



# Chapter 4

## The Institutionalization of Business Ethics

# Institutionalization in Business Ethics

- ✦ Institutionalization in business ethics relates to established **laws, customs**, and expected **organizational programs** that are considered normative in establishing reputation.
- ✦ Institutions provide **requirements, structure**, and **societal expectations** to reward and sanction ethical decision making.

# Voluntary Boundary, Core Practices, and Mandated Boundaries

## ✦ Voluntary boundary

- A management-initiated **boundary of conduct** (beliefs, values, voluntary policies, and voluntary contractual obligations).

## ✦ Core practice

- A highly **appropriate and common practice** that helps ensure compliance with legal and requirements, industry self-regulation, and societal expectations.

## ✦ Mandated boundary

- An externally imposed boundary of conduct (laws, rules, regulations, and other requirements)

# Legal and Regulatory Issues

- ✦ Laws and regulations are established by the **government** to set minimum **standards** of acceptable **behavior**.
- ✦ Laws are passed because society does not always **trust business** to act in its best interest.



# Types of Laws

- ✦ **Civil law** defines the rights and duties of individuals and organizations.
- ✦ **Criminal law** prohibits specific actions and imposes punishment for breaking the law.
- ✦ The difference between the two is enforcement.
  - Criminal laws are enforced by the **state or nation**.
  - Civil laws are enforced by **individuals** (generally in court).

# Business ethics disputes are generally resolved through lawsuits.

Most laws affecting business fall into one of five categories:

- Laws regulating **competition** (prevent restraint of trade)
- Laws **protecting consumers** (safety, disclosure, privacy, etc.)
- Laws **protecting equity and safety** (discrimination, workplace safety, equal employment practice)
- Laws **protecting the environment** (air, water, noise)
- Laws that encourage **ethical conduct** (Federal Sentencing Guidelines for Organizations, Sarbanes-Oxley Act)

# Laws Protecting Consumers

- ✦ Laws that protect consumers require businesses to provide **accurate information** about products and services and to follow safety standards.
- ✦ The role of the FTC's Bureau of Consumer Protection is to protect consumers against **unfair, deceptive**, or fraudulent practices.

# Laws Promoting Equity and Safety

- ✦ Laws promoting equity in the **workplace protect** the rights of **minorities, women, older persons,** and persons with disabilities.
- ✦ Equal Employment Opportunity Commission (EEOC)
- ✦ Affirmative action programs
- ✦ The Equal Pay Act mandates that **women and men** who do **equal** work must receive equal pay.



# Laws Promoting Equity and Safety

**TABLE 4-4**

**Laws Promoting Equity and Safety**

Equal Pay Act of 1963	Prohibits discrimination in pay on the basis of sex.
Equal Pay Act of 1963 (amended)	Prohibits sex-based discrimination in the rate of pay to men and women working in the same or similar jobs.
Title VII of the Civil Rights Act of 1964 (amended in 1972)	Prohibits discrimination in employment on the basis of race, color, sex, religion, or national origin.
Age Discrimination in Employment Act, 1967	Prohibits discrimination in employment against persons between the ages of 40 and 70.
Occupational Safety and Health Act, 1970	Designed to ensure healthful and safe working conditions for all employees.
Title IX of Education Amendments of 1972	Prohibits discrimination based on sex in education programs or activities that receive federal financial assistance.
Vocational Rehabilitation Act, 1973	Prohibits discrimination in employment because of physical or mental handicaps.
Vietnam Era Veterans Readjustment Act, 1974	Prohibits discrimination against disabled veterans and Vietnam War veterans.
Pension Reform Act, 1974	Designed to prevent abuses in employee retirement, profit-sharing, thrift, and savings plans.
Equal Credit Opportunity Act, 1974	Prohibits discrimination in credit on the basis of sex or marital status.
Age Discrimination Act, 1975	Prohibits discrimination on age in federally assisted programs.
Pregnancy Discrimination Act, 1978	Prohibits discrimination on the basis of pregnancy, childbirth, or related medical conditions.
Immigration Reform and Control Act, 1986	Prohibits employers from knowingly hiring a person who is an unauthorized alien.
Americans with Disabilities Act, 1990	Prohibits discrimination against people with disabilities and requires that they be given the same opportunities as people without disabilities.
Civil Rights Act of 1991	Provides monetary damages in cases of intentional employment discrimination.

# Laws Protecting the Environment

- ✦ Environmental Protection Agency (EPA)
- ✦ Many environmental protection laws result in the elimination or modification of goods and services
- ✦ Affirmative action programs
- ✦ Toxic waste and disposal
- ✦ Computer recycling



# Laws Protecting the Environment

**TABLE 4-5**

**Laws Protecting the Environment**

Clean Air Act, 1970	Established air-quality standards; requires approved state plans for implementation of the standards.
National Environmental Policy Act, 1970	Established broad policy goals for all federal agencies; created the Council on Environmental Quality as a monitoring agency.
Coastal Zone Management Act, 1972	Provides financial resources to the states to protect coastal zones from overpopulation.
Federal Water Pollution Control Act, 1972	Designed to prevent, reduce, or eliminate water pollution.
Endangered Species Act, 1973	Provides a program for the conservation of threatened and endangered plants and animals and the habitats in which they are found.
Noise Pollution Control Act, 1972	Designed to control the noise emission of certain manufactured items.
Federal Insecticide, Fungicide and Rodenticide Act, 1972	Provides federal control of pesticide distribution, sale, and use.
Safe Drinking Water Act, 1974	Established to protect the quality of drinking water in the United States; focused on all waters actually or potentially designed for drinking use, whether from above ground or underground sources; established safe standards of purity and required all owners or operators of public water systems to comply with primary (health-related) standards.

# Laws Protecting the Environment (cont'd)

**TABLE 4-5** Laws Protecting the Environment

Toxic Substances Control Act, 1976	Requires testing and restricts use of certain chemical substances, to protect human health and the environment.
Resource Conservation and Recovery Act, 1976	Gives the EPA authority to control hazardous waste from the "cradle to grave"; includes the generation, transportation, treatment, storage, and disposal of hazardous waste, as well as a framework for the management of nonhazardous waste.
Comprehensive Environmental Response, Compensation, and Liability Act, 1980	Created a tax on chemical and petroleum industries and provides broad federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment.
Emergency Planning and Community Right-to-Know Act, 1986	The national legislation on community safety, designed to help local communities protect public health, safety, and the environment from chemical hazards.
Oil Pollution Act, 1990	Streamlined and strengthened the EPA's ability to prevent and respond to catastrophic oil spills; a trust fund financed by a tax on oil is available to clean up spills when the responsible party is incapable or unwilling to do so.
Pollution Prevention Act, 1990	Focuses industry, government, and public attention on reducing the amount of pollution through cost-effective changes in production, operation, and raw materials use.
Food Quality Protection Act, 1996	Amended the Federal Insecticide, Fungicide and Rodenticide Act and the Federal Food Drug and Cosmetic Act; the requirements included a new safety standard—reasonable certainty of no harm—that must be applied to all pesticides used on foods.



# The Sarbanes–Oxley Act

- ✚ Establishes a system of federal **oversight** of corporate accounting practices
- ✚ Gives the Public Company Accounting Oversight Board (PCAOB) authority to monitor **accounting** firms that audit public corporations and establishes standards and rules for auditors in accounting firms
- ✚ Requires top managers to **certify** that their firms' **financial reports** are complete and **accurate**, making CEOs and CFOs accountable
- ✚ Provides protection for “whistle-blowing” employees who might report illegal activity to authorities

# Major Provisions of the Sarbanes-Oxley Act

**TABLE 4-6**

Major Provisions of the Sarbanes-Oxley Act

1. Requires the establishment of a Public Company Accounting Oversight Board in charge of regulations administered by the SEC.
2. Requires CEOs and CFOs to certify that their companies' financial statements are true and without misleading statements.
3. Requires that corporate board of directors' audit committees consist of independent members who have no material interests in the company.
4. Prohibits corporations from making or offering loans to officers and board members.
5. Requires codes of ethics for senior financial officers; code must be registered with the SEC.
6. Prohibits accounting firms from providing both auditing and consulting services to the same client without the approval of the client firm's audit committee.
7. Requires company attorneys to report wrongdoing to top managers and, if necessary, to the board of directors; if managers and directors fail to respond to reports of wrongdoing, the attorney should stop representing the company.
8. Mandates "whistle-blower protection" for persons who disclose wrongdoing to authorities.
9. Requires financial securities analysts to certify that their recommendations are based on objective reports.
10. Requires mutual fund managers to disclose how they vote shareholder proxies, giving investors information about how their shares influence decisions.
11. Establishes a ten-year penalty for mail/wire fraud.
12. Prohibits the two senior auditors from working on a corporation's account for more than five years; other auditors are prohibited from working on an account for more than seven years. In other words, accounting firms must rotate individual auditors from one account to another from time to time.

# Benefits of the Sarbanes-Oxley Act

- Greater **accountability** of top managers
- Renewed investor **confidence**
- Greater protection of **retirement** plans
- Greater penalties for senior managers
- Improved information from **stock analysts**
- Clear explanations by CEOs as to why their compensation package is in the best interest of the company

# Institutionalization of Ethics Through Laws

**TABLE 4-8**

Institutionalization of Ethics Through Laws

1991	<i>Organizational Sentencing Guidelines created.</i> These guidelines, added to the FSGO, created organizational responsibility for employee conduct. Sentences and fines are lessened for organizations with ethics programs. Firms that fail to take due diligence actions to prevent misconduct are given stricter sentences or fines.
2002	<i>Sarbanes–Oxley Act passed.</i> Companies now must create an independent board audit committee, a code of conduct and ethics policies, whistle-blower hot lines, and annual reports on effectiveness of financial reporting systems. CEOs and CFOs must sign off on the accuracy of financial statements. The act directs that Organizational Sentencing Guidelines be reviewed and amended. Penalties: up to \$5 million and twenty years in prison.
2004	<i>Organizational Sentencing Guidelines stiffened.</i> In accord with the Sarbanes–Oxley Act, guidelines are revised so that organizations are held to a stiffer definition of an effective ethics program in order to receive lenient treatment for offenses. Directors and executives must assume responsibility for such programs, identify areas of risk, train officials in ethics, create an ethics hot line, designate an individual to oversee ethics, and give that person sufficient authority and resources to do the job. Companies must also create a corporate culture that encourages ethics.

SOURCE: Adapted from James C. Hyatt, "Birth of the Ethics Industry," *Business Ethics*, Summer 2005, p. 27. Reprinted with permission of Business Ethics.



# Federal Sentencing Guidelines for Organizations

- ✦ Creates an incentive for organizations to develop and implement programs designed to foster ethical and legal compliance
- ✦ Developed by the U.S. Sentencing Commission and apply to all felonies and class A misdemeanors committed by employees at work
- ✦ Government philosophy behind FSGO is that legal violations can be prevented through organizational values and a commitment to ethical conduct

# Philanthropic Issues

- ☀️ Involve business's **contribution** to the **local community and society**
- ☀️ Quality of life issues
  - **Responsible production** of goods and services
  - **Technology** improvements...yet not **damaging** to the environment or jeopardizing personal privacy
- ☀️ Philanthropic issues
  - Making the **local community** a better place to live
- ☀️ Strategic philanthropy
  - Synergistic and **mutually beneficial** use of a company's core competencies and resources to **deal** with **social issues**

