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CCBC Legal Studies – Business Law I

An OER Textbook for MNGT 140

Business Ethics

Most of those who write about ethics do not make a clear distinction between ethics and morality. The question of what is “right” or “morally correct” or “ethically correct” or “morally desirable” in any situation is variously phrased, but all of the words and phrases are after the same thing: what act is “better” in a moral or ethical sense than some other act? People sometimes speak of morality as something personal but view ethics as having wider social implications. Others see morality as the subject of a field of study, that field being ethics. Ethics would be morality as applied to any number of subjects, including journalistic ethics, business ethics, or the ethics of professionals such as doctors, attorneys, and accountants. For our purposes, *ethics* and *morality* will be used as equivalent terms.

People often speak about the ethics or morality of individuals and also about the morality or ethics of corporations and nations. There are clearly differences in the kind of moral responsibility that we can fairly ascribe to corporations and nations; we tend to see individuals as having a soul, or at least a conscience, but there is no general agreement that nations or corporations have either. Still, our ordinary use of language does point to something significant: if we say that some nations are “evil” and others are “corrupt,” then we make moral judgments about the quality of actions undertaken by the governments or people of that nation. For example, if North Korea is characterized by the US president as part of an “axis of evil,” or if we conclude that WorldCom or Enron acted “unethically” in certain respects, then we are making judgments that their collective actions are morally deficient.

In talking about morality, we often use the word *good*; but that word can be confusing. If we say that Microsoft is a “good company,” we may be making a statement about the investment potential of Microsoft stock, or their preeminence in the market, or their ability to win lawsuits or appeals or to influence administrative agencies. Less likely, though possibly, we may be making a statement about the civic virtue and corporate social responsibility of Microsoft. In the first set of judgments, we use the word *good* but mean something other than ethical or moral; only in the second instance are we using the word *good* in its ethical or moral sense.

A word such as *good* can embrace ethical or moral values but also nonethical values. If I like Daniel and try to convince you what a “good guy” he is, you may ask all sorts of questions: Is he good-looking? Well-off? Fun to be with? Humorous? Athletic? Smart? I could answer all of those questions with a yes, yet you would still not know any of his moral qualities. But if I said that he was honest, caring, forthright, and diligent, volunteered in local soup kitchens, or donated to the church, many people would see Daniel as having certain ethical or moral qualities. If I said that he keeps the Golden Rule as well as anyone I know, you could conclude that he is an ethical person. But if I said that he is “always in control” or “always at the top of his game,” you would probably not make inferences or assumptions about his character or ethics.

There are three key points here:

1. Although morals and ethics are not precisely measurable, people generally have similar reactions about what actions or conduct can rightly be called ethical or moral.
2. As humans, we need and value ethical people and want to be around them.

3. Saying that someone or some organization is law-abiding does not mean the same as saying a person or company is ethical.

Here is a cautionary note: for individuals, it is far from easy to recognize an ethical problem, have a clear and usable decision-making process to deal with it, and then have the moral courage to do what's right. All of that is even more difficult within a business organization, where corporate employees vary in their motivations, loyalties, commitments, and character. There is no universally accepted way for developing an organization where employees feel valued, respected, and free to openly disagree; where the actions of top management are crystal clear; and where all the employees feel loyal and accountable to one another.

Before talking about how ethics relates to law, we can conclude that ethics is the study of morality —“right” and “wrong” —in the context of everyday life, organizational behaviors, and even how society operates and is governed.

How Do Law and Ethics Differ?

There is a difference between legal compliance and moral excellence. Few would choose a professional service, health care or otherwise, because the provider had a record of perfect legal compliance, or always following the letter of the law. There are many professional ethics codes, primarily because people realize that law prescribes only a minimum of morality and does not provide purpose or goals that can mean excellent service to customers, clients, or patients.

Business ethicists have talked for years about the intersection of law and ethics. Simply put, what is legal is not necessarily ethical. Conversely, what is ethical is not necessarily legal. There are lots of legal maneuvers that are not all that ethical; the well-used phrase “legal loophole” suggests as much.

Here are two propositions about business and ethics. Consider whether they strike you as true or whether you would need to know more in order to make a judgment.

- Individuals and organizations have reputations. (For an individual, moral reputation is most often tied to others' perceptions of his or her character: is the individual honest, diligent, reliable, fair, and caring? The reputation of an organization is built on the goodwill that suppliers, customers, the community, and employees feel toward it. Although an organization is not a person in the usual sense, the goodwill that people feel about the organization is based on their perception of its better qualities by a variety of stakeholders: customers or clients, suppliers, investors, employees, government officials.
- The goodwill of an organization is to a great extent based on the actions it takes and on whether the actions are favorably viewed. (This goodwill is usually specifically counted in the sale of a business as an asset that the buyer pays. While it is difficult to place a monetary value on goodwill, a firm's good reputation will generally call for a higher evaluation in the final accounting before the sale. Legal troubles or a reputation for having legal troubles will only lessen the price for a business and will even lessen the value of the company's stock as bad legal news comes to the public's attention.) Another reason to think about ethics in connection with law is that the laws themselves are meant to express some moral view. If there are legal prohibitions against cheating the Medicare program, it is because people (legislators or their agents) have collectively decided that cheating Medicare is wrong. If there are legal prohibitions against assisting someone to commit suicide, it is because there has been a group decision that doing so is immoral. Thus the law provides some important cues as to what society regards as right or wrong.

Finally, important policy issues that face society are often resolved through law, but it is important to understand the moral perspectives that underlie public debate—as, for example, in the continuing controversies over stem-cell research, medical use of marijuana, and abortion. Some ethical perspectives focus on rights, some on social utility, some on virtue or character, and some on social justice. People

consciously (or, more often, unconsciously) adopt one or more of these perspectives, and even if they completely agree on the facts with an opponent, they will not change their views. Fundamentally, the difference comes down to incompatible moral perspectives, a clash of basic values. These are hot-button issues because society is divided, not so much over facts, but over basic values. Understanding the varied moral perspectives and values in public policy debates is a clarifying benefit in following or participating in these important discussions.

Why Should an Individual or a Business Entity Be Ethical?

The usual answer is that good ethics is good business. In the long run, businesses that pay attention to ethics as well as law do better; they are viewed more favorably by customers. But this is a difficult claim to measure scientifically, because “the long run” is an indistinct period of time and because there are as yet no generally accepted criteria by which ethical excellence can be measured. In addition, life is still lived in the short run, and there are many occasions when something short of perfect conduct is a lot more profitable.

Some years ago, Royal Dutch/Shell (one of the world’s largest companies) found that it was in deep trouble with the public for its apparent carelessness with the environment and human rights. Consumers were boycotting and investors were getting frightened, so the company took a long, hard look at its ethic of short-term profit maximization. Since then, changes have been made. The CEO told one group of business ethicists that the uproar had taken them by surprise; they thought they had done everything right, but it seemed there was a “ghost in the machine.” That ghost was consumers, non-governmental organizations (NGOs), and the media, all of whom objected to the company’s seeming lack of moral sensitivity.

The market does respond to unethical behavior. For example, the Arthur Andersen story illustrates this point quite dramatically. A major accounting firm, Andersen worked closely with Enron in hiding its various losses through creative accounting measures. Suspiciously, Andersen’s Houston office also did some shredding around the clock, appearing to cover up what it was doing for Enron. A criminal case based on this shredding resulted in a conviction, later overturned by the Supreme Court. But it was too late. Even before the conviction, many clients had found other accounting firms that were not under suspicion, and the Supreme Court’s reversal came too late to save the company. Even without the conviction, Andersen would have lost significant market share.

The irony of Andersen as a poster child for overly aggressive accounting practices is that the man who founded the firm built it on integrity and straightforward practices. “Think straight, talk straight” was the company’s motto. Andersen established the company’s reputation for integrity over a hundred years ago by refusing to play numbers games for a potentially lucrative client.

Maximizing profits while being legally compliant is not a very inspiring goal for a business. People in an organization need some quality or excellence to strive for. By focusing on pushing the edge of what is legal, by looking for loopholes in the law that would help create short-term financial gain, companies have often learned that in the long term they are not actually satisfying the market, the shareholders, the suppliers, or the community generally.

Captive Customers

Ann Marie Wagoner studies at the University of Alabama (UA). She pays \$1,200 a year for books, which is exasperating, but what really ticks her off is the text for her composition class. Called *A Writer's Reference (Custom Publication for the University of Alabama)*, it's the same *Writer's Reference* sold everywhere else, with slight modifications: there are thirty-two extra pages describing the school's particular writing program, the Alabama A is emblazoned on the front cover, there's an extra \$6 on the price tag (compared with the price of the standard version when purchased new), and there's an added sentence on the back: "This book may not be bought or sold used." The modifications are a collective budget wrecker. Because she's forced to buy a new copy of the customized Alabama text, she ends up paying about twice what she'd pay for a used copy of the standard, not-customized book that's available at Chegg.com and similar used-book dealers.

For the extra money, Wagoner doesn't get much—a few additional text pages and a school spirit cover. Worse, those extra pages are posted free on the English department's website, so the cover's the only unambiguous benefit. Even there, though, it'd be cheaper to just buy a UA bumper sticker and paste it across the front. It's hard to see, finally, any good reason for the University of Alabama English Department to snare its own students with a textbook costing so much.

Things clear up when you look closely at the six-dollar difference between the standard new book cost and the customized UA version. Only half that money stays with the publisher to cover specialized printing costs. The other part kicks back to the university's writing program, the one requiring the book in the first place. It turns out there's a quiet moneymaking scheme at work here: the English department gets some straight revenue, and most students, busy with their lives, don't notice the royalty details. They get their books, roll their eyes at the cash register, and get on with things.

Wagoner noticed, though. According to an extensive article in the *Wall Street Journal*, she calls the cost of new custom books "ridiculous." She's also more than a little suspicious about why students aren't more openly informed about the royalty arrangement: "They're hiding it so there isn't a huge uproar." John Hechinger, "As Textbooks Go 'Custom,' Students Pay: Colleges Receive Royalties for School-Specific Editions; Barrier to Secondhand Sales," *Wall Street Journal*, July 10, 2008, accessed May 11, 2011, <http://online.wsj.com/article/SB121565135185141235.html> (<http://online.wsj.com/article/SB121565135185141235.html>).

While it may be true that the Tuscaloosa university is hiding what's going on, they're definitely not doing a very good job since the story ended up splattered across the *Wall Street Journal*. One reason the story reached one of the United States' largest circulation dailies is that a lot of universities are starting to get in on the cash. Printing textbooks within the kickback model is, according to the article, the fastest growing slice of the \$3.5 billion college textbook market.

The money's there, but not everyone is eager to grab it. James Koch, an economist and former president of Old Dominion University and the University of Montana, advises schools to think carefully before tapping into customized-textbook dollars because, he says, the whole idea "treads right on the edge of what I would call unethical behavior. I'm not sure it passes the smell test" (Hechinger).

What Is Business Ethics?

What does it mean to say a business practice doesn't "pass the smell test"? And what would happen if someone read the article and said, "Well, to me it smells all right"? If no substance fills out the idea, if there's no elaboration, then there probably wouldn't be much more to say. The two would agree to

disagree and move on. Normally, that's OK; no one has time to debate everything. But if you want to get involved—if you're like Wagoner, who sounds angry about what's going on and maybe wants to change it—you'll need to do more than make comments about how things hit the nose.

Doing business ethics means providing reasons for how things ought to be in the economic world. This requires the following:

Arranging values to guide decisions. There needs to be a clearly defined and well-justified set of priorities about what's worth seeking and protecting and what other things we're willing to compromise or give up. For example, what's more important and valuable: consumers (in this case students paying for an education) getting their books cheaply or protecting the right of the university to run the business side of its operation as it sees fit?

Understanding the facts. To effectively apply a set of values to any situation, the situation itself must be carefully defined. Who, for example, is involved in the textbook conflict? Students, clearly, as well as university administrators. What about parents who frequently subsidize their college children? Are they participants or just spectators? What about those childless men and women in Alabama whose taxes go to the university? Are *they* involved? And how much money are we talking about? Where does it go? Why? How and when did all this get started?

Constructing arguments. This shows how, given the facts, one action serves our values better than other actions. While the complexities of real life frequently disallow absolute proofs, there remains an absolute requirement of comprehensible reasoning. Arguments need to make sense to outside observers. In simple, practical terms, the test of an ethical argument resembles the test of a recipe for a cook: others need to be able to follow it and come to the same result. There may remain disagreements about facts and values at the end of an argument in ethics, but others need to understand the reasoning marking each step taken on the way to your conclusion.

Finally, the last word in ethics is a determination about right and wrong. This actual result, however, is secondary to the process: the verdict is only the remainder of forming and debating arguments. That's why doing ethics isn't brainwashing. Conclusions are only taken seriously if composed from clear values, recognized facts, and solid arguments.

Bringing Ethics to Kickback Textbooks

The *Wall Street Journal* article on textbooks and kickbacks to the university is a mix of facts, values, and arguments. They can be sorted out; an opportunity to do the sorting is provided by one of the article's more direct assertions: Royalty arrangements involving specially made books may violate colleges' conflict-of-interest rules because they appear to benefit universities more than students.

A conflict of interest occurs when a university pledges to serve the interest of students but finds that *its own* interest is served by not doing that. It doesn't sound like this is a good thing (in the language of the article, it smells bad). But to reach that conclusion in ethical terms, the specific values, facts, and arguments surrounding this conflict need to be defined.

Start with the values. The priorities and convictions underneath the conflict-of-interest accusation are clear. When a university takes tuition money from a student and promises to do the best job possible in providing an education to the student, then it better *do* that. The truth matters. When you make a promise, you've got to fulfill it. Now, this fundamental value is what makes a conflict of interest worrisome. If we didn't care about the truth at all, then a university promising one thing and doing something else

wouldn't seem objectionable. In the world of poker, for example, when a player makes a grand show of holding a strong hand by betting a pile of chips, no one calls him a liar when it's later revealed that the hand was weak. The truth isn't expected in poker, and bluffing is perfectly acceptable. Universities aren't poker tables, though. Many students come to school expecting honesty from their institution and fidelity to agreements. To the extent these values are applied, a conflict of interest becomes both possible and objectionable.

With the core value of honesty established, what are the facts? The "who's involved?" question brings in the students buying the textbooks, the company making the textbooks (Bedford/St. Martin's in Boston), and the University of Alabama. As drawn from the UA web page, here's the school's purpose, the reason it exists in the first place: "The University of Alabama is a student-centered research university and an academic community united in its commitment to enhancing the quality of life for all Alabamians."

Moving to the financial side, specific dollar amounts should be listed (the textbook's cost, the cost for the noncustomized version). Also, it may be important to note the financial context of those involved: in the case of the students, some are comfortably wealthy or have parents paying for everything, while others live closer to their bank account's edge and are working their way through school.

Finally, the actual book-selling operation should be clearly described. In essence, what's going on is that the UA English Department is making a deal with the Bedford/St. Martin's textbook company. The university proposes, "If you give us a cut of the money you make selling textbooks, we'll let you make more money off our students." Because the textbooks are customized, the price goes up while the supply of cheap used copies (that usually can be purchased through the Internet from stores across the nation) goes way down. It's much harder for UA students to find used copies, forcing many to buy a new version. This is a huge windfall for Bedford/St. Martin's because, for them, every time a textbook is resold used, they lose a sale. On the other side, students end up shelling out the maximum money for each book because they have to buy new instead of just recycling someone else's from the previous year. Finally, at the end of the line there is the enabler of this operation, the English department that both requires the book for a class and has the book customized to reduce used-copy sales. They get a small percentage of Bedford/St. Martin's extra revenue.

With values and facts established, an argument against kickback textbooks at Alabama can be drawn up. By customizing texts and making them mandatory, UA is forcing students to pay extra money to take a class: they have to spend about thirty dollars extra, which is the difference between the cost of a new, customized textbook and the standard version purchased used. Students generally don't have a lot of money, and while some pass through school on the parental scholarship, others scrape by and have to work a McJob to make ends meet. So for at least some students, that thirty dollars directly equals time that could be spent studying, but that instead goes to flipping burgers. The customized textbooks, consequently, hurt these students' academic learning in a measurable way. Against that reality there's the university's own claim to be a "student-centered" institution. Those words appear untrue, however, if the university is dragging its own students out of the library and forcing them to work extra hours. To comply with its own stated ideals—to serve the *students'* interests—UA should suspend the kickback textbook practice. It's important to do that, finally, because fulfilling promises is valuable; it's something worth doing.

Argument and Counterargument

The conclusion that kickback textbooks turn universities into liars doesn't end debate on the question. In fact, because well developed ethical positions expose their reasoning so openly (as opposed to "it doesn't smell right"), they tend to invite responses. One characteristic, in other words, of good ethical arguments is that, paradoxically but not contradictorily, they tend to provoke counterarguments.

Broadly, there are three ways to dispute an argument in ethics. You can attack the facts, values, and reasoning.

In the textbook case, disputing the facts might involve showing that students who need to work a few extra hours to afford their books *don't* subtract that time from their studying; actually, they subtract it from late-night hours pounding beers in dank campus bars. The academic damage done, therefore, by kickback textbooks is zero. Pressing this further, if it's true that increased textbook prices translate into less student partying, the case could probably be made that the university actually serves students' interests—at least those who drink too much beer—by jacking up the prices.

The values supporting an argument about kickback textbooks may, like the facts, be disputed. Virginia Tech, for example, runs a text-customization program like Alabama's. According to Tech's English Department chair Carolyn Rude, the customized books published by Pearson net the department about \$20,000 a year. Some of that cash goes to pay for instructors' travel stipends. These aren't luxury retreats to Las Vegas or Miami; they're gatherings of earnest professors in dull places for discussions that reliably put a few listeners to sleep. When instructors—who are frequently graduate students—attend, they're looking to burnish their curriculum vitae (aka resumes) and get some public responses to their work. Possibly, the trip will help them get a better academic job later on. Regardless, it won't do much for the undergraduates at Virginia Tech. In essence, the undergrads are being asked to pay a bit extra for books to help graduate students hone their ideas and advance professionally.

Can that tradeoff be justified? With the right values, yes. It must be conceded that Virginia Tech is probably rupturing a commitment to serve the undergrads' interest. Therefore, it's true that a certain amount of dishonesty shadows the process of inflating textbook costs. If, however, there's a higher value than truth, that won't matter so much. Take this possibility: what's right and wrong isn't determined by honesty and fidelity to commitments, but the general welfare. The argument here is that while it's true that undergrads suffer a bit because they pay extra, the instructors receiving the travel stipends benefit a lot. Their knowledge grows, their career prospects improve, and in sum, they benefit so much that it entirely outweighs the harm done to the undergrads. As long as this value—the greatest total good—frames the assessment of kickback textbooks, the way is clear for Tech or Alabama to continue the practice. It's even recommendable.

The final ground on which an ethical argument can be refuted is the reasoning. Here, the facts are accepted, as well as the value that universities are duty bound to serve the interests of the tuition-paying undergraduate students since that's the commitment they make on their web pages. What can still be debated, however, is the extent to which those students may actually *be* benefitted by customizing textbooks. Looking at the *Wall Street Journal* article, several partially developed arguments are presented on this front. For example, at Alabama, part of the money collected from the customized texts underwrites teaching awards, and that, presumably, motivates instructors to perform better in the classroom, which ends up serving the students' educational interests. Similarly, at Virginia Tech, part of the revenue is apportioned to bring in guest speakers, which should advance the undergraduate educational cause. The broader argument is that while it's true that the students are paying more for their books than peers at other universities, the sequence of reasoning doesn't necessarily lead from that fact to the conclusion that there's a reproachable conflict of interest. It can also reach the verdict that students' educational experience is improved; instead of a conflict of interest, there's an elevated commitment to student welfare inherent in the kickback practice.

Conclusion. There's no irrefutable answer to the question about whether universities ought to get involved in kickback textbooks. What is clear, however, is that there's a difference between responding to them by asserting that something doesn't smell right, and responding by uniting facts, values, and reasoning to produce a substantial ethical argument.

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