Chapter one

An Overview of Business Ethics

Definition and Nature

Ethics refers to well based standards of right and wrong that prescribe what humans ought to do in terms of right, obligation, benefit to society, fairness or specific virtues. Ethics is the branch of philosophy that studies the values and behavior of a person. Ethics studies concepts like good and evil, responsibility and right and wrong. Ethics can be distinguished in three categories: normative ethics, descriptive ethics and meta-ethics. Meta-ethics focuses on the issues of universal truths, ethical judgments and the meaning of ethical terms. Normative ethics can be used to regulate the right and wrong behavior of individuals. Descriptive ethics, also called applied ethics, is used to consider controversial issues, such as abortion, animal rights, capital punishment and nuclear war.

Wrong doing by some businesses has focused public attention and government involvement on encouraging more acceptable business conduct. Any business decision may be judged as right or wrong, ethical or unethical, legal or illegal.

1.1.Ethics and Business Ethics

1.1.1. Meaning of Ethics

The term 'ethics' defines the standards that bear on right and wrong issues of society. Business ethics is thus a set of professional standards, which emphasize principles of honesty and duty to the business and the general public.

Principles and standards that determine acceptable conduct in business. The acceptability of behavior in business is determined by customers, competitors, government regulators, interest groups, and the public, as well as each individual's personal moral principles and values. Enron, one of the largest ethical disasters in the 21st century, is an example. Two former Enron CEOs, Ken Lay and Jeff Skilling, were found guilty on all counts of conspiring to hide the company's financial condition. The judge in the case said the defendants could be found guilty of consciously avoiding knowing about wrong doing at the company. Many other top executives including Andy Fastow, the chief financial officer, were found guilty of misconduct and are serving time in prison. The fall of Enron took many layers of management pushing the envelope

Organizations are expected to establish ethical standards and provide compliance systems to maintain appropriate conduct within all levels of the organization. Many companies are starting to recognize that providing jobs and profits are not sufficient criteria to be a responsible member of society. It is important to be socially responsible—that is, to work with stakeholders such as employees, customers, communities, and governments to make sure that the company does its part to minimize negative impacts on society and maximize contributions to important issues that are being addressed worldwide. Global warming, recycling, and sustainability are social responsibility issues; employee misconduct in performing business activities is a significant concern of business ethics.

The significant principles included in business ethics are:

- Fairness
- Integrity
- Commitment to agreements
- Broad-mindedness
- Considerateness
- Importance given to human esteem and self-respect
- Responsible citizenship
- Attempt to excel
- Accountability

These principles, if strictly pursued, lead to a decent business environment and create healthy relationships in the organization. However, deviations from these principles can occur due to the following factors:

- Ignorance and indifference to issues
- Selfishness
- Imperfect reasoning

1.1.2. Concept of Business

A business includes that part of production, which is equally exchanged and results in mutual benefits to the parties who exchanged goods in the transaction. Business may be defined as an activity in which different persons exchange something of value, whether goods or services for mutual gain or profit. It's an activity of earning income either by production or purchase, sale and exchange of goods and services to satisfy the needs of people and to earn profit. The following points may be discussed to reveal the true nature of a business:

Economic activity: Business is an essential economic activity. Profit motive is the key element that inspires a businessman to work efficiently.

Human activity: Business is a human activity. In this sense, business is considered to be an economic activity of human beings only. A business is by the people and for the people.

Social process: Business is a social process. All the individuals involved in a business, such as owners, customers and employees, are an integral part of society. Business has to fulfill its social responsibilities.

System: A system is a combination of things or parts forming a unitary whole. It is an established arrangement of components for the attainment of objectives. Similarly, business is a system consisting of various subsystems that are operated in a balanced and coordinated way.

1.1.3. Types of Business Activities

All human activities concerned with earning money are included under the term business. Cultivation by a farmer, teaching by a teacher and treatment taken by a patient from a doctor are also treated as business activities.

There are different types of business activities, which may be classified as follows:

Industry: An industry includes the activities connected with the production and processing of goods. Manufacturing enterprises are engaged in the production of goods. These kinds of industries can be classified as follows:

- **Analytical enterprises**: An oil refinery that separates crude oil into petroleum, kerosene and diesel oil is an analytical concern.
- **Synthetic enterprises**: An enterprise which combines several materials to produce one product is a synthetic enterprise. All soap mills and cement factories are synthetic enterprises.
- **Assembling enterprises**: All those plants engaged in the production of products, such as radios, scooters and television sets are assembling enterprises. A few enterprises involved in mining are involved in mineral resource production, for example, iron ore, coal, gold and silver.

Commerce: It is the total of all those activities that are engaged in the removal of hindrances of persons or trade, places or transportation, risk of loss or insurance and time, such as warehousing, banking and financing of commodities. Commerce can be divided into two categories: trade and aid to trade. Trade can be further divided into two categories, which are as follows:

- **Internal**: This includes the trade that is done with the country, such as wholesale and retail trade.
- **External**: This includes the trade that is done with various countries, such as export and import.

Aid to trade can be divided into transport, banking and insurance.

1.1.4. Characteristics of Business

Business means the creation of utilities. There are many features of business activities and, thus, the business. The essential characteristics of business may be summarized as follows:

- **Exchange or sale**: A business includes the sale, purchase and exchange of goods and services.
- **Creation of utilities**: A business creates transfers and utilities of goods by making them available in proper form at the appropriate time and place.
- **Social institution**: A business deals with the people of society. All the persons engaged in the business, such as owners, customers, employees and other professionals belong to the society. A business has to fulfill its social responsibilities towards each part of the community and has to follow the business ethics as well.
- **Profit motive**: Business activities are carried out to make profit. A non-profitable business cannot continue to exist for long. Profits are essential for growth of a business.
- **Risk and uncertainty**: There are two types of risks in a business. The first type of risk is floods and thefts. The second type of risk is loss due to fall in demand and labor trouble. Uncertainty arises because of unpredictability of profit in a business. Profit is such an element which cannot be predicted in advance.
- **Customer satisfaction**: A business always tries to satisfy its customer with better quality and reasonable prices.

1.2.Responsibilities of a Business towards Various Interest Groups

Interest groups consist of the various persons connected with a business, such as consumers, shareholders and the community. The responsibilities of a business towards various interest groups are as follows:

1. **Responsibilities towards consumers**: A consumer is a person who determines what goods shall be produced and whether they should be sold in the market or not. Consumers not only determine the income of the business but also affect the success and survival of the business. Therefore, a business has some basic responsibilities towards the consumers and these are as follows:
    - To produce those goods that meet the needs of consumers of different tastes, classes and purchasing power
    - To establish the lowest possible price with efficiency and reasonable profit to the business
    - To ensure fair distribution of products among all sections of the consumers
    - To make the products more satisfactory to consumers through the study of consumer needs
    - To handle the complaints of consumers more carefully and to analyze them properly
    - To answer consumers' enquiries related to the company, its products and services
2. **Responsibilities towards shareholders**: The basic responsibility of a business is to ensure the safety of investment and higher rate of return on the investment. Owners of a business may be proprietors, partners or shareholders. The interest of shareholders lies in participating in the management and getting regular dividends at appropriate rates. It is, therefore, the responsibility of the management to improve communication between the company and its shareholders. This can be done by providing maximum information to the shareholders through newsletters, annual reports or by holding the annual general meeting of the company at an appropriate time and place so that the maximum number of members can come and participate in the discussions.
3. **Responsibilities towards community**: The management has the responsibility of informing the community about the organizational policies, activities and contribution towards the betterment of society. The various other responsibilities towards the community are as follows:
    - Financial help to the municipal and district boards for the improvement of housing conditions
    - To help the community by aiding hospitals, schools, colleges, religious institutions, and so on
    - To organize community forums and group discussions to promote better understanding of national and local affairs

- To encourage sports and provide recreational facilities

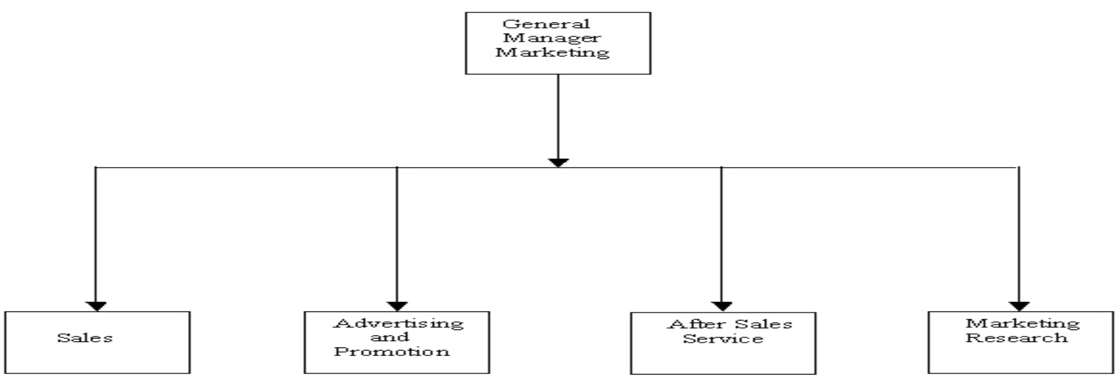
1.3.ETHICS IN THE FUNCTIONAL AREA

Ethical issues can arise in various functional areas of a business such as marketing, research and development, HRM, production and finance. Ethical issues in all these functional areas must be controlled or coordinated by the chief executive officer (CEO) of the enterprise.

1.3.1. ETHICS IN MARKETING

Marketing is a technique that is used to attract and persuade customers. Marketing provides a way in which a product is sold to the target audience. Marketing is a management process that identifies, anticipates and supplies consumer requirements efficiently and effectively. The main aim of marketing is to make customers aware of the products and services. It also focuses on attracting new customers and keeping existing customers interested in the product. The marketing department consists of various subdivisions, such as sales, after-sales service and marketing and research.

Figure1: subdivision of marketing



In the field of sales, the following ethical issues require safeguards against unethical behavior:

- Not supplying the products made by the company as per the order
- Not accepting responsibility for the defective product
- Not giving details about the hidden costs, such as transportation cost, while making the contract with the client
- Changing the specifications of the product without giving any prior information to the customer
- Changing the terms of the business without taking any approval from the client
- Delaying the delivery of the goods without giving any proper reason

- Treating two customers differently
- Not providing the after sales service as per the contract
- Selling the same product at different prices to different customers

Advertising and promotion provide the means for communicating with the customer. In the field of advertising and promotion, the following are examples of unethical communication practices:

- Making false commitments to the customers about the benefits of the product
- Supplying products that are different from those that are advertised
- Giving wrong prices to the customers during advertising
- Not giving the promised gift in the promotional campaign
- Hiding major flaws of the product
- Providing wrong testimonials about the product to prospective customers
- Not providing the advertised service to the customers as a part of the promotional plans
- Increasing the price of the product before starting its promotional campaign
- Making false references about the competitive products

While selling the product to the customer, a company provides some extended features or facilities along with the product, such as after-sales service. These facilities are provided to increase the sale of the product. In the field of after-sales service, the following ethical issues require safeguards against unethical behavior:

- Using below-standard material for the service and charging for relatively better material from the customer
- Using outmoded service equipment which can be harmful for the products during service
- Not taking the service calls if the location is not easy to reach, while free service was promised before the sale of the product
- Making only temporary adjustment in the product, which can last only for a short time or to make the product useful for the time being
- Not keeping proper service records of major products for future use, as they can help in easy diagnosis of problem

1.3.2. ETHICS IN HUMAN RESOURCE MANAGEMENT (HRM)

HRM is concerned with the management of the ‘people’ of an organization. The term HRM is used to refer to the procedures, philosophy, policies, and practices related to the management of people within an organization. it is responsible for performing various functions like planning, organizing, directing and controlling of human resources.

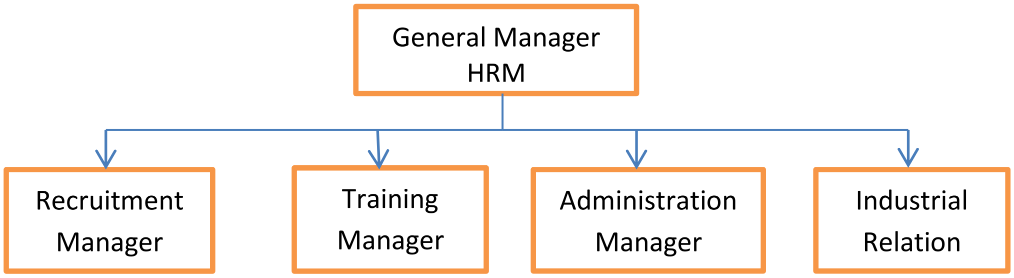


Figure 2: Subdivision of HRM

The following are examples of unethical practices during the recruitment process of a company:

- Recruitment of known persons without assessing their abilities
- Recruitment on the basis of financial favors
- Recruitment of the relatives of other employees
- Recruitment based on the recommendations of friend, business associates and other persons close to the leader
- Recruitment of under qualified persons
- Recruitment of overqualified persons
- Recruitment of less acceptable men when there are better suited women available for the job.
- Employing children below fourteen years for the job
- Giving less than minimum wages fixed by the government

The training manager of the company can also indulge in unethical practices as can be seen from the following points:

- Arranging training only for favorite employees, whether they deserve it or not
- Employing outsiders for providing training to trainees even when there are several persons available inside
- Planning and organizing the training programme without even knowing the need for training
- Organizing training during peak seasons or on days when workload is very high
- Starting training programmes in an ill-prepared manner
- Extending the time of the training programme to allow the trainees to have a relaxed time

- Supplying outmoded and old training materials for the purpose of training
- Experimenting with trainees by asking them to set their own timetable for Training

In the area of administration, the following are the unethical practices the manager can indulge in:

- Tampering leave records of the employees
- Giving leaves continuously to favourite employees
- Giving promotions to non-eligible persons merely on the recommendations of a friend or business associate
- Ignoring issues related to the security of the company
- Interference in various activities of the administration from the top management
- Giving the contract for uniforms of the employees to the wrong companies just for the sake of personal benefits

1.3.3. ETHICS IN FINANCE

Finance is an important element of an organization and it helps in its growth and development. Finance plays an important role in making resources available in an organization, such as man, machine, material, market and money. The finance manager of the firm is responsible for arranging the finances for the firm. The finance manager can raise funds from the following two sources:

 Internal Sources: Internal sources means the owner's own funds that are invested as equity in the organization. In case of small organizations, the owner's contribution in terms of equity is low. Therefore, large amount of money is raised from external sources. The entrepreneur can raise finance internally from various sources:

- Deposits and loans given by owner
- Personal loan from provident fund and life insurance policy
- Funds accumulated by the retention of profits
- Ploughing back of profits

 External Sources: External sources mean the various financial institutions from where entrepreneurs can raise funds, such as fixed capital, commercial banks and development banks. The entrepreneur can raise finance by:

- Borrowing money from friends and relatives
- Borrowing from financial institutions

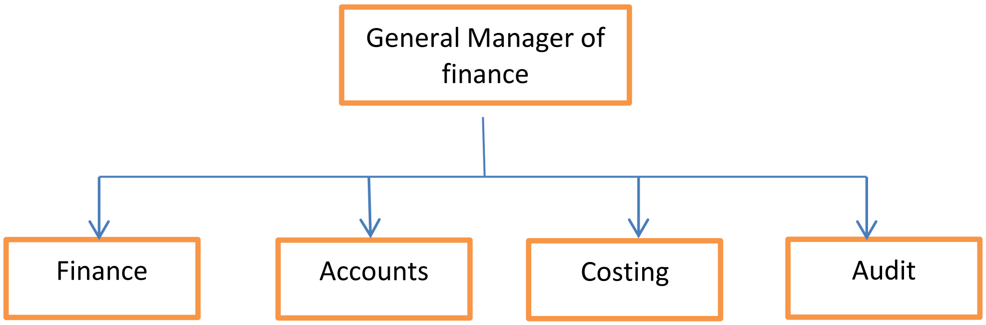


Figure 3: organizational chart for finance function

The finance department of an enterprise is prone to the following unethical practices:

- Overestimating promoters' capital utilization
- Over budgeting project costs
- Using underhand tactics with the financers to gain benefits for the firm as well as for themselves
- Purchasing capital equipment at a time when there is no requirement for it
- Selling the capital equipment in order to raise additional and unaccounted funds
- Siphoning funds for the promoter's personal benefit
- Investing unapproved funds in order to gain extra profits
- Claiming insurance cover for losses that never happened
- Overpricing the current assets in order to gain more working capital than permitted
- Using working capital funds for personal gains

The accounts department of an enterprise is prone to the following types of unethical issues:

- Showing inflated salaries and getting receipts from employees for an amount larger than what they actually get
- Playing inflated vendor bills in order to get discounts or commissions
- Paying overtime wages when there is no requirement for them
- Maintaining two different sets of books, one for the management and the other for income tax
- Refusing to reject unacceptable raw materials when the vendor bills have to be paid
- Delaying the clearance of the bills payable in order to get maximum interest for the amount to be paid

- Allotting extra travelling allowances to favorite employees
- Showing wrong figures in the monthly trial balances for personal benefits

The following are the unethical practices of the costing manager:

- Reducing manufacturing costs by manipulating work hours
- Ignoring cost of rejects
- Ignoring cost of rework
- Not accounting for man-hours lost due to strikes and absenteeism
- Not accounting for man-hours lost in maintenance work
- Not considering the work stoppages due to change in models
- Ignoring the man-hours lost due to change in the manufacturing process
- Ignoring time lost in failed experimentations
- Not taking into account the benefits of economies of sales and experience curve

The following points describe the unethical behavior of the auditing manager:

- Ignoring major deviations from the budgets
- Rejecting the tender having lowest cost among all due to personal reasons
- Helping in hiding black money in order to reduce the tax payable amount
- Ignoring inflated travel bills of selected employees
- Accepting payments made by the directors for personal purchases as official payments
- Approving payments to suppliers without checking bills or deliverables
- Approving the substandard construction made by the constructor and approving their bills for payment

1.4.IMPORTANCE OF ETHICS IN BUSINESS ENVIRONMENT

An ethical image for a company can bring good will and loyalty among customers and clients.

The following lists some of the importance of ethical behavior for business organizations.

Ethical Motivation: it protects or improves reputation of the organization by creating an efficient and productive work environment.

Balance the needs and wishes of stakeholders: it requires business to think about the impact of its decision on people or stakeholders who are directly or indirectly affected by those decisions. Helps companies build their image by acting in accordance with values.

Global challenge: business must become aware of ethical diversity in the world because of increasing globalization. According to resent study, transnational corporations account for 2/3 of world trade.

Ethical pay-off: serve to protect the organization from significant risks and help grow the business. If a company is ethical, it can reduce the violation of rules and regulations there by reducing risks associated with unethical behavior.

Employee retention: high employee turnover is a cost for companies. Ethical behaviors of companies help to retain employees in an organization.

Preventing and reduction of criminal penalties: A sound ethical program prevents companies from engaging in unethical behavior.

Preventing civil law suits: unethical behavior towards employees or customers may create law suits against companies. It helps companies resolve issues before complaints go outside.

Market leadership: when a company fully integrates its values into its culture, quality arises due to employees focus on values. Businesses that demonstrate the highest ethical standard are also the most profitable and successful.