Business Ethics
Florida International University
College of Business
State Farm® Financial Literacy Lab
http://www.business.fiu.edu/sffll
305-348-1542
BUSINESS ETHICS

An analysis of business ethics involves examining the principles and/or ethical problems that may arise in a business environment context. Ethics in general is a philosophy that deals with values relating to people’s conduct when it comes to the rightness and wrongness of their actions, and the goodness and badness of the motives of such actions. This examination of people’s conduct is applied to business professionals conducting business activity when analyzing business ethics.

Difference between “lawful” and “ethical”

Many business professionals who are confronted with problems regarding their business activities will justify their decisions based on the legality of the ensuing actions. The fact that a particular action is legal might be enough for an individual to remove herself of any responsibility for negative consequences that might result. This leads to an incorrect thinking that because the legal systems allows it, unethical behavior cannot occur. “Lawful” does not always mean “ethical.”

In 2006, Nike Inc. contracted with a supplier to make its soccer balls. The soccer balls were manufactured in Pakistan before they were sold to Nike, who would then market and sell the product worldwide. Many criticized Nike for its soccer balls being manufactured in Pakistan because child labor was being used for the production line in Pakistan. Of course employing child labor in the United States, where Nike is incorporated, is illegal but American child labor laws differ from Pakistani child labor laws. The child labor used for such production fell within Pakistani laws, so Nike purchasing these soccer balls from its supplier was not illegal under the Pakistani legal system. Later on, this stirred up Western debate and controversy regarding the business ethics of Nike.

What is the ethical decision?

A question that arises when confronted with an ethical dilemma is: “Should I act in a way that will help someone else when this act will go against my self-interest?” This question often results in a debate that is a tug-of-war between differing moral principles. A frequent occurrence, many countries have universally accepted moral principles held by its people already embedded within the nation’s laws. For example, many widely accepted Western moral principles lie within American laws. However, morally accepted principles often differ within countries and cultures throughout the world. We can find differing moral principles with one region, state, city, neighborhood, or even family.

ETHICS IN THE BUSINESS WORLD
Actions taken and decisions made by businesses affect:

- Managers
- Stockholders/Investors
- Employees
- Suppliers
- Distributors
- Customers

A company that practices good business ethics sets an example for all fellow employees. When this happens, a priority of maintaining ethical behavior becomes the norm → employees are less likely to step outside this norm.

The reason businesses engage in unethical behavior stems from immediate self interest, which is detrimental to others.

- greed
- “cutting corners” to save money
- profiting through dishonesty
  o scams
  o false advertisements
  o false reporting
  o tax evasion (illegal)

Potential consequences for unethical business activities:

- lawsuits
- fines
- damaged reputation
- negative portrayal of company by consumers
- investors will withdraw their investments
  o hurts the economy
- lack of trust and credibility; others are less willing to do future business with a company if they lose trust in that company
  o LOSS OF BUSINESS$
The same ethical principles apply to financial institutions as they would to other businesses, large or small. A major motivation in recent cases of unethical business practices in the financial industry is short-term profit. An example would be when a company seeks to beat their quarterly estimates—a mechanism used four times a year that notifies the public of a company’s financial position/performance. However, in order for a company to thrive and maintain viability, long-term goals are more important than short-term goals.

Unethical business practices have wide-reaching effects on many different stakeholders. Such practices in the financial industry were some of the main causes behind the near collapse of the U.S. economy in 2008, not to mention the economic downturn of the entire world.

2007-2010 Financial Crisis

The deregulation of the banking system that was in place originally started in the 1980’s. Commercial banks, investment banks, and other financial institutions had relatively lax restrictions in how they were allowed to conduct their financial activities. Deregulation had its advantages and upsides, but it also allowed greed and fraud to run rampant.

Risky Loans

Financial institutions lent more money to borrowers than they held in their reserves. This kind of leverage was at historic levels. In 2004, the SEC adopted a rule change that led to increased leverage lending practices by investment banks. Loans for residential housing were allowed to be leveraged as much as 25 to 1 and 60 to 1 if the loans were bundled together and financed with securities. These extraordinary leverage ratios did not discourage lenders because these loans were being sold to investors for a profit.

- short-term interest of the investment banks because they knew they were going to make a profit
- based on historical data at the time, the risk appeared to be minimal

Congress made an effort to give everyone an opportunity to own a home. Through governmental agencies (Fannie Mae and Freddie Mac), this effort was pushed forth. Because many people now desired to own a home, many loans were extended. These loans (the homebuyer’s obligation to the bank) were pooled together and sold to investors as mortgage backed securities.

Mortgage Back Securities

Starting from 2000, American home prices were rising to record levels. These elevated home prices warranted more borrowing, hence more loans. Conventional wisdom at the time believed that real estate value would continue to appreciate and would never depreciate. Investment banks and individual investors saw this as an opportunity to invest in these popular securities, which were backed by the mortgage loans.
The overall economy began to falter by way of a culmination of factors (high unemployment, an increasing deficit, and two ongoing wars, just to name a few). Many homebuyers became unable to make good on their mortgage obligations. Financial institutions lost billions of dollars → mortgage backed securities became nearly worthless → investors lost $$$$$. This resulted in what is often called the Subprime Mortgage Crisis.

What can we learn from the Subprime Mortgage Crisis?

Ethical dilemma in the Subprime Mortgage Crisis

- financial institutions were overly leveraged
- predatory lending practices ensued
  - fine print and complicated language in mortgage contracts
- over-extended borrowing
- investor speculation

When dealing with finances, as we have discussed, unethical business practices are often have over-reaching effects. Stakeholders include those outside of business transactions. When investing, one should always maintain a properly leveraged position and understand the risk involved (bonds, stocks, real-estate).

Fostering Ethical Business Practices

When confronted with an ethical dilemma, business managers should think of the bigger picture and ask questions such as: How will this decision affect other stakeholders? To what extent? In the area of conducted business activity, what are the widely accepted moral principles? To foster internal ethical behavior among its employees, a company should constantly review all business activities pursued. Management should also make sure that employees understand the company’s ethical standards. This can be done through seminars, meetings, tutorials, and through maintaining strong level of communication.

Corporations not only have an obligation to company performance in order to satisfy stockholders and investors, but an obligation to society as a whole.

For example:

- obligation to respect the environment (BP Oil Spill)
- a toymaker’s responsibility to produce safe/non-toxic toys
- responsibility of car makers to sell cars with effective brake pads
- messages that cigarette advertisements send to society (glamorizing of cigarette smoking)