to the management of the business. If neglected, any one group can use its influence to negatively affect the performance of a company. To avoid this conflict, stakeholder interests should be carefully considered and wisely balanced.

3. Why might small business CEOs focus more attention on profit and less on social goals than large business CEOs do?

Most small business CEOs are close to the action. They must often work aggressively to earn profits. Large business CEOs often have more abundant resources and can afford to be more socially conscious. Also, they face greater pressure to be socially responsible as a result of their size. Small firm CEOs are spending their own money, and they may be making contributions from their personal rather than their business resources (which makes them conscious of costs).

4. What is skimming? How do you think owners of small firms might attempt to rationalize such a practice?

Skimming is a method of reducing income taxes by falsifying tax returns through under-reporting of income. It might be rationalized in many ways—for example, “We’re already paying too many taxes,” “It provides compensation for unnecessary paperwork required by the government,” “Others do it,” or “It’s the only way we can survive.”

5. What is a legitimacy lie? In the case of a startup, how can an entrepreneur use PRO factors to win the confidence of potential customers, partners, etc. and avoid resorting to the telling of legitimacy lies?

The legitimacy lie is caused when small business owners create false impressions to make their companies look good. That is, sometimes small businesses misrepresent the facts to mislead others intentionally to earn their confidence.

PRO factors (Products, Representatives, and the Organization) can promote the firm’s performance when customers are satisfied with them. Small businesses can win confidence by demonstrating the following:

- Show the customer of the PRODUCT (or service) will serve the needs of the customer better than the alternatives.
- Ensure that the company REPRESENTATIVES know what they are talking about.
- Make sure the ORGANIZATION will stand behind its product or service.

6. What privacy issues are most important to small businesses? What should a company do to guard against violations of the privacy rights of customers, employees, and others?

An issue of great concern to Internet users is personal privacy. A recent poll found that more than 80 percent of Web users worry about whether and how their personal information is being protected. Businesses and consumers often disagree about how private the identity of visitors to websites should be. To minimize customer concerns, it is very important that a company be honest and transparent with customers about its practices and that it drafts a privacy policy that conforms to the guidelines provided by organizations like the Better Business Bureau or through consultation with an attorney.

Privacy issues extend to employees as well. The extent to which an employer may monitor an employee’s Internet activity is hotly debated. Many workers believe it is inappropriate for employers to monitor their e-mail. Employers, are concerned that employees may be wasting company time dealing with personal e-mail, shopping online, and surfing the internet. Data shows there is reason for this concern. An increasing number of small businesses are installing software to

monitor Internet use, and one study found that 38 percent of firms go so far as hiring staff to read or analyze employees' e-mail.

Beyond productivity concerns, companies are very worried these days about deliberate or accidental leaks of sensitive information, employee access to inappropriate content, and system exposure to risky viruses and malware.

Taking measures to protect privacy, on both ends, communicates that the firm respects its employees and signals sound commitment to high standards or integrity.

7. *What are some of the advantages of conducting business with integrity? Some people say they have no responsibility beyond maximizing the value of the firm in financial terms—can this position be defended? If so, how?*

There are many advantages to conducting business with integrity, beginning with maintaining a clear conscience! Integrity suggests that due attention will be given to the interests of the owners who, after all, have put up their personal resources to make the business possible, and more investment is likely to follow that which is appropriately managed. Integrity generates trust, which leads to repeat business by customers, low levels of turnover among employees, and a positive reputation in the community. These are all likely to lead to a financial edge for the company, but the primary motivation should run deeper, established on the knowledge that operating with integrity is simply the right thing to do, regardless of the outcomes. It should also be noted, though, that conducting business with integrity (e.g., paying all taxes owed under the law) can offer the important advantage of keeping the entrepreneur out of jail. Economist Milton Friedman, among others, argues that the only purpose of the business is to generate profits in an honest way, and this position seems sound. However, the path to profitability is not as clear as most people think. For example, the chapter cites research suggesting that companies perform best when they focus on all of the important stakeholders of the firm. In fact, the differences in performance levels are substantial. Those who accept Friedman's position argue that it is not the right of decision makers in the firm to redirect the investment of the firm's owners to community needs and other causes with which the owners may not have an interest, and this is a valid concern. It should be noted, however, that small companies often face a different situation since a single person—or a small group of investors—who can legitimately decide to spend their resources in any way they choose, usually owns them.

8. *Explain the connection between underlying values and ethical business behavior.*

A person's basic values show in ethical or unethical behavior. If a business leader deals unscrupulously with employees or customers, for example, it is evident that he or she lacks a strong internalized value system. Judeo-Christian values are the most widely accepted framework of values in our business world.

9. Why are the six steps in the ethical decision making process presented in this chapter? What is the practical value of this model to the processing of decision in a small business?

Step 1: Define the problem.

Step 2: Identify alternative solutions to the problem.

Step 3: Evaluate the identified alternatives

Step 4: Make the decision

Step 5: Implement the decision

Step 6: Evaluate the decision

Ethical decision making often is not a very clear-cut process. In fact, the appropriate course of action may still not be apparent in some business situation. This six-step process may help small business owners see the issues more clearly and help them to make better ethical decisions.

10. Give some examples of expenditures required on the part of small business firms to protect the environment. In your opinion, do rising concerns for the environment create more costs or more business opportunities for small companies?

Numerous examples are possible; students should be encouraged to cite examples of which they are personally aware. Some of those mentioned in the chapter refer to added costs borne by livestock feed lots, cement plants, and pet-food processors.

SUGGESTED ANSWERS TO YOU MAKE THE CALL EXERCISES

Situation 1

1. What decision on Sally's part would contribute most to the success of her business?

Hiring Julie seems to be the best choice. The fact that she is superior to the other candidates, based on experience and ability, suggests that she should be able to contribute most to the business. (Of course, one might also argue that hiring Julie is more ethical and that ethical decisions pay off in the long run.)

2. What ethical reasoning would support hiring Mary?

Sally has given her word to applicant Mary. She has told Mary that she has the job. The starting time has been specified. Since the instructions were verbal, it is probably not legally enforceable. However, does the principle of keeping one's promise allow for backing down at this stage? Mary may already have made commitments in view of the new job, and that fact that Mary needs the job to support her family makes this especially difficult.

3. What ethical reasoning would support hiring Julie?

Can the instructions to Mary be construed as merely tentative? If the agreement with Mary is not yet finalized, the job is still open until Monday. It might be

argued that Sally can hire Julie and still be ethical. The welfare of Sally's own family would pull in this direction, even though it would be a big disappointment to Mary. Which of these positions or arguments is more persuasive?

Situation 2

1. What are the advantages and possible drawbacks to Wilson's title-transfer scheme?

The only false advantage here is the increase in revenue for Darryl. Darryl believes he is profitable because he's able to skim money that is owed to the state of Texas. The drawbacks to this indiscretion are many. Darryl's integrity is in jeopardy. He runs the risk of getting caught and losing his business, going to jail, and being unable to provide for his family. If caught, his reputation will be tarnished, he'll incur legal costs in trying to defend himself, he will have embarrassed himself and his family, and he will have a very hard time recovering from this indiscretion.

2. Which stakeholders are affected by this approach, either positively or negatively? How great are their gains/losses?

Assuming Darryl doesn't get caught, the primary stakeholders that are affected negatively by this are: the State of Texas, private sellers, private buyers. Primary stakeholders that are affected positively by this are: Darryl, his family, the company business. However, the losses far outweigh the gains. The gains are small- roughly \$250 per car. If caught, the private sellers and private buyers could be impacted by this as they may be questioned by police officials during the investigation. Moreover, if caught, Darryl will lose his business and will incur a significant cost in trying to defend himself. He will also likely have to pay a fine for this theft. His family may disown him and he may serve time in jail. The IRS will also file charges and fine him for tax evasion. The costs far outweigh the benefits. Overall this is a bad decision by Darryl.

3. Wilson finds it hard to identify a downside to his approach, and so far it is working like a charm. What risks might he be overlooking?

It's only a matter of time before Darryl gets caught. He may get caught during an audit. He may get caught because a wise private seller may be astute enough to fill in the property transfer paperwork correctly or pick up on Darryl's evasive tactics (and report Darryl to the authorities). Darryl may get caught in an undercover investigation, perhaps even a public investigation which would be hugely embarrassing to he and his family. Darryl may be turned into the Better Business Bureau for unethical conduct. His lapse of judgment also impinges on the qualities of social responsibility. Darryl has an obligation to conduct himself in an ethical way within his community. Should his community find out about his governmental violations, there will surely be varying degrees of response among the citizens- largely negative.

4. ***What would you do if you were in Wilson’s shoes? If his competitors are following the same practice (and some of them surely are), would that make any difference to you?***

Darryl has adopted an ethical philosophy of ethical relativism- whereby he is acting the way others may be acting in his industry because no one has been caught (yet). He has found a “loophole” and is exploiting it. This doesn’t make this act right nor is it right even if others in his industry are behaving the same way. Rather, Darryl should think about adopting an attitude of ethical imperialism whereby his standards (high standards) are the ones that should guide him, regardless of others lower ethical standards. Darryl needs to evaluate his values and commit his decision making towards these values.

Situation 3

1. ***In your opinion, whose responsibility is it to initiate the payment of this debt?***

While the contractor is responsible for submitting an invoice for payment, London has a moral obligation to pay this debt and initiate contact with the contractor to solicit a copy of the invoice.

2. ***What if London is unable to come up with the money to pay the bill when (if) it is finally submitted/ What should he do then?***

He should then contact the accounting department and establish a payment plan.

3. ***What are the best options available to London in this case? Assess these using each of the following tests: (1) the Rotary Club’s four-question test, (2) the “newspaper report” test, (3) the “explain it to my mother” test, and (4) the Golden Rule. Do you arrive at the same conclusion when applying each of these? If not, which one should London use to decide what he should do?***

1. The Rotary Club’s four-question test could be applied to this scenario as follows:

i. Is it the Truth? YES

ii. Is it Fair to all concerned? To avoid paying the contractor is not fair. To pay would be fair.

iii. Will it build Goodwill and Better Friendships? If London pays then YES.

iv. Will it be Beneficial to all concerned? If London pays then YES.

2. The “newspaper report” asks, “How would I feel if my decision were reported in the daily newspaper? Under these circumstances London would not feel good about his decision.

3. The “explain it to my mother” test asks, “How well could I explain this decision to my mother or children.” While London may be able to rationalize his decision, no one would really accept his answer.

4. The Golden Rule states, “Treat others as you would want to be treated.” Under this covenant, London again fails--- no one would want to be treated this way.

Using each of these ethical tests, one arrives at the same conclusion. Any one of these tests will point London in the morally and ethically right direction.

SUGGESTED SOLUTION TO VIDEO CASE 2: PORTIONPAC CHEMICAL CORPORATION

- 1. Based on what you have learned about PortionPac, what do you think the owners would claim to be the most important features of doing business with integrity? Do you agree? Why or why not?***

The owners' sense of integrity refers to the honesty and reliability in their strong commitment to doing the right thing. They have always considered the "triple bottom line" of social, environmental, and economic balance while growing operations. They made the conscientious decision before starting the company to continually improve environmental standards and the human condition. This honesty, reliability, and accountability are PortionPac's claim to running a business with integrity.

- 2. Who are the most important stakeholders for PortionPac? What is the order of emphasis on the interests for these stakeholders—from most important and influential to least important and influential--on the company's decision-making processes? In your opinion, does this represent a wise ordering of stakeholder interests?***

PortionPac's most important stakeholders are their employees and clients. It's difficult to separate stakeholders from most important/most influential to least important/least influential because the company is founded on sustainability and the environment, external and human. This doggedness to their goal is apparent when considering the history of the company, and how it took so many years of sticking to their goals before achieving financial success. Their concern has been for the maximum safety for their employees to produce their products and for their clients to use them. The company holds itself accountable to the end-user and recognizes its role in health and safety, and these tenets have been behind the company's decision-making process.

- 2. PortionPac is very concerned about the environment. Is the company's environmental focus good for the company? Why or why not? 4. Would you want to work for a company that operates according to the goals discussed in the case? What would be the pros and cons of working there?***

Although it took PortionPac many years to achieve success, their commitment to the environment has proved invaluable for the company in terms of financial success and their leadership role in the industry.

ADDITIONAL ACTIVITIES

Purpose: The purpose of these activities is to give students the opportunity to see how companies express ethical principles and then to think about their own personal ethics. Understanding their own underlying values will then help students to see how those values can inform and support their business ventures.

Setting it up: These three activities are organized so that you can move students from the familiar (what they saw in the video) to the unfamiliar (working on a set of values for their own business venture). The first activity can be done in class as group work after watching the video. Let students spend about 10 minutes in groups of three to four working on mission and values statements for Joseph's Lite Cookies. After the allotted time is up, reconvene as an entire class to share results and discuss differences of perspectives.

For the second activity, it is probably best to have students work independently. If they have a business venture in mind, they may be reluctant to share it with another student, particularly if they are passionate about it. The purpose of the second activity is to have students think about what mission statements will drive their own business.

Likewise, the third activity is best used as an assignment. Many businesspeople use their companies to express their own values. For example, Howard Shultz, the entrepreneur who founded Starbucks, shows his commitment to the company's employees by offering full health care benefits to part-time workers, offering a tuition reimbursement plan, and by working to create coffee growing technologies that don't deplete the rainforest areas of the world. By doing activity number 3, students will explore the possibilities – and the limitations – of using a business to express core personal values.

1. It is not uncommon for large corporations to have documents that provide ethics guidelines. The world's leading producer of cereal and a leading producer of cookies and convenience foods, Kellogg's, is one such corporation. At the company's Web site, <http://www.kelloggcompany.com>, you will find Kellogg's Corporate Social Responsibility commitment statement and a long list of what it terms "K Values"—written very much like a mission statement. Review the commitment statement and values statement on the Web site. Draft a mission and values statement for Joseph's Lite Cookies that reflects what you have seen in the videos. (At the time of publication, there was no such document posted on the Joseph's Lite Cookies Web site.) Share your work with your classmates or study group partners.
2. Now practice writing mission and values for your own business enterprise. Even if you don't currently have a business concept or plan, you can still organize your thoughts on the values that will guide your future business ventures. How detailed do you think you want to be? Dow Chemical's Code of Business Conduct is 35 pages; Nordstrom's fits on a 3 x 5 index card.

3. Once you have written down your own underlying values, indicate ways that you will act on them. You may find the following list of questions a good starting place for thinking about on how your business will reflect your personal values:

- Will your business give to charities? If so, how will you select groups that receive donations?
- Will you be involved in the community? How so? If not, why not?
- How will you find employees? For example, will your recruitment efforts take into account the disabled, low-income, minorities, and others in underrepresented groups?
- How will you manage your company's waste? If it costs more to recycle, will you do it?
- Will you reward employees for their community involvement with non-profit organizations or civic groups? Will you encourage your employees to become active in their community?
- How will you determine pay levels?
- What kinds of benefits will you offer?
- Where will you locate?

Sources: Small Business School video; company Web site at <http://www.josephslitecookies.com>; April Y. Pennington, "Making Their Mark," *Entrepreneur*, February 15, 2006, online; The American Business Awards: The Stevies, stevieawards.com, online; Kellogg's Web site, <http://www.kelloggcompany.com/company.aspx?id=35> and <http://www.kelloggcompany.com/social.aspx?id=56>