CASE 10

Banking Industry Meltdown: The Ethical and Financial Risks of Derivatives

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The 2008–2009 global recession was caused in part by a failure of the financial industry to take appropriate responsibility for its decision to utilize risky and complex financial instruments. Corporate cultures were built on rewards for taking risks rather than rewards for creating value for stakeholders. Unfortunately, most stakeholders, including the public, regulators, and the mass media, do not always understand the nature of the financial risks taken on by banks and other institutions to generate profits.

Problems in the subprime mortgage markets sounded the alarm in the 2008–2009 economic downturn. Very simply, the subprime market was created by making loans to people who normally would not qualify based on their credit ratings. The debt from these loans was often repackaged and sold to other financial institutions in order to take it off lenders' books and reduce their exposure. When the real estate market became overheated, many people were no longer able to make the payments on their variable rate mortgages. When consumers began to default on payments, prices in the housing market dropped and the values of credit default swaps (the repackaged mortgage debt, also known as CDSs) lost significant value. The opposite was supposed to happen. CDSs were sold as a method of insuring against loss. These derivatives, investors were told, would act as an insurance policy to reduce the risk of loss. Unfortunately, losses in the financial industry were so widespread that even the derivative contracts that had been written to cover losses from unpaid subprime mortgages could not be covered by the financial institutions that had written these derivatives contracts. The financial industry and managers at all levels had become focused on the rewards for these transactions without concerns about how their actions could potentially damage others.

In addition to providing a simplified definition of what derivatives are, this case allows for a review of questionable, often unethical or illegal, conduct associated with a number of respected banks in the 2008–2009 financial crisis. First, we review the financial terminology

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associated with derivatives, as they were an integral part of the downfall of these financial institutions. Derivatives were, and still are, considered a legal and ethical financial instrument when used properly, but they inherently hold a lot of potential for mishandling. When misused, they provide a ripe opportunity for misconduct. To illustrate the types of misconduct that can result, this case employs a number of examples. First, we examine Barings Bank, which ceased to exist because of a rogue trader using derivatives. Next, we look at United Bank of Switzerland (UBS) and its huge losses from bad mortgages and derivatives. Bear Stearns, an investment bank that suffered its demise through derivatives abuse, is the third example. Finally, Lehman Brothers is an investment bank that was involved with high-risk derivatives that also led to its bankruptcy. At the conclusion of this case, we examine the risk of derivatives and potential ethical risks associated with the use of these instruments in the financial industry.

DERIVATIVES DEFINED

Derivatives are financial instruments with values that change relative to underlying variables, such as assets, events, or prices. In other words, the value of derivatives is based on the change in value of something else, called the *underlying* trade or exchange.

The main types of derivatives are futures, forwards, options, and swaps. A *futures* contract is an agreement to buy or sell a set quantity of something at a set rate at a predetermined point in the future. The date on which this exchange is scheduled to take place is called the delivery, or settlement, date. Futures contracts are often associated with buyers and sellers of commodities who are concerned about supply, demand, and changes in prices. They can be traded only on exchanges. Almost any commodity, such as oil, gold, corn, or soybeans, can have a futures contract defined for a specific trade.

> *"The value of derivatives is based on different types of underlying values"*

Forwards are similar to futures, except they can be traded between two individuals. A forward contract is a commitment to trade a specified item at a specific price in the future. The forward contract takes whatever form to which the parties agree.

An *option* is a less binding form of derivative. It conveys the right, but not the obligation, to buy or sell a particular asset in the future. A *call option* gives the investor the right to buy at a set price on delivery day. A *put option* gives the investor the option to sell a good or financial instrument at a set price on the settlement date. It is a financial contract with what is called a *long position,* giving the owner the right but not the obligation to sell an amount at a preset price and maturity date.

Finally, *swaps* live up to their name. A swap can occur when two parties agree to exchange one stream of cash flows against another one. Swaps can be used to hedge risks such as changes in interest rates, or to speculate on the changing prices of commodities or currencies. Swaps can be difficult to understand, so here is an example. JP Morgan developed CDSs that bundled together as many as 300 different assets, including subprime loans. Credit default swaps were meant as a form of insurance. In other words, securities were bundled into one financial package, and companies such as JP Morgan were essentially paying insurance premiums to the investors who purchased them, who were now on the hook if payments of any of the securities included in the CDSs did not come through.

As mentioned before, the value of derivatives is based on different types of underlying values, including assets such as commodities, equities (stocks), bonds, interest rates, exchange rates, or indexes such as a stock market index, consumer price index (CPI), or even an index of weather conditions. For example, a farmer and a grain storage business enter into a futures contract to exchange cash for grain at some future point. Both parties have reduced a future risk. For the farmer it is the uncertainty of the future grain price, and for the grain storage business it is the availability of the grain at a predetermined price.

Some believe derivatives lead to market volatility because enormous amounts of money are controlled by relatively small amounts of margin or option premiums. The job of a derivatives trader is something like a bookie taking bets on how people will bet. *Arbitrage* is defined as attempting to profit by exploiting price differences of identical or similar financial instruments, on different markets, or in different forms. As a result, derivatives can suffer large losses or returns from small movements in the underlying asset's price. Investors are like gamblers in that they can bet for or against the price (going up or down) and can consequently lose or win large amounts.

BARINGS BANK

Barings Bank, which had been in operation in the United Kingdom for 233 years, ceased to exist in 1995 when a futures trader named Nick Leeson lost approximately $1.4 billion in company assets. The extinction was due, in part, to a large holding position in the Japanese futures market. Leeson, chief trader for Barings Futures in Singapore, accumulated a large number of opening positions on the Nikkei Index. He then generated losses in the first two months of 1995 when the Nikkei dropped more than 15 percent. To try and recover these losses, Leeson placed what is called a short "straddle" on the Singapore and Tokyo stock markets. He was betting that the stock market would not move significantly in the short term. This strategy is risky but can be profitable in stable markets. However, when the Kobe earthquake hit and sent the Japanese stock market plummeting, Leeson lost a lot of money. He did not, however, change his approach. In fact, Leeson tried to cover his losses through a series of other risky investments that, instead, only increased the losses. When he finally quit his job, Leeson sent a fax to his manager, stating "sincere apologies for the predicament that I have left you in." Barings was purchased by ING, a Dutch bank for £1 (approximately $1), which then sold it under the name Baring Asset Management (BAM) to MassMutual and Northern Trust in 2005.

Nick Leeson's life is a rags-to-riches tale. Son of a plasterer, he started his career in 1984 as a clerk with royal bank Coutts and later worked briefly for Morgan Stanley. He then got a position in operations at Barings, and later was transferred to Jakarta. Leeson worked in a back office solving clients' problems of wrongly denominated certificates and difficulties of delivery. Before long, Leeson was appointed manager of a new operation in the futures markets on the Singapore Monetary Exchange (SIMEX). Leeson had the authority to hire traders and staff and to sell six financial products, but his main business was doing inter-exchange arbitrage or "switching." Switching is betting on small differences between contracts by buying and selling futures simultaneously on two different stock exchanges. For example, if a contract was worth the equivalent of $3 in London and $2.75 in Singapore, Leeson would buy in Singapore and sell in London, making a 25-cent profit.

The key to Leeson's strategy in the 1980s was the knowledge that one stock market was slower in processing trades than the other. To hide any bad bets, Leeson created an error account (named 8888 for its auspiciousness in Chinese numerology) for his losses. Because no one could see the losses hidden by this account, Leeson was widely regarded as a brilliant trader. He had assured Barings that he was not trading with company money and that all the positions were perfectly hedged and virtually risk-free. Barings managers had little knowledge in trading and did not suspect Leeson of deception. Based on their trust, Barings put a billion dollars into Leeson's account and made no attempt to check his statements. All it took to bring down this house of cards was one earthquake.

When the Kobe earthquake hit in 1995, Leeson's luck finally ran out. He fled to Malaysia, Thailand, and then Germany, and was finally arrested for fraud in Frankfurt. He was extradited back to Singapore and sentenced to six-and-a-half years in Singapore's Changi prison where he was diagnosed with colon cancer and divorced by his wife. During that time, Leeson wrote *Rogue Trader: How I Brought Down Barings Bank and Shook the Financial World*, which was later made into a movie. He was released from prison in 1999. Since then he has become CEO of the Galway United Football Club. Although he has tried to atone for his actions, to many he is still considered to be the rogue trader who, through his misuse of derivatives, destroyed the United Kingdom's oldest bank.

UBS

United Bank of Switzerland (UBS) is a diversified global financial services company, headquartered in Switzerland. It is the world's largest manager of private wealth assets and the second-largest bank in Europe with overall invested assets of approximately $3.167 trillion.

In 2000, UBS acquired PaineWebber Group Inc. to become the world's largest wealth management firm for private clients. Three years later, all UBS business groups rebranded under the UBS name as the company began operating as one large firm. As a result of the rebranding, UBS took a $1 billion write-down for the loss of goodwill associated with the retirement of the PaineWebber brand. (Write-downs represent a reduction in an asset's book value.) UBS is no longer an acronym but is the company's brand name. Its logo of three keys stands for confidence, security, and discretion. UBS had offices in the world's financial centers in 50 countries, and employed approximately 82,000.

In the late 2000s, UBS came under scrutiny for questionable practices. In 2008, Internal Revenue Service investigators asked for the names of some 20,000 American clients suspected of hiding as much as $20 billion in assets to avoid at least $300 million in federal taxes on funds in offshore accounts. The issue is complicated because using offshore accounts is not illegal in the United States, but hiding income in undeclared accounts is. However, Switzerland does not consider tax evasion a crime, and using undeclared accounts is legal. In 2008, former UBS banker Bradley Birkenfeld and Liechtenstein banker Mario Staggl were indicted in Florida for helping an American property developer evade taxes by creating bogus trusts and corporations to hide the ownership and control of offshore assets. They also were accused of advising clients to destroy bank records and of helping them to file false tax returns. UBS had asked the bankers to sign papers saying that they, not the bank, would be responsible if they broke non-Swiss tax laws.

Indian authorities also are probing suspected violations of foreign exchange controls involving accounts held at UBS by two companies controlled by India's richest man. The accusations involve transactions that were allegedly arranged by unspecified parties by taking overdrafts on accounts held with UBS London.

However, tax evasion accusations are not the only problems UBS faces. Like other banks, it has suffered from the subprime crisis due to its heavy dependence on derivatives and mortgage-related securities. In fact, UBS has suffered more losses than any other lender in Europe. By the end of 2008, the bank had been forced to write-down over $46 billion in losses on bad mortgages and derivatives. The bank blamed weak risk controls and risky investment dealings for its loss.

In 2008, UBS appealed to the Swiss government, which doled out an aid package of approximately $59.2 billion to the ailing bank. In exchange, UBS agreed to forgo nearly $27.7 million in pay to the company's top three executives. From then on, the bank promised, bonuses would depend more on the bank's performance, a decision that came to the relief of those who had criticized what they saw as the bank's excessive pay for CEOs. Additionally, some CEOs who resigned promised to return some of the compensation they received. Time will tell whether these combined decisions will be able to resolve the bank's burgeoning problems.

BEAR STEARNS

Unlike many companies that existed before the Great Depression of 1929, Bear Stearns thrived through much of the twentieth century. Unfortunately, in the early twenty-first century, Bear Stearns encountered another severe economic crisis that it did not survive. JP Morgan acquired the company in March 2008 after Bear Stearns lost billions in the subprime crisis.

Bear Stearns was a global investment bank and a securities and brokerage firm. Located in New York City, it was founded as an equity trading-house in 1923 by Joseph Bear, Robert Stearns, and Harold Mayer. With an initial $500,000 in capital, the company thrived in the twenties and even in the post–stock market crash of the 1930s. In fact, the company did so well that while other banks were failing by the dozens, Bear Stearns was able to pay out bonuses. By 1933, the company employed seventy-five people and opened its first regional office in Chicago. About twenty years later, the company began operating international offices. Bear Stearns continued to grow and prosper, and in 1985 it formed a holding company known as Bear Stearns Companies, Inc. In 2002, while other firms were struggling, Bear Stearns was the only securities firm to report a first-quarter profit increase. It also began focusing more on the housing industry, which would spell out its doom a mere five years later.

In 2005, Bear Stearns was listed as *Fortune* magazine's "America's Most Admired Securities Firm" for the second time in three years. At the end of 2006, the company's total capital was $66.7 billion and its assets totaled $350.4 billion. The subprime crisis first hit Bear Stearns early in 2007. Previously, the bank had seen a fifty-two-week high of $133.20 per share. By late 2007, two Bear Stearns hedge funds had collapsed, the company's third-quarter profit had decreased by 61 percent, and it had written off $1.2 billion in mortgage securities. In 2008, the Federal Reserve attempted to bail out the company, but it could not save Bear Stearns. JP Morgan agreed to buy the company for a mere $2 per share, which was a decrease of $131 per share in about a year. After lawsuits and intense negotiations, JP Morgan raised the buying price to $10 per share.

What caused a long-standing institution like Bear Stearns to fall? Its investment in subprime loans was a significant factor, but derivatives could also be a major reason. Since its failure, information has come out that Bear Stearns widely misrepresented clients' information on loan applications in order to make them appear more desirable mortgage recipients. Once these risky subprime loans were given out, the company packaged and sold the debt as securities to other institutions. In this way, Bear Stearns managed to keep the risky subprime lending debt off its books and moved the onus to investors. Bear Stearns had derivatives amounting to $13.4 trillion at the end of 2007. These securities were backed by cash flow from the loans, but that only works when loan payments come in as they are supposed to.

Since its failure, the Bear Stearns scheme has been exposed as a risky "house of cards." Executives have been charged with misleading investors by concealing that hedge funds were failing as the mortgage market crumbled. Investors lost $1.6 billion in assets. Executives Ralph R. Cioffi and Matthew M. Tannin were arrested and face criminal charges. Yet this has done little to console investors or Bear Stearns' employees as they have watched the company's fall and acquisition by JP Morgan.

LEHMAN BROTHERS

Another firm that had been around for a long time, more than 150 years in this case, found that it could not survive the subprime mortgage crisis either. In 2008, Lehman Brothers, the fourth-largest investment bank in the United States, filed for chapter 11 bankruptcy.

Lehman Brothers was founded by Henry, Emanuel, and Mayer Lehman, German immigrants who migrated to America in the mid-nineteenth century. It opened its first store in Montgomery, Alabama, in 1850. As cotton was the cash crop of the South, the brothers often accepted payment in cotton and began acting as brokers for those who were buying and selling the crop. The brothers' business expanded quickly, and they opened an office in New York in 1858. Soon they had transformed from brokerage to merchant banking, and Lehman Brothers became a member of the New York Stock Exchange in 1887.

"By late 2008, the company's shares had lost 73 percent of their value"

The company continued to thrive even through the stock market crash of 1929. It advised and financed several other businesses, including Halliburton, Digital Equipment, and Campbell Soup. The firm opened its first international office in Paris in 1960. After going public in 1994, Lehman Brothers joined the S&P 100 Index in 1998 and watched its stock rise to $100 per share by the early 2000s. In 2007, the year the subprime crisis began, Lehman Brothers was ranked as number one in the "Most Admired Firms" list by *Fortune* magazine. CEO Richard Fuld was placed on the list of the world's thirty best CEOs. For its third quarter, Lehman Brothers possessed assets worth $275 billion.

Then the subprime mortgage crisis came to a head. By late 2008, the company's shares had lost 73 percent of their value. Even as the company asked for government aid, its executives continued to pocket millions of dollars in bonuses, an action that caused public outrage. The company filed for bankruptcy that year, with $613 billion in debt. Company shares rapidly fell 90 percent to 21 cents per share. The bank received some relief after Barclay PLC agreed to purchase much of Lehman Brothers for $1.75 billion. The purchase of Lehman Brothers was welcome news for some workers, as many of them thought they were going to lose their jobs. Yet this did little to help many shareholders, who had already seen their stocks reduced to nothing. Even CEO Fuld had lost $600 million between 2007 and 2008.

What caused such a well-established company like Lehman Brothers to go belly-up? Its dependence on subprime mortgages was the central factor. Additionally, some are accusing the firm of unethical behavior in its dealings with First Alliance Mortgage, a company accused of "predatory lending." Lehman Brothers helped bundle millions of dollars in mortgages into derivatives instruments for First Alliance and helped make them seem like appealing investment vehicles for Wall Street. When the loans defaulted, these investments contributed to the massive financial crisis.

Lehman Brothers had also acquired several credit default swaps (CDSs), a type of derivative contract. The company had acquired large amounts of subprime mortgage debt and other lower-rated assets when securitizing the underlying mortgages. Even though Lehman had closed its subprime mortgage division in 2007, it maintained much of its subprime mortgage liability through 2008, resulting in large losses from the collapse of the subprime market. Creditors of Lehman Brothers, AIG among them, had taken out CDSs to hedge against the case of a Lehman bankruptcy. The estimated amount of settling these swaps stands at $100 to $400 billion.

Additionally, many major money market funds had significant exposure to Lehman Brothers. Lehman's bankruptcy caused the investors in these money market accounts to lose millions. Undoubtedly, the fall of Lehman Brothers will have severe effects on businesses across the world for a long time, a negative legacy of this once great company.

ETHICAL ISSUES WITH DERIVATIVES

Derivatives (especially swaps) expose investors to counter-party risk. For example, if a business wants a fixed-interest loan but banks only offer variable rates, the business swaps payments with another business that wants a variable rate, creating a fixed rate for the first business. However, if the second business goes bankrupt, the first business loses its fixed rate and has to pay the variable rate. If interest rates increase to the point where the first business cannot pay back the loan, it causes a chain reaction of failures.

Derivatives also can pose high amounts of risk for small or inexperienced investors. Because derivatives offer the possibility of large rewards, they are attractive to individual investors. However, the basic premise of derivatives is to transfer risk among parties based on their willingness to assume additional risk, or hedge against it. Many small investors do not comprehend this until they lose. As a result, a chain reaction leading to a domestic or global economic crisis can occur.

Warren Buffett, a well-known investor, has stated that he regards derivatives as "financial weapons of mass destruction." Derivatives have been used to leverage the debt in an economy, sometimes to a massive degree. When something unexpected happens, an economy will find it very difficult to pay its debts, thus causing a recession or even depression. Marriner S. Eccles, U.S. Federal Reserve chair from 1934 to 1948, stated that an excessively high level of debt was one of the primary causes of the Great Depression.

Some experts believe derivatives have significant benefits as well. Although it is always the case with derivatives that someone loses while someone else gains, under normal circumstances, derivatives should not adversely affect the economic system because it is not a zero-sum game—derivatives theoretically allow for absolute economic growth. In other words, while one party gains in relation to the other, both gain relative to their previous positions. Former Federal Reserve Board chair Alan Greenspan commented in 2003 that he believed that derivatives softened the impact of the economic downturn at the beginning of the twenty-first century, and UBS believed that derivatives were part of its future.

However, derivatives have a checkered history. In the 1900s, derivatives trading and bucket shops were rampant. Bucket shops are small operators in options and securities that lure clients into transactions and then flee with the money, setting up shop elsewhere. In 1922 the federal government attempted to stop this practice with the Grain Futures

Act, and in 1936 options on grain futures were temporarily banned in the United States as well as in other countries. In 1972 the Chicago Mercantile Exchange (the Merc) created the International Monetary Market, allowing trading in currency futures, representing the first futures contracts associated with nonphysical commodities. In 1975 the Merc introduced the Treasury bill futures contract that was based purely on interest rate futures. In 1977 and 1982, T–bond (Treasury) futures contracts, Eurodollar contracts, and stock index futures were created. The 1980s marked the beginning of swaps and other over-the-counter derivatives. Soon every large, and even some not-so-large, corporations were using derivatives to hedge a wide variety of investment risks. Derivatives soon became too complex for the average person to understand, and Wall Street turned to mathematicians and physicists to create models and computer programs that could analyze these exotic instruments.

In the end, the ethical issues in using derivatives hinge on the managers and traders who use these highly complex and risky financial instruments. Derivatives are used in sales transactions where there is an opportunity of great financial rewards. However, managers and traders often do not take into account the level of risk for investors or other stakeholders. If the risk associated with a derivative is not communicated to the investor, this can result in deception or even fraud. It has become apparent that the use of derivatives such as credit default swaps became so profitable that traders and managers lost sight of anything but their incentives for selling these instruments. In other words, financial institutions were selling what could be called defective products because the true risk of these financial instruments was not understood by or disclosed to the customer. In some cases, these defective products were given to traders to sell without any due diligence from the company as to the level of risk.

CONCLUSION

While derivatives, including credit default swaps, were not the only cause of the failure of the banks discussed in this case, the use of these instruments by decision makers resulted in these banks taking enormous risks. In hindsight, these actions seem to be unwise and unfair to stakeholders. An ethical issue relates to the level of transparency that exists in using complex financial instruments to create profits for customers. If purchasers do not understand the potential risks and the possibility of the loss of their money, then a chance for deception exists. In the banks examined in this case, there is no doubt that a number of key decision makers not only pushed the limits of legitimate risk-taking, but also engaged in manipulation, and in some cases fraud, to deceive stakeholders.

At this point, it is doubtful whether banks have learned enough about the 2008– 2009 financial crises to avoid future failures. Investors and shareholders need to start looking beyond short-term results and understand the value of long-term thinking. CEOs and boards of directors need to develop a transparent business model that balances risk with market opportunity. The ethical risks of lower-level managers using deception and manipulation to create profits, often through loopholes and unregulated areas of decision making, are high. Through ethical leadership and compliance programs, all these risks can be minimized.

MORAL PHILOSOPHY DEFINED

When people talk about philosophy, they usually mean the general system of values by which they live. **Moral philosophy**, on the other hand, refers in particular to the specific principles or rules that people use to decide what is right or wrong. It is important to understand the distinction between moral philosophies and business ethics. A moral philosophy is a person's principles and values that define what is moral or immoral. Moral philosophies are person-specific, whereas business ethics is based on decisions in groups or those made when carrying out tasks to meet business objectives. In the context of business, ethics refers to what the group, firm, or strategic business unit (SBU) defines as right or wrong actions pertaining to its business operations and the objective of profits, earnings per share, or some other financial measure of success as defined by the group. For example, a production manager may be guided by a general philosophy of management that emphasizes encouraging workers to know as much as possible about the product that they are manufacturing. However, the manager's moral philosophy comes into play when he must make decisions such as whether to notify employees in advance of upcoming layoffs. Although workers would prefer advance warning, giving it might adversely affect the quality and quantity of production. Such decisions require a person to evaluate the "rightness," or morality, of choices in terms of his or her own principles and values.

Moral philosophies present guidelines for "determining how conflicts in human interests are to be settled and for optimizing mutual benefit of people living together in groups," guiding businesspeople as they formulate business strategies and resolve specific ethical issues.[1] However, there is no single moral philosophy that everyone accepts. Some managers, for example, view profit as the ultimate goal of an enterprise and therefore may not be concerned about the impact of their firms' decisions on society. As we have seen, the economist Milton Friedman supports this viewpoint, contending that the market will reward or punish companies for unethical conduct without the need for government regulation.[2] The emergence of this Friedman-type capitalism as the dominant and most widely accepted economic system has created market-driven societies around the world. Over the past six decades, the United States has been waging an ideological war over capitalism; first with the Soviet Union, then with Latin America in the 1980s, and finally with China. Even China's communist government has adapted capitalism and free enterprise to help it become a leading economic power. The United States has been actively exporting the idea that the invisible hand of free market capitalism can solve the troubles of mankind and lead toward greater happiness and prosperity. Such happiness is derived from the increased availability of products and services. Marketing helps consumers to understand, compare, and obtain these products and services, thereby increasing the efficiency and effectiveness of the exchange. However, free markets may not be a panacea- For example, empirical research and a study of history show that excessive consumption can have negative effects and may be psychologically, spiritually, and physically unhealthy.[3] In other words, more is not necessarily best.

Adam Smith is considered the father of free market capitalism. He was a professor of logic and moral philosophy and wrote the seminal "The Theory of Moral Sentiments" and the book *Inquiry into the Nature and Causes of the Wealth of Nations* (1776). Smith believed that business was and should be guided by the morals of good men. But in the eighteenth century, Smith could not image the complexity of modern markets or the size of multinationals, nor could he fathom the concept that four or five companies could gain control of the vast majority of the resources of the world. His ideas did not take into account the full force of democracy, nor the immense wealth and power some firms wield within countries.

Economic systems not only allocate resources and products within a society but also affect individuals and society as a whole. Thus, the success of an economic system depends both on its philosophical framework and on the individuals within the system who maintain moral philosophies that bring people together in a cooperative, efficient, and productive marketplace. Going back to Aristotle, there is a long Western tradition of questioning whether a market economy and individual moral behavior are compatible. In reality, individuals in today's society exist within the framework of social, political, and economic institutions.

People who face ethical issues often base their decisions on their own values and principles of right or wrong, most of which are learned through the socialization process with the help of family members, social groups, religions, and formal education. Individual factors that influence decision making include personal moral philosophies. Ethical dilemmas arise in problem-solving situations in which the rules governing decision making are often vague or in conflict. In real-life situations, there is no substitute for an individual's own critical thinking and ability to accept responsibility for his or her decision.

Moral philosophies are ideal moral perspectives that provide individuals with abstract principles for guiding their social existence. For example, individuals' decisions to recycle waste or to purchase or sell recycled or recyclable products are influenced by moral philosophies and attitudes toward recycling.[4] Thus, it is often difficult to implement an individual moral philosophy within the complex environment of a business organization. On the other hand, the functioning of our economic system depends on individuals coming together and sharing philosophies that create the moral values, trust, and expectations that allow the system to work. Most employees within a business organization do not think about what particular moral philosophy they are using when they are confronted with an ethical issue. Individuals learn decision making approaches or philosophies through their cultural and social development.

Many theories associated with moral philosophies refer to a value orientation and such things as economics, idealism, and relativism. The concept of the **economic value orientation** is associated with values that can be quantified by monetary means; thus, according to this theory, if an act produces more value than its effort, then it should be accepted as ethical. **Idealism,** on the other hand, is a moral philosophy that places special value on ideas and ideals as products of the mind, in comparison with the world's view. The term refers to efforts to account for all objects in nature and experience and assign to such representations a higher order of existence. Studies have found that there is a positive correlation between idealistic thinking and ethical decision making. **Realism** is the view that an external world exists independent of our perception of it. Realists work under the assumption that humankind is not inherently benevolent and kind but instead is inherently self-centered and competitive. According to realists, each person is always ultimately guided by his or her own self-interest. Research shows a negative correlation between realistic thinking and ethical decision making. Thus, the belief that all actions are ultimately self-motivated leads to a tendency toward negative ethical decision making.

MORAL PHILOSOPHIES

There are many moral philosophies, but because a detailed study of all moral philosophies is beyond the scope of this book, we limit our discussion to those that are most applicable to the study of business ethics. Our approach focuses on the most basic concepts needed to help you understand the ethical decision making process in business. We do not prescribe the use of any particular moral philosophy, for there is no one "correct" way to resolve ethical issues in business.

To help you understand how the moral philosophies discussed in this chapter may be applied in decision making, we use a hypothetical situation as an illustration. Suppose that Sam Colt, a sales representative, is preparing a sales presentation for his firm Midwest Hardware, which manufactures nuts and bolts. Sam hopes to obtain a large sale from a construction firm that is building a bridge across the Mississippi River near St. Louis. The bolts manufactured by Midwest Hardware have a 3 percent defect rate, which, although acceptable in the industry, makes them unsuitable for use in certain types of projects, such as those that may be subject to sudden, severe stress. The new bridge will be located near the New Madrid Fault line, the source of the United States' greatest earthquake in 1811. The epicenter of that earthquake, which caused extensive damage and altered the flow of the Mississippi, is less than 200 miles from the new bridge site. Earthquake experts believe there is a 50 percent chance that an earthquake with a magnitude greater than 7 on the Richter scale will occur somewhere along the New Madrid Fault by the year 2020. Bridge construction in the area is not regulated by earthquake codes, however. If Sam wins the sale, he will earn a commission of $25,000 on top of his regular salary. But if he tells the contractor about the defect rate, Midwest may lose the sale to a competitor that markets bolts with a lower defect rate. Thus, Sam's ethical issue is whether to point out to the bridge contractor that, in the event of an earthquake, some Midwest bolts could fail, possibly resulting in the collapse of the bridge.

We will come back to this illustration as we discuss particular moral philosophies, asking how Sam Colt might use each philosophy to resolve his ethical issue. We don't judge the quality of Sam's decision, nor do we advocate any one moral philosophy; in fact, this illustration and Sam's decision rationales are necessarily simplistic as well as hypothetical. In reality, the decision maker would probably have many more factors to consider in making his or her choice and thus might reach a different decision. With that note of caution, we introduce the concept of goodness and several types of moral philosophy: teleology, deontology, the relativist perspective, virtue ethics, and justice theories (see Table 6–1).

TABLE 6–1 A Comparison of the Philosophies used in Business Decisions

Teleology	Stipulates that acts are morally right or acceptable if they produce some desired result, such as realization of self-interest or utility.
Egoism	Defines right or acceptable actions as those that maximize a particular person's self-interest as defined by the individual.
Utilitarianism	Defines right or acceptable actions as those that maximize total utility, or the greatest good for the greatest number of people.
Deontology	Focuses on the preservation of individual rights and on the intentions associated with a particular behavior rather than on its consequences.
Relativist	Evaluates ethicalness subjectively on the basis of individual and group experiences.
Virtue ethics	Assumes that what is moral in a given situation is not only what conventional morality requires but also what the mature person with a "good" moral character would deem appropriate.
Justice	Evaluates ethicalness on the basis of fairness: distributive, procedural, and interactional.

Goodness—Instrumental and Intrinsic

To appreciate moral philosophy, one must understand the differing perspectives of goodness. Are there clearly defined goods and bads and, if so, what is the relationship between the ends and the means of bringing them about? Is there some intrinsic way of determining if the ends can be identified independently as good or bad? Aristotle, for example, argued that happiness is an intrinsically good end—in other words, its goodness is natural and universal, without relativity. On the other hand, the philosopher Immanuel Kant emphasized means and motivations to argue that goodwill, seriously applied toward accomplishment, is the only thing good in itself.

Two basic concepts of goodness are monism and pluralism. **Monists** believe that only one thing is intrinsically good, and the pluralists believe that two or more things are intrinsically good. Monists are often exemplified by **hedonism**—that one's pleasure is the ultimate intrinsic good or that the moral end, or goodness, is the greatest balance of pleasure over pain. Hedonism defines right or acceptable behavior as that which maximizes personal pleasure. Moral philosophers describe those who believe that more pleasure is better as **quantitative hedonists** and those who believe that it is possible to get too much of a good thing (such as pleasure) as **qualitative hedonists**.

Pluralists, often referred to as nonhedonists, take the opposite position that no *one* thing is intrinsically good. For example, a pluralist might view other ultimate goods as beauty, aesthetic experience, knowledge, and personal affection. Plato argued that the good life is a mixture of (1) moderation and fitness, (2) proportion and beauty, (3) intelligence and wisdom, (4) sciences and arts, and (5) pure pleasures of the soul.

Although all pluralists are nonhedonists, it is important to note that all monists are not necessarily hedonists. An individual can believe in a single intrinsic good other than pleasure; Machiavelli and Nietzsche, for example, each held power to be the sole good, and Kant's belief in the single virtue of goodwill classifies him as a monistic nonhedonist.

A more modern view is expressed in the instrumentalist position. Sometimes called pragmatists, **instrumentalists** reject the idea that (1) ends can be separated from the means that produce them and (2) ends, purposes, or outcomes are intrinsically good in and of themselves. The philosopher John Dewey argued that the ends-means perspective is a relative distinction, that the difference between ends and means is no difference at all but merely a matter of the individual's perspective; thus, almost any action can be an end or a means. Dewey gives the example that people eat in order to be able to work, and they work in order to eat. From a practical standpoint, an end is only a remote means, and a means is but a series of acts viewed from an earlier stage. From this it follows that there is no such thing as a single, universal end.

So how does this discussion equate to business? Isn't business about shareholder wealth and the wealth of executives? To measure success in business is to measure monetary wealth . . . right? To answer this question, let's go back to 1923 when a meeting was held at the Edgewater Beach Hotel in Chicago. Attending this meeting were nine of the richest men in the world: (1) Charles Schwab, president of the world's largest independent steel company; (2) Samuel Insull, president of the world's largest utility company; (3) Howard Hopson, president of the world's largest gas firm; (4) Arthur Cutten, the greatest wheat speculator; (5) Richard Whitney, president of the New York Stock Exchange; (6) Albert Fall, member of the president's cabinet; (7) Leon Fraizer, president of the Bank of International Settlements; (8) Jessie Livermore, the greatest speculator in the stock market; and (9) Ivar Kreuger, head of the company with the most widely distributed securities in the world. Twenty-five years later, (1) Charles Schwab had died having lived on borrowed money for the last five years of his life, (2) Samuel Insull had died a penniless fugitive,

(3) Howard Hopson had gone insane, (4) Arthur Cutten had died bankrupt, (5) Richard Whitney had spent time in prison, (6) Albert Fall had been pardoned from prison so that he could die at home, and (7) Leon Fraizer, (8) Jessie Livermore, and (9) Ivar Kreuger had committed suicide. Measured by wealth and power, these men had achieved success, at least temporarily. So this begs the question of whether money guarantees happiness; in other words, do the ends always justify the means?

A discussion of moral value often revolves around the nature of goodness—instrumental or intrinsic. Theories of moral obligation, by contrast, change the question to "What makes a given action right or obligatory?" **Goodness theories** typically focus on the *end result* of actions and the goodness or happiness created by them, whereas **obligation theories** emphasize the *means* and *motives* by which actions are justified. These obligation theories are teleology and deontology, respectively.

Teleology

Teleology (from the Greek word for "end" or "purpose") refers to moral philosophies in which an act is considered morally right or acceptable if it produces some desired result such as pleasure, knowledge, career growth, the realization of self-interest, utility, wealth, or even fame. In other words, teleological philosophies assess the moral worth of a behavior by looking at its consequences, and thus moral philosophers today often refer to these theories as **consequentialism**. Two important teleological philosophies that often guide decision making in individual business decisions are egoism and utilitarianism.

> *"Teleological philosophies assess the moral worth of a behavior by looking at its consequences"*

Egoism defines right or acceptable behavior in terms of its consequences for the individual. Egoists believe that they should make decisions that maximize their own self-interest, which is defined differently by each individual. Depending on the egoist, self-interest may be construed as physical well-being, power, pleasure, fame, a satisfying career, a good family life, wealth, or something else. In an ethical decision making situation, an egoist will probably choose the alternative that contributes most to his or her self-interest. The egoist's creed generally can be stated as "Do the act that promotes the greatest good for oneself." Many believe that egoistic people and companies are inherently unethical, are short-term oriented, and will take advantage of any opportunity. For example, some telemarketers demonstrate this negative tendency when they prey on elderly consumers who may be vulnerable because of loneliness or fear of losing their financial independence. Thousands of senior citizens fall victim to fraudulent telemarketers every year, in many cases losing all of their savings and sometimes their homes.

However, there is also **enlightened egoism**. Enlightened egoists take a long-range perspective and allow for the well-being of others although their own self-interest remains paramount. An example of enlightened egoism is helping a turtle across a highway because, if killed, the person would feel distressed. To feel good, or eliminate the chance of a feeling of distress, the person helps the turtle to cross the road.[5] Enlightened egoists may, for example, abide by professional codes of ethics, control pollution, avoid cheating on taxes, help create jobs, and support community projects. Yet they do so not because these actions benefit others but because they help achieve some ultimate goal for the egoist, such as advancement within the firm. An enlightened egoist might call management's attention to a coworker who is making false accounting reports but only to safeguard the company's reputation and thus the egoist's own job security. In addition, some enlightened egoists may become whistle-blowers and report misconduct to a government regulatory agency to keep their job and receive a reward for exposing misconduct. When businesses donate money, resources, or time to specific causes and institutions, their motives may not be purely altruistic either. For example, International Business Machines (IBM) has a policy of donating or reducing the cost of computers to educational institutions. In exchange, the company receives tax breaks for donations of equipment, which reduces the cost of its philanthropy. In addition, IBM hopes to build future sales by placing its products on campuses. When students enter the workforce, they may request the IBM products with which they have become familiar. Although the company's actions benefit society in general, in the long run they also benefit IBM.

Let's return to the hypothetical case of Sam Colt, who must decide whether to warn the bridge contractor that 3 percent of Midwest Hardware's bolts are likely to be defective. If he is an egoist, he will probably choose the alternative that maximizes his own self-interest. If he defines self-interest in terms of personal wealth, his personal moral philosophy may lead him to value a $25,000 commission more than a chance to reduce the risk of a bridge collapse. As a result, an egoist might well resolve this ethical dilemma by keeping quiet about the bolts' defect rate, hoping to win the sale and the $25,000 commission, rationalizing that there is a slim chance of an earthquake, that bolts would not be a factor in a major earthquake, and that, even if they were, no one would be able to prove that defective bolts caused the bridge to collapse.

"The utilitarian seeks the greatest good for the greatest number of people."

Like egoism, **utilitarianism** is concerned with consequences, but the utilitarian seeks the greatest good for the greatest number of people. Utilitarians believe that they should make decisions that result in the greatest total *utility*, that achieve the greatest benefit for all those affected by a decision. An argument for utilitarianism may be President Obama's 2009 economic stimulus package. Its costs to the American taxpayer may have been weighted against the greater costs of allowing the market to fall into a depression without government intervention.

Utilitarian decision making relies on a systematic comparison of the costs and benefits to all affected parties. Using such a cost–benefit analysis, a utilitarian decision maker calculates the utility of the consequences of all possible alternatives and then selects the one that results in the greatest benefit. For example, the U.S. Supreme Court has ruled that supervisors are responsible for the sexual misconduct of employees, even if the employers knew nothing about the behavior, establishing a strict standard for harassment on the job. One of the justices indicated in the ruling that the employer's burden to prevent harassment is "one of the costs of doing business."[6] Apparently, the Court has decided that the greatest utility to society will result from forcing businesses to prevent harassment.

In evaluating an action's consequences, some utilitarians consider the effects on animals as well as on human beings. This perspective is especially significant in the controversy surrounding the use of animals for research purposes by cosmetics and pharmaceutical companies. Animal rights groups have protested that such testing is unethical because it harms and even kills the animals, depriving them of their rights. Researchers for pharmaceutical and cosmetics manufacturers, however, defend animal testing on utilitarian grounds. The consequences of the research (such as new or improved drugs to treat disease, or safer cosmetics) create more benefit for society, they argue, than would be achieved by halting the research and preserving the animals' rights. Nonetheless, many cosmetics firms have responded to the controversy by agreeing to stop animal research.

Now suppose that Sam Colt, the bolt salesperson, is a utilitarian. Before making his decision, he would conduct a cost–benefit analysis to assess which alternative would create the greatest utility. On one hand, building the bridge would improve roadways and allow more people to cross the Mississippi River to reach jobs in St. Louis. The project would create hundreds of jobs, enhance the local economy, and unite communities on both sides of the river. Additionally, it would increase the revenues of Midwest Hardware, allowing the firm to invest more in research to lower the defect rate of bolts it produced in the future. On the other hand, a bridge collapse could kill or injure as many as 100 people. But the bolts have only a 3 percent defect rate, there is only a 50 percent probability of an earthquake *somewhere* along the fault line, and there might be only a few cars on the bridge at the time of a disaster.

After analyzing the costs and benefits of the situation, Sam might rationalize that building the bridge with his company's bolts would create more utility (jobs, unity, economic growth, and company growth) than would result from telling the bridge contractor that the bolts might fail in an earthquake. If so, a utilitarian would probably not alert the bridge contractor to the defect rate of the bolts.

Utilitarians use various criteria to judge the morality of an action. Some utilitarian philosophers have argued that general rules should be followed to decide which action is best.[7] These **rule utilitarians** determine behavior on the basis of principles, or rules, designed to promote the greatest utility rather than on an examination of each particular situation. One such rule might be "Bribery is wrong." If people felt free to offer bribes whenever they might be useful, the world would become chaotic; therefore, a rule prohibiting bribery would increase utility. A rule utilitarian would not bribe an official, even to preserve workers' jobs, but would adhere strictly to the rule. Rule utilitarians do not automatically accept conventional moral rules, however; thus, if they determined that an alternative rule would promote greater utility, they would advocate changing it.

Other utilitarian philosophers have argued that the rightness of each individual action must be evaluated to determine whether it produces the greatest utility for the greatest number of people.[8] These **act utilitarians** examine a specific action itself, rather than the general rules governing it, to assess whether it will result in the greatest utility. Rules such as "Bribery is wrong" serve only as general guidelines for act utilitarians. They would likely agree that bribery is generally wrong, not because there is anything inherently wrong with bribery, but because the total amount of utility decreases when one person's interests are placed ahead of those of society.[9] In a particular case, however, an act utilitarian might argue that bribery is acceptable.

For example, a sales manager might believe that his or her firm will not win a construction contract unless a local government official gets a bribe; moreover, if the firm does not obtain the contract, it will have to lay off 100 workers. The manager might therefore argue that bribery is justified because saving 100 jobs creates more utility than obeying a law. Another example may be found in the actions of farmers in China who use toxic melamine to increase milk quality. Melamine's chemical properties boost the apparent presence of protein in food. Manufacturers of melamine, an industrial chemical used in plastics, say they had noticed a rising demand for their factories' scrap. Actual protein powders are also prohibited from being added to raw milk. They are made from ground animal parts, soy, and other sources. China's biggest local seller of liquid milk, Nestlé SA, said it was aware that Chinese farmers and traders added unauthorized substances to raw milk, but that it didn't know melamine was among them. Among other common milk additives: a viscous yellow liquid containing fat and a combination of preservatives and antibiotics, known as "fresh-keeping liquid" is "very common" and hard to detect. It can be argued that everyone within the milk supply chain saw their actions as helping more people financially rather than harm them from the unknown dangers of the additives.[10]

Deontology

Deontology (from the Greek word for "ethics") refers to moral philosophies that focus on the rights of individuals and on the intentions associated with a particular behavior rather than on its consequences. Fundamental to deontological theory is the idea that equal respect must be given to all persons. Unlike utilitarians, deontologists argue that there are some things that we should *not* do, even to maximize utility. For example, deontologists would consider it wrong to kill an innocent person or commit a serious injustice against a person, no matter how much greater social utility might result from doing so, because such an action would infringe on that person's rights as an individual. The utilitarian, however, might consider as acceptable an action that resulted in a person's death if that action created some greater benefit. Deontological philosophies regard certain behaviors as inherently right, and the determination of this rightness focuses on the individual actor, not society. Thus, these perspectives are sometimes referred to as **nonconsequentialism** an ethics based on *respect for persons.*

> *"Teleological philosophies consider the ends associated with an action whereas deontological philosophies consider the means."*

Contemporary deontology has been greatly influenced by the German philosopher Immanuel Kant, who developed the so-called categorical imperative: "Act as if the maxim of thy action were to become by thy will a universal law of nature."[11] Simply put, if you feel comfortable allowing everyone in the world to see you commit an act and if your rationale for acting in a particular manner is suitable to become a universal principle guiding behavior, then committing that act is ethical. For example, if a person borrows money, promising to return it but with no intention of keeping that promise, he or she cannot "universalize" that act. If everyone were to borrow money without the intention of returning it, no one would take such promises seriously, and all lending would cease.[12] Therefore, the rationale for the action would not be a suitable universal principle, and the act could not be considered ethical.

The term *nature* is crucial for deontologists. In general, deontologists regard the nature of moral principles as permanent and stable, and they believe that compliance with these principles defines ethicalness. Deontologists believe that individuals have certain absolute rights:

- Freedom of conscience
- Freedom of consent
- Freedom of privacy
- Freedom of speech
- Due process[13]

To decide whether a behavior is ethical, deontologists look for conformity to moral principles. For example, if a manufacturing worker becomes ill or dies as a result of conditions in the workplace, a deontologist might argue that the company must modify its production processes to correct the condition, no matter what the cost—even if it means bankrupting the company and thus causing all workers to lose their jobs. In contrast, a utilitarian would analyze all the costs and benefits of modifying production processes and make a decision on that basis. This example is greatly oversimplified, of course, but it helps clarify the difference between teleology and deontology. In short, teleological philosophies consider the *ends* associated with an action whereas deontological philosophies consider the *means.*

Returning again to our bolt salesperson, let's consider a deontological Sam Colt. He would probably feel obliged to tell the bridge contractor about the defect rate because of the potential loss of life that might result from an earthquake-caused bridge collapse. Even though constructing the bridge would benefit residents and earn Sam a substantial commission, the failure of the bolts during an earthquake would infringe on the rights of any person crossing the bridge at the time of the collapse. Thus, the deontological Sam would likely inform the bridge contractor of the defect rate and point out the earthquake risk, even though, by doing so, he would probably lose the sale.

As with utilitarians, deontologists may be divided into those who focus on moral rules and those who focus on the nature of the acts themselves. **Rule deontologists** believe that conformity to general moral principles determines ethicalness. Deontological philosophies use reason and logic to formulate rules for behavior. Examples include Kant's categorical imperative and the Golden Rule of the Judeo-Christian tradition: Do unto others as you would have them do unto you. Such rules, or principles, guiding ethical behavior override the imperatives that emerge from a specific context. One could argue that Jeffery Wigand—who exposed the underside of the tobacco industry when he blew the whistle on his employer, Brown & Williamson Tobacco—was such a rule deontologist. Although it cost him both financially and socially, Wigand testified to Congress about the realities of marketing cigarettes and their effects on society.[14]

Rule deontology is determined by the relationship between the basic rights of the individual and a set of rules governing conduct. For example, a video store owner accused of distributing obscene materials could argue from a rule deontological perspective that the basic right to freedom of speech overrides the other indecency or pornography aspects of his business. Indeed, the free-speech argument has held up in many courts. Kant and rule deontologists would support a process of discovery to identify the moral issues relevant to a firm's mission and objectives. Then, they would follow a process of justifying that mission or those objectives based on rules.[15] An example of rule deontology is Kellogg's president, David Mackay. After hearing about possible salmonella contamination in peanut butter, he encouraged supermarkets not to sell Kellogg's products using peanut butter until the source of the contamination was discovered and peanut butter was deemed safe again.

Act deontologists, in contrast, hold that actions are the proper basis on which to judge morality or ethicalness. Act deontology requires that a person use equity, fairness, and impartiality when making and enforcing decisions.[16] For act deontologists, as for act utilitarians, rules serve only as guidelines, with past experiences weighing more heavily than rules upon the decision making process. In effect, act deontologists suggest that people simply *know* that certain acts are right or wrong, regardless of the consequences or any appeal to deontological rules. In addition, act deontologists regard the particular act or moment in time as taking precedence over any rule. For example, many people view data collection by Internet sites as a violation of personal privacy in itself. Regardless of any website's stated rules or policies, many Internet users want to be left alone unless they provide permission to be tracked while online.[17] A high school teacher at Hoover High in Alabama purportedly lost her job because she refused to change a football player's grade. It would have been much easier for her to do as others had done, yet the philosophy she used was within the act deontologist's range.[18] Current research suggests that rule and act deontological principles play a larger role in a person's decision than teleological philosophies.[19]

As we have seen, ethical issues can be evaluated from many different perspectives. Each type of philosophy discussed here would have a distinct basis for deciding whether a particular action is right or wrong. Adherents of different personal moral philosophies may disagree in their evaluations of a given action, yet all are behaving ethically *according to their own standards.* All would agree that there is no one "right" way to make ethical decisions and no best moral philosophy except their own. The relativist perspective may be helpful in understanding how people make such decisions in practice.

Relativist Perspective

From the **relativist perspective**, definitions of ethical behavior are derived subjectively from the experiences of individuals and groups. Relativists use themselves or the people around them as their basis for defining ethical standards, and the various forms of relativism include descriptive, metaethical, or normative.[20] **Descriptive relativism** relates to observing cultures. We may observe that different cultures exhibit different norms, customs, and values and, in so doing, arrive at a factual description of a culture. These observations say nothing about the higher questions of ethical justification, however. At this point metaethical relativism comes into play.

Metaethical relativists understand that people naturally see situations from their own perspectives and argue that, as a result, there is no objective way of resolving ethical disputes between value systems and individuals. Simply put, one culture's moral philosophy cannot logically be preferred to another because there exists no meaningful basis for comparison. Because ethical rules are relative to a specific culture, the values and behaviors of people in one culture need not influence the behaviors of people in another culture.[21] At the individual level of reasoning, we have **normative relativism.** Normative relativists assume that one person's opinion is as good as another's.[22]

> *Normative relativists assume that one person's opinion is as good as another's.*

Basic relativism acknowledges that we live in a society in which people have many different views and bases from which to justify decisions as right or wrong. The relativist looks to the interacting groups and tries to determine probable solutions based on group consensus. When formulating business strategies and plans, for example, a relativist would try to anticipate the conflicts that might arise between the different philosophies held by members of the organization, its suppliers, its customers, and the community at large.

The relativist observes the actions of members of an involved group and attempts to determine that group's consensus on a given behavior. A positive consensus, for example, would signify that the group considers the action to be right or ethical. However, such judgments may not remain valid forever. As circumstances evolve or the makeup of the group changes, a formerly accepted behavior may come to be viewed as wrong or unethical, or vice versa. Within the accounting profession, for example, it was traditionally considered unethical to advertise. However, advertising has been gaining acceptance among accountants. This shift in ethical views may have come about as a result of the steady increase in the number of accountants, which has led to greater competition. Moreover, the federal government investigated the restrictions that accounting groups placed on their members and concluded that they inhibited free competition. Consequently, an informal consensus has emerged in the accounting industry that advertising is now acceptable. A problem with relativism is that it places too much emphasis on peoples' differences while ignoring their basic similarities. Similarities within different people and cultures—such as beliefs against incest, murder, and theft or promoting reciprocity and respect for the elderly—are hard to argue away and hard to explain from the relativist perspective.

In the case of the Midwest Hardware salesperson, if he were a relativist, he would attempt to determine the group consensus before deciding whether to tell his prospective customer about the bolts' defect rate. The relativist Sam Colt would look at both his own company's policy and at the general industry practice. He might also informally survey his colleagues and superiors as well as consulting industry trade journals and codes of ethics. Such investigations would help him determine the group consensus, which should reflect a variety of moral philosophies. If he learns that general company policy, as well as industry practice, is to discuss defect rates with those customers for whom faulty bolts may cause serious problems, he may infer that there is a consensus on the matter. As a relativist, he would probably then inform the bridge contractor that some of the bolts may fail, perhaps leading to a bridge collapse in the event of an earthquake. Conversely, if he determines that the normal practice in his company and the industry is to not inform customers about defect rates, he would probably not raise the subject with the bridge contractor.

Empirical research into the general concept of relativism suggests that it is negatively related to a person's ethical sensitivity to issues. Thus, if someone scores high on relativism, he or she will probably be less likely to detect or be sensitive to issues that are defined by others as having an ethical component.[23]

Virtue Ethics

A moral virtue represents an acquired disposition that is valued as a part of an individual's character. As an individual develops socially, he or she may become disposed to behave in the same way (in terms of reasons, feelings, and desires) as what he or she considers to be moral.[24] A person who has the character trait of honesty will be disposed to tell the truth because it is considered to be right and comfortable. This individual will always try to tell the truth because of its importance in human communication. A virtue is considered praiseworthy because it is an achievement that an individual develops through practice and commitment.[25]

This philosophy is called **virtue ethics**, and it posits that what is moral in a given situation is not only what conventional morality or moral rules (current societal definitions) require but also what the mature person with a "good" moral character would deem appropriate.

Proponents of virtue ethics frequently discuss lists of basic goods and virtues, which are generally presented as positive and useful mental habits or cultivated character traits. Aristotle named, among others, standards of loyalty, courage, wit, community, and judgment as the "excellences" that society requires. While listing the important virtues is a popular theoretical task, the philosopher Dewey cautions that virtues should not be looked at separately. The pluralism of virtues gives the businessperson a positive character and constitutes the very best idea of integrity of character. The virtue ethics approach to business can be summarized as follows:

1. Individual virtue and integrity count, but good corporate ethics programs encourage individual virtue and integrity.
2. By the employee's role in the community (organization), these virtues associated with appropriate conduct form a good person.
3. The ultimate purpose is to serve society's demands and the public good and to be rewarded in one's career.
4. The well-being of the community goes together with individual excellence because of the social consciousness and public spirit of every individual.[26]

The difference between deontology, teleology, and virtue ethics is that the first two are applied *deductively* to problems whereas virtue ethics is applied *inductively*. Virtue ethics assumes that what current societal moral rules require may indeed be the moral minimum for the beginning of virtue. The viability of our political, social, and economic systems depends on the presence of certain virtues among the citizenry that are vital for the proper functioning of a market economy.[27]

Indeed, virtue theory could be thought of as a dynamic theory of how to conduct business activities. The virtue ethicist believes that to have a successful market economy, society must be capable of carving out sanctuaries such as family, school, church, and community, where virtues can be nurtured. These virtues, including truth, trust, tolerance, and restraint, can play a role in the functioning of an individualistic, contractual economy and create obligations that make social cooperation possible. The operation of a market economy based on virtues provides a traditional existence where individuals in the economic system have powerful inducements to conform to prevailing standards of behavior. Some philosophers think that virtues may be weakened by the operation of the market, but virtue ethicists believe that institutions and society must maintain a balance and constantly add to their stock of virtues.[28] Some of the virtues that could drive a market economy are listed in Table 6–2; the list, although not comprehensive, provides examples of the types of virtues that support the business environment.

TABLE 6–2 Virtues That Support Business Transactions

Trust: The predisposition to place confidence in the behavior of others while taking the risk that the expected behavior will not be performed	Trust eliminates the need for and associated cost of monitoring compliance with agreements, contracts, and reciprocal agreements. There is the expectation that a promise or agreement can be relied on.
Self-control: The disposition to pass up an immediate advantage or gratification. It indicates the ability to avoid exploiting a known opportunity for self-interest	The trade-off is between short-term self-interest and long-term benefits.
Empathy: The ability to share the feelings or emotions of others	Empathy promotes civility because success in the market depends on the courteous treatment of people who have the option of going to competitors. The ability to anticipate needs and satisfy customers and employees contributes to a firm's economic success.
Fairness: The disposition to deal equitably with the perceived injustices of others	Fairness often relates to doing the right thing with respect to small matters in order to cultivate a long-term business relationship.
Truthfulness: The disposition to provide the facts or correct information as known to the individual	Telling the truth involves avoiding deception and contributes to trust in business relationships.
Learning: The disposition to constantly acquire knowledge internal and external to the firm, whether of an industry, culture, or other societies	Learning involves gaining knowledge to make better, more informed decisions.
Gratitude: A sign of maturity that is the beginning of civility and decency	Gratitude is the recognition that people do not succeed alone.
Civility: The disposition or essence of courtesy, politeness, respect, and consideration for others	Civility relates to the process of doing business in a culturally correct way, thus decreasing communication errors and increasing trust.
Moral leadership: Strength of character, peace of mind, heart, and happiness in life	Moral leadership is a trait of those leaders who follow a consistent pattern of behavior based on virtues

Source: Adapted from Ian Maitland, "Virtuous Markets: The Market as School of the Virtues," *Business Ethics Quarterly* (January 1997): 97; and Gordon B. Hinckley, *Standing for Something: 10 Neglected Virtues That Will Heal Our Hearts and Homes* (New York: Three Rivers Press, 2001).

The elements of virtue that are important to business transactions have been defined as trust, self-control, empathy, fairness, and truthfulness. Attributes in contrast to virtue would include lying, cheating, fraud, and corruption. In their broadest sense, these concepts appear to be accepted within all cultures. The problem of virtue ethics comes in its implementation within and between cultures, as those who practice virtue ethics go beyond social norms. For example, if a company tacitly approves of corruption, the employee who adheres to the virtues of trust and truthfulness would consider it wrong to sell unneeded repair parts despite the organization's approval of such acts. Some employees might view this truthful employee as highly ethical but, in order to rationalize their own behavior, judge his or her ethics as going beyond what is required by their job or society. They might argue that virtue is an unattainable goal and thus one should not be obliged to live up to its standards. However, to those who espouse virtue ethics, this relativistic argument is meaningless because they believe in the universal reality of the elements of virtue.

If our salesperson Sam Colt were a virtue ethicist, he would consider the elements of virtue and then tell the prospective customer about the defect rate and about his concerns regarding the building of the bridge. He would not resort to puffery to explain the product or its risks and, indeed, might suggest alternative products or companies that would lower the probability of the bridge collapsing.

Justice

Justice as it is applied in business ethics involves evaluations of fairness or the disposition to deal with perceived injustices of others. Justice is fair treatment and due reward in accordance with ethical or legal standards. In business, this means that the decision rules used by an individual to determine the justice of a situation could be based on the perceived rights of individuals and on the intentions of the people involved in a given business interaction. For that reason, justice is more likely to be based on deontological moral philosophies than on teleological or utilitarian philosophies. In other words, justice deals more with the issue of what individuals feel they are due based on their rights and performance in the workplace. For example, the U.S. Equal Employment Opportunity Commission exists to help employees who suspect they have been unjustly discriminated against in the workplace.

Three types of justice provide a framework for evaluating the fairness of different situations (see Table 6–3). **Distributive justice** is based on the evaluation of the outcomes or results of the business relationship. If some employees feel that they are paid less than their coworkers for the same work, then they have concerns about distributive justice. Distributive justice is difficult to develop when one member of the business exchange intends to take advantage of the relationship. A boss who forces his employees to do more work so that he can take more time off would be seen as unjust because he is taking advantage of his position to redistribute the workers under him. Situations such as this cause an imbalance in distributive justice.

Procedural justice is based on the processes and activities that produce the outcome or results. Evaluations of performance that are not consistently developed and applied can lead to problems with procedural justice. For instance, employees' concerns about inequitable compensation would relate to their perception that the processes of fairness or justice in their company were inconsistent. A climate that emphasizes procedural justice is expected to positively influence employees' attitudes and behaviors toward work-group cohesion. The visibility of supervisors and the work group's perceptions of its own cohesiveness

TABLE 6-3 Types of Justice

Justice Type	Evaluations of Fairness
Distributive justice: Based on the evaluation of outcomes or results of the business relationship	Benefits derived Equity in rewards
Procedural justice: Based on the processes and activities that produce the outcome or results	Decision making process Level of access, openness, and participation
Interactional justice: Based on an evaluation of the communication process used in the business relationship	Accuracy of information Truthfulness, respect, and courtesy in the process

are products of a climate of procedural justice.[29] When there is strong employee support for decisions, decision makers, organizations, and outcomes, procedural justice is less important to the individual. In contrast, when employees' support for decisions, decision makers, organizations, or outcomes is not very strong, then procedural justice becomes more important.[30] For example, Wainwright Bank and Trust Corporation in Boston has made a commitment to promoting justice to all stakeholders by providing a "sense of inclusion and diversity that extends from the boardroom to the mail room."[31] The bank, in other words, uses methods of procedural justice to establish positive stakeholder relationships by promoting understanding and inclusion in the decision making process.

Interactional justice is based on evaluating the communication processes used in the business relationship. Because interactional justice is linked to fairness in communication, it often involves the individual's relationship with the business organization through the accuracy of the information the organization provides. Employees can also be guilty in interactional justice disputes. For example, many employees admit that they stay home when they are not really sick if they feel they can get away with it. Such workplace absenteeism costs businesses millions of dollars each year. Being untruthful about the reasons for missing work is an example of an interactional justice issue.

All three types of justice—distributive, procedural, and interactional—could be used to evaluate a single business situation and the fairness of the organization involved. In the example of Sam Colt, Sam's decision to implement a justice perspective would be identical to using a deontological moral philosophy. That is, he would feel obligated to tell all affected parties about the bolt defect rate and the possible consequences of it. In general, justice evaluations result in restitution seeking, relationship building, and evaluations of fairness in business relationships.

APPLYING MORAL PHILOSOPHY TO ETHICAL DECISION MAKING

Strong evidence shows that individuals use different moral philosophies depending on whether they are making a personal decision outside the work environment or making a work-related decision on the job.[32] Two possible reasons may explain this. First, in the business arena, some goals and pressures for success differ from the goals and pressures in a person's life outside of work. As a result, an employee might view a specific action as "good" in the business sector but "unacceptable" in the nonwork environment. It is often suggested that business managers are morally different from other people. In a way, this is correct in that business has one variable that is absent from other situations: the profit motive. The weights on the various factors that make up a person's moral philosophy are shifted in a business (profit) situation. The statement "it's not personal, it's just business" demonstrates the conflict businesspeople can have when their personal values do not align with utilitarian or profit-oriented decisions. The reality is that if firms do not make a profit, they will fail. This should not be construed to be a justification for seeking excessive profits or executive pay, issues which are now being questioned by stakeholders. The second reason people change moral philosophies could be the corporate culture where they work. When a child enters school, for example, he or she learns certain rules such as raising your hand to speak or asking permission to use the restroom. So it is with a new employee. Rules, personalities, and historical precedence exert pressure on the employee to conform to the new firm's culture. As this occurs, the individual's moral philosophy may change to be compatible with the work environment. The employee may alter some or all of the values within his or her moral philosophy as he or she shifts into the firm's different moral philosophy. Many people are acquainted with someone who is known for their goodness at home or in their communities who makes unethical decisions in the workplace. Even Bernard Madoff, the perpetrator of the largest Ponzi scheme in history, had a reputation as an upstanding citizen before his fraud was uncovered.

Obviously, the concept of a moral philosophy is inexact. For that reason, moral philosophies must be assessed on a continuum rather than as static entities. Simply put, when examining moral philosophies, we must remember that each philosophy states an ideal perspective and that most individuals seem to shift to other moral philosophies in their individual interpretation of and experiencing of ethical dilemmas. In other words, implementing moral philosophies from an individual perspective is not an exact science. It requires individuals to apply their own accepted value systems to real-world situations. Individuals make judgments about what they believe to be right or wrong, but in their business lives they make decisions that may be based not only on perceived right or wrong but also on producing the greatest benefits with the least harm. Such decisions should respect fundamental moral rights as well as perspectives on fairness, justice, and the common good, but these issues become complicated in the real world.

The virtue approach to business ethics, as discussed earlier, assumes that there are certain ideals and values that everyone should strive for in order to achieve the maximum welfare and happiness of society.[33] Aspects of these ideals and values are expressed through individuals' specific moral philosophies. Every day in the workplace, employees must decide what is right or wrong and act accordingly. At the same time, as a member of a larger organization, an employee cannot simply enforce his or her own personal perspective, especially if he or she adheres narrowly to a single moral philosophy. Because individuals cannot control most of the decisions in their work environment, though they are always responsible for their own actions, they rarely have the power (especially in entry-level and middle-management positions) to impose their own personal moral perspective on others. In fact, the idea that a new employee has the freedom to make independent decisions on a variety of job responsibilities is not realistic.

Sometimes a company makes decisions that could be questionable according to individual customers' values and moral philosophies. For example, a brewery or a distributor of sexually explicit movies could be considered unethical to some stakeholders based on a personal perspective. A company's core values will determine how decisions that bring moral philosophies into conflict are made. Most businesses have developed a mission statement, a corporate culture, and a set of core values that express how they want to relate to their stakeholders, including customers, employees, the legal system, and society. It is usually impossible to please all stakeholders.

Problems arise when employees encounter ethical situations that they cannot resolve. Sometimes gaining a better understanding of the basic premise of their decision rationale can help them choose the "right" solution. For instance, to decide whether they should offer bribes to customers to secure a large contract, salespeople need to understand their own personal moral philosophies as well as their firm's core values. If complying with company policy or legal requirements is an important motivation to the individual, he or she is less likely to offer a bribe. On the other hand, if the salesperson's ultimate goal is a "successful" career and if offering a bribe seems likely to result in a promotion, then bribery might not be inconsistent with that person's moral philosophy of acceptable business behavior. Even though bribery is illegal under U.S. law, the employee may rationalize that bribery is necessary "because everyone else does it."

COGNITIVE MORAL DEVELOPMENT

"Problems arise when employees encounter ethical situations that they cannot resolve."

Many people believe that individuals advance through stages of moral development as their knowledge and socialization continue over time. In this section, we examine a model that describes this cognitive moral development process—that is, the stages through which people may progress in their development of moral thought. Many models, developed to explain, predict, and control individuals' ethical behavior within business organizations, have proposed that cognitive moral processing is an element in ethical decision making. Cognitive moral processing is based on a body of literature in psychology that focuses on studying children and their cognitive development.[34] Psychologist Lawrence Kohlberg adapted Piaget's theory and developed the six-stage model of cognitive development, which, although not specifically designed for business contexts, provides an interesting perspective on the question of moral philosophy in business. According to **Kohlberg's model of cognitive moral development**, people make different decisions in similar ethical situations because they are in different stages of six cognitive moral development stages:

1. *The stage of punishment and obedience.* An individual in Kohlberg's first stage defines *right* as literal obedience to rules and authority. A person in this stage will respond to rules and labels of "good" and "bad" in terms of the physical power of those who determine such rules. Right and wrong are not associated with any higher order or philosophy but rather with a person who has power. Stage 1 is usually associated with small children, but signs of stage 1 development are also evident in adult behavior. For example, some companies forbid their buyers to accept gifts from salespeople. A buyer in stage 1 might justify a refusal to accept gifts from salespeople by referring to the company's rule that defines accepting gifts as an unethical practice, or the buyer may accept the gift if he or she believes that there is no chance of being caught and punished.
2. *The stage of individual instrumental purpose and exchange.* An individual in stage 2 defines *right* as that which serves his or her own needs. In this stage, the individual no longer makes moral decisions solely on the basis of specific rules or authority figures; he or she now evaluates behavior on the basis of its fairness to him or her. For example, a sales representative in stage 2 doing business for the first time in a foreign country

may be expected by custom to give customers "gifts." Although gift giving may be against company policy in the United States, the salesperson may decide that certain company rules designed for operating in the United States do not apply overseas. In the culture of some foreign countries, gifts may be considered part of a person's pay. So, in this instance, not giving a gift might put the salesperson at a disadvantage. Some refer to stage 2 as the stage of reciprocity because, from a practical standpoint, ethical decisions are based on an agreement that "you scratch my back and I'll scratch yours" instead of on principles of loyalty, gratitude, or justice.

3. *The stage of mutual interpersonal expectations, relationships, and conformity.* An individual in stage 3 emphasizes others rather than him or herself. Although ethical motivation is still derived from obedience to rules, the individual considers the well-being of others. A production manager in this stage might obey upper management's order to speed up an assembly line if he or she believed that this would generate more profit for the company and thus save employee jobs. This manager not only considers his or her own well-being in deciding to follow the order but also tries to put him or herself in upper management's and fellow employees' shoes. Thus, stage 3 differs from stage 2 in that fairness to others is one of the individual's ethical motives.
4. *The stage of social system and conscience maintenance.* An individual in stage 4 determines what is right by considering his or her duty to society, not just to other specific people. Duty, respect for authority, and maintaining the social order become the focal points. For example, some managers consider it a duty to society to protect privacy and therefore refrain from monitoring employee conversations.
5. *The stage of prior rights, social contract, or utility.* In stage 5, an individual is concerned with upholding the basic rights, values, and legal contracts of society. Individuals in this stage feel a sense of obligation or commitment, a "social contract," to other groups and recognize that in some cases legal and moral points of view may conflict. To reduce such conflict, stage 5 individuals base their decisions on a rational calculation of overall utilities. The president of a firm may decide to establish an ethics program because it will provide a buffer against legal problems and the firm will be perceived as a responsible contributor to society.
6. *The stage of universal ethical principles.* A person in this stage believes that right is determined by universal ethical principles that everyone should follow. Stage 6 individuals believe that there are inalienable rights, which are universal in nature and consequence. These rights, laws, or social agreements are valid, not because of a particular society's laws or customs, but because they rest on the premise of universality. Justice and equality are examples of principles that are deemed universal in nature. A person in this stage may be more concerned with social ethical issues and thus not rely on the business organization for ethical direction. For example, a businessperson at this stage might argue for discontinuing a product that has caused death and injury because the inalienable right to life makes killing wrong, regardless of the reason. Therefore, company profits would not be a justification for the continued sale of the product.[35]

Kohlberg's six stages can be reduced to three different levels of ethical concern. At the first level, a person is concerned with his or her own immediate interests and with external rewards and punishments. At the second level, an individual equates *right* with conformity to the expectations of good behavior of the larger society or some significant reference group. Finally, at the third, or "principled," level, an individual sees beyond the norms, laws, and authority of groups or individuals. Employees at this level make ethical decisions regardless of negative external pressures. However, research has shown that most workers' abilities to identify and resolve moral dilemmas do not reside at this third level and that their motives are often a mixture of selflessness, self-interest, and selfishness.

Kohlberg suggests that people continue to change their decision making priorities after their formative years, and as a result of time, education, and experience, they may change their values and ethical behavior. In the context of business, an individual's moral development can be influenced by corporate culture, especially ethics training. Ethics training and education have been shown to improve managers' cognitive development scores.[36] Because of corporate reform, most employees in *Fortune* 1000 companies today receive some type of ethics training. Training is also a requirement of the Federal Sentencing Guidelines for Organizations.

Some feel that experience in resolving moral conflicts accelerates an individual's progress in moral development. A manager who relies on a specific set of values or rules may eventually come across a situation in which the rules do not apply. For example, suppose Sarah is a manager whose policy is to fire any employee whose productivity declines for four consecutive months. Sarah has an employee, George, whose productivity has suffered because of depression, but George's coworkers tell Sarah that George will recover and soon be a top performer again. Because of the circumstances and the perceived value of the employee, Sarah may bend the rule and keep George. Managers in the highest stages of the moral development process seem to be more democratic than autocratic, more likely to consider the ethical views of the other people involved in an ethical decision making situation.

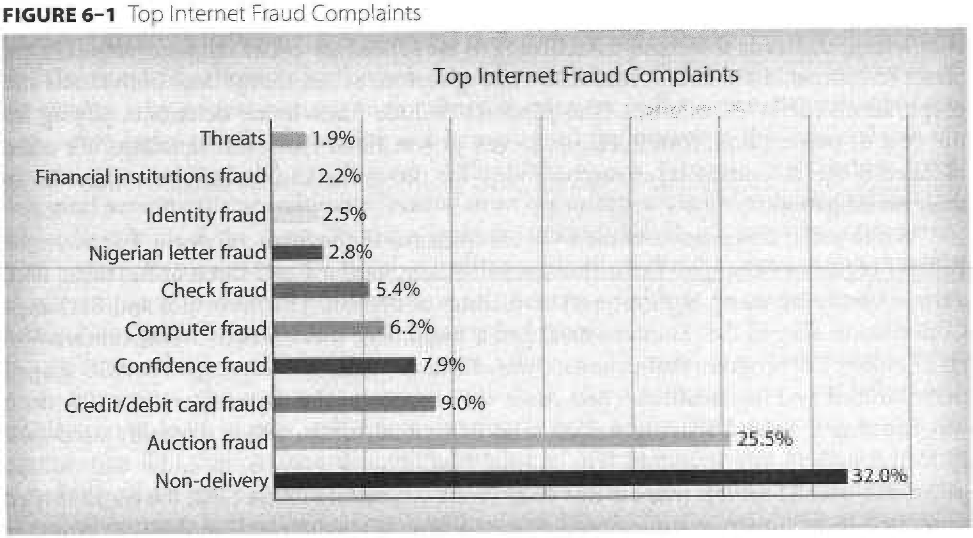
Once thought to be critical, the theory of cognitive moral development and the empirical research for the last 10 years has been mixed, suggesting both a positive and negative relationship between it and ethical decision making. The consensus appears to be that cognitive moral development is difficult at best to measure and connect with ethical decision making.[37]

WHITE-COLLAR CRIME

The terms *crime* and *criminal* normally conjure up thoughts of rape, arson, armed robbery, or murder. The news constantly reports on the damages that occur as a result of these types of crimes. But, although the devastation caused by these "crimes of the street" is more appealing to the evening news, it is no less destructive than the crimes perpetrated every year by seemingly nonviolent white-collar criminals. Referred to as **white-collar crimes** (WCCs), these "crimes of the suite" do more damage in monetary and emotional loss in one year than the crimes of the street over several years combined.[38]

WCC creates victims by establishing trust and respectability. WCCs are often considered to be different than crimes of the street. It is interesting to note in Figure 6–1 that deceptive pricing, unnecessary repairs, and credit card fraud are the three victim categories that were found in the national public household survey of consumers reporting over their lifetime. The victims of WCC are often trusting consumers who believe that businesses are legitimate. Unfortunately, senior citizens and other disadvantaged consumers fall prey to WCC perpetrators. Online white-collar crime is a growing problem around the world. Online WCC surged 33 percent during the most recent recession, accounting for

FIGURE 6–1 Top Internet Fraud Complaints



Source: "2008 Internet Crime Report," Bureau of Justice, http://www.ic3.gov/media/annualreport/2008_ic3report.pdf (accessed August 18, 2009).

nearly $265 billion in losses to U.S. households.[39] As a response to the surge in white-collar crimes, the Unites States government has stepped up its efforts to combat it, with the number of cases being investigated more than tripling since 2005. The government is concerned about the destabilizing effect that WCC has on U.S. households and the economy in general.[40]

At first glance, the job of deciding what constitutes a white-collar crime seems fairly simple. According to the glossary of legal terms for the Office of Justice Programs at the U.S. Department of Justice, a WCC is a "non-violent criminal act involving deceit, concealment, subterfuge and other fraudulent activity." The corporate executive who manipulates the stock market, the tax cheat, or the doctor who sets up an operation to swindle Medicaid are all fairly obvious candidates. However, WCC is not always so easy to define. Because government, Congress, and the American people want to better understand WCC, a number of subcategories have been created. Although the government official who accepts an illegal payment may have been wearing a white collar, he probably will be prosecuted under another title: official corruption. And while the corporate executive who orders his workers to dump illegal toxic waste materials in a nearby river also may be wearing a white collar, he probably will be classified as a violator of environmental regulations.

From various proposed definitions of WCC, the following appears to be inclusive of the main criminology literature yet parsimonious and exacting enough to be understood:

> *An individual or group committing an illegal act in relation to his/her employment, who is highly educated (college), in a position of power, trust, respectability and responsibility, within a profit/nonprofit business or government organization and who abuses the trust and authority normally associated with the position for personal and/or organizational gains.*

As one can see in Figure 6–1, many white-collar crimes are now being perpetrated via the Internet. A few of the most common white-collar offenses include antitrust violations, computer and Internet fraud, credit card fraud, bankruptcy fraud, health care fraud, tax evasion, violating environmental laws, insider trading, bribery, kickbacks, money laundering, and trade secret theft. According to the FBI, white-collar crime costs the United States an estimated $300 billion annually. The government can charge both individuals and corporations for WCC offenses. The penalties include fines, home detention, paying for the cost of prosecution, forfeitures, and even prison time. However, sanctions are often reduced if the defendant takes responsibility for the crime and assists the authorities in their investigation.

White-collar crime has become a virtual epidemic in the financial world. For example, Federal regulators charged Texas financier R. Allen Stanford and three of his firms with a fraud that centered on high-interest certificates of deposit. The Securities and Exchange Commission alleged that Stanford arranged a fraudulent investment scheme centered on an $8 billion CD program that promised unrealistically high interest rates. The SEC alleged that Stanford and his businesses lied about the security of the deposits and that Stanford was running a second scheme tied to sales of mutual funds, which allegedly used fake historical data to lure investors. The mutual fund scheme grew from under $10 million in 2004 to over $1 billion when it was discovered. According to the SEC, the fraud helped generate $25 million in revenue from fees for Stanford Group in 2007 and 2008.[41] Another example of someone committing WCC is former Illinois Governor Rod Blagojevich, who was arrested for allegedly trying to sell former Senator Obama's vacant Senate seat. He was also found guilty of taking campaign contributions to exchange for official actions.[42] He faces a maximum of 140 years in prison.

The presence of technology also seems to be giving a whole new generation of criminals the opportunity to score big. WCCs that previously originated at the top of organizations are now able to be committed at lower levels. Because of these advanced technology systems and corporate culture's increased reliance on them, anyone with the ability to hack into a system now can access the highly sensitive information necessary to commit WCC.

A classic example of WCC is the fraud perpetrated by Bernard Madoff, which was discovered in December 2008. Madoff's scam was based upon a Ponzi scheme, in which the operating principle is that you must constantly attract new investors to pay off old investors the "gains" they were promised. Most Ponzi schemes self-destruct fairly quickly as the ability to keep attracting new investors dwindles.

However, Madoff kept his scheme going for many years. The business that started with a small circle of friends and relatives was built on the promise of modest and steady returns in spite of market swings. With Madoff's social and business connections, and remarkably steady returns of 10 percent to 12 percent, investors were willing to spend billions of dollars. Part of the appeal was the aura that this investment opportunity was highly exclusive, although it later came out that thousands had given their money to Madoff.

When investors questioned Madoff about their investments, he refused to provide them online access to their accounts. Nonetheless, Madoff's well-dressed, multilingual sales representatives continued to convince European buyers to invest.

Many people indicate that one red flag would have been the fact that Madoff would have overtaken the market had he traded the options in the volumes necessary to meet his financial goals. Madoff ultimately admitted to running a 4,800-client Ponzi scheme for more than a decade. While investors thought they had nearly $65 billion invested with Madoff, his financial advisement firm never had anywhere near that much money. Incredibly, he had not invested a single penny. Instead, Madoff deposited the money in a bank account, which he then used to pay investors when they asked for their money back.

The only way he sustained the operation for as long as he did was through attracting new clients. Madoff will spend the rest of his life in prison for his crime.[43]

The focus of criminology is often the behavior of the individual and discovery of the reasons why people commit such crimes. Advocates of the organizational deviance perspective argue that a corporation is a living, breathing organism that can collectively become deviant; that companies have a life of their own, separate and distinct from biological persons; that the ultimate "actors" in an organization are individuals; and that the corporate culture of the company transcends the individuals who occupy these positions. With time, patterns of activities become institutionalized within the organization that live on after those who established them have left the firm. Table 6–4 lists some of the top justifications given by perpetrators of white collar crimes.

Another common cause of WCC is peer influence, the result of an individual's circle of acquaintances within an organization, with their accompanying views and behaviors. Employees, at least in part, self-select the people with whom they associate within an organization. For companies with a high number of ethical employees, there is a higher probability that a fence sitter (the 40 percent of businesspeople who could be persuaded to be ethical or unethical) will go along with their coworkers.

Finally, there is an argument to be made that some businesspeople may have personalities that are inherently criminal.[44] Personality tests have been used to predict behavior in individuals working within an organization, but such tests presuppose that values and philosophies are constant; thus, they seem to be ineffective as an approach to understanding the subtleties of white-collar criminals.[45] We also know that businesspeople and companies must make a profit on revenue to exist, slanting their orientation toward teleology and making them increasingly likely to commit white-collar crimes. The answer to the increase in WCC is not easy to pinpoint because many variables cause good people to make bad decisions. Many people disagree that the government is devoting enough resources to combat WCC. The current focus of the Federal Sentencing Guidelines for Organizations is that all organizations should develop effective ethics and compliance programs to prevent WCC.

TABLE 6–4 Common Justifications for White Collar Crime

1.	Denial of responsibility (Everyone can, with varying degrees of plausibility, point the finger at someone else.)
2.	Denial of injury (White-collar criminals often never meet or interact with those who are harmed by their actions.)
3.	Denial of the victim (The offender is playing tit-for-tat, and claims to be responding to a prior offense inflicted by the supposed victim.)
4.	Condemnation of the condemners (Executives dispute the legitimacy of the laws under which they are charged, or impugn the motives of the prosecutors who enforce them.)
5.	Appeal to a higher authority ("I did it for my family" remains a popular excuse.)
6.	Everyone else is doing it (Because of the highly competitive marketplace, certain pressures exist to perform that may drive people to break the law.)
7.	Entitlement (Criminals simply deny the authority of the laws they have broken.)

Source: Adapted from Daniel J. Curran and Claire M. Renzetti, *Theories of Crime* (Needham Heights, MA: Allyn & Bacon, 1994).

THE ROLE OF INDIVIDUAL FACTORS IN BUSINESS ETHICS

Of course, not everyone agrees on what the role of traditional moral philosophies in ethical decision making in an organization is. Some types such as Machiavellianism, which comes from the writing of Machiavelli, an Italian political theorist, have been found to influence ethical decisions. *The Prince* (a letter that Machiavelli wrote from exile to an Italian prince) argues against the relevance of morality in political affairs and holds that craft and deceit are justified in pursuing and maintaining political power. Machiavelli is famous for the idea that, for a leader, it is better to be feared than to be loved. This type of thinking abounds within *The Prince* because Machiavelli basically presents a guidebook for obtaining and maintaining power without the need for morality. Most business managers do not embrace this extreme philosophy, and most managers cannot communicate the exact moral philosophy that they use to make ethical decisions.

> *"Although a personal moral compass is important, it is not sufficient to prevent ethical misconduct in an organizational context."*

According to ethics consultant David Gebler, "Most unethical behavior is not done for personal gain, it's done to meet performance goals."[46] Unfortunately, many people believe that individual moral philosophies are the main driver of ethical behavior in business. This belief can be a stumbling block in assessing ethical risk and preventing misconduct in an organizational context. The moral values learned within the family and through religion and education are key factors that influence decision making, but as indicated in the models in Chapter 5, it is only one factor. The fact that many companies and business schools focus on personal character or moral development in their training programs as the main consideration reinforces the idea that employees can control the work environment. Although a personal moral compass is important, it is not sufficient to prevent ethical misconduct in an organizational context. The rewards for meeting performance goals and the corporate culture, especially for coworkers and managers, have been found to be the most important drivers of ethical decision making.[47]

Strong abilities in ethical reasoning will probably lead to more ethical business decisions in the future than trying to provide detached character education for each employee.[48] Equipping employees with intellectual skills that will allow them to understand and resolve complex ethical dilemmas that they encounter in complex corporate cultures will help them make the right decisions. This approach will hopefully keep them from being carried along by peer pressure and lulled by unethical managers to engage in misconduct.[49] The West Point model for character development focuses on the fact that competence and character must be developed simultaneously. This model assumes that ethical reasoning has to be approached in the context of a specific profession. The military has been effective in teaching skills and developing principles and values that can be used in most situations that a soldier will encounter. In a similar manner, accountants, managers, or marketers need to develop ethical reasoning in the context of their jobs.

SUMMARY

Moral philosophy refers to the set of principles, or rules, that people use to decide what is right or wrong. These principles, rules, or philosophies present guidelines for resolving conflicts and for optimizing the mutual benefit of people living in groups. Businesspeople are somewhat guided by moral philosophies as they formulate business strategies and resolve specific ethical issues.

Teleological, or consequentialist, philosophies stipulate that acts are morally right or acceptable if they produce some desired result, such as realization of self-interest or utility. Egoism defines right or acceptable behavior in terms of the consequences for the individual. In an ethical decision making situation, the egoist will choose the alternative that contributes most to his or her own self-interest. Egoism further can be classified into hedonism and enlightened egoism. Utilitarianism is concerned with maximizing total utility, or providing the greatest benefit for the greatest number of people. In making ethical decisions, utilitarians often conduct a cost–benefit analysis, which considers the costs and benefits to all affected parties. Rule utilitarians determine behavior on the basis of rules designed to promote the greatest utility rather than by examining particular situations. Act utilitarians examine the action itself, rather than the rules governing the action, to determine whether it will result in the greatest utility.

Deontological, or nonconsequentialist, philosophies focus on the rights of individuals and on the intentions behind an individual's particular behavior rather than on its consequences. In general, deontologists regard the nature of moral principles as permanent and stable, and they believe that compliance with these principles defines ethicalness. Deontologists believe that individuals have certain absolute rights that must be respected. Rule deontologists believe that conformity to general moral principles determines ethicalness. Act deontologists hold that actions are the proper basis on which to judge morality or ethicalness and that rules serve only as guidelines.

According to the relativist perspective, definitions of ethical behavior are derived subjectively from the experiences of individuals and groups. The relativist observes behavior within a relevant group and attempts to determine what consensus group members have reached on the issue in question.

Virtue ethics posits that what is moral in a given situation is not only what is required by conventional morality or current social definitions, however justified, but also what a person with a "good" moral character would deem appropriate. Those who profess virtue ethics do not believe that the end justifies the means in any situation.

Ideas of justice as applied in business relate to evaluations of fairness. Justice relates to the fair treatment and due reward in accordance with ethical or legal standards. Distributive justice is based on the evaluation of the outcome or results of a business relationship. Procedural justice is based on the processes and activities that produce the outcomes or results. Interactional justice is based on an evaluation of the communication process in business.

The concept of a moral philosophy is not exact; moral philosophies can only be assessed on a continuum. Individuals use different moral philosophies depending on whether they are making a personal or a workplace decision.

According to Kohlberg's model of cognitive moral development, individuals make different decisions in similar ethical situations because they are in different stages of moral development. In Kohlberg's model, people progress through six stages of moral development: (1) punishment and obedience; (2) individual instrumental purpose and exchange; (3) mutual interpersonal expectations, relationships, and conformity; (4) social system and conscience maintenance; (5) prior rights, social contract, or utility; and (6) universal ethical principles. Kohlberg's six stages can be further reduced to three levels of ethical concern: immediate self-interest, social expectations, and general ethical principles. Cognitive moral development may not explain as much as was once believed.

White-collar crime can be defined as an individual who is educated and in a position of power, trust, respectability, and responsibility committing an illegal act in relation to his or her employment, and who abuses the trust and authority normally associated with the position for personal and/or organizational gains. Some reasons why white-collar crime is not being heavily researched are that it doesn't come to mind when people think of crime, the offender (or organization) is in a position of trust and respectability, criminology or criminal justice systems look at white-collar crime differently, and many researchers have not moved past the definitional issues. The increase in technology use seems to be increasing the opportunity to commit white-collar crime with less risk.

Individual factors such as religion, moral intensity, and a person's professional affiliations can affect a person's values and decision making process. Other factors such as ethical awareness, biases, conflict, personality type, and intelligence have been studied, but no definitive conclusions can be made at this time about their relationship to ethical behavior. One thing we do know is that moral philosophies, values, and business are more complex than merely giving people honesty tests or value profiles that are not business oriented. Paper-and-pencil techniques do not yield accurate profiles for companies.

IMPORTANT TERMS FOR REVIEW

- moral philosophy
- economic value orientation
- idealism
- realism
- monist
- hedonism
- quantitative hedonist
- qualitative hedonist
- pluralist
- instrumentalist
- goodness theory
- obligation theory
- teleology
- consequentialism
- egoism
- enlightened egoism
- utilitarianism
- rule utilitarian
- act utilitarian
- deontology
- nonconsequentialist
- rule deontologist
- act deontologist
- relativist perspective
- descriptive relativism
- metaethical relativist
- normative relativism
- virtue ethics
- justice
- distributive justice
- procedural justice
- interactional justice
- Kohlberg's model of cognitive moral development
- white-collar crime