



# business<sup>7e</sup>



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# business

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## M: BUSINESS, SEVENTH EDITION

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Dr. Ferrell is past president of the Academy of Marketing Science. He is past president of the Academic Council of the American Marketing Association and chaired the American Marketing Association Ethics Committee. Under his leadership, the committee developed the AMA Code of Ethics and the AMA Code of Ethics for Marketing on the Internet. In addition, he is a former member of the Academy of Marketing Science Board of Governors and is a Society of Marketing Advances and Southwestern Marketing Association Fellow and an Academy of Marketing Science Distinguished Fellow. He served for nine years as the vice president of publications for the Academy of Marketing Science. In 2010, he received a Lifetime Achievement Award from the Macromarketing Society and a special award for service to doctoral students from the Southeast Doctoral Consortium. He received the Harold Berkman Lifetime Service Award from the Academy of Marketing Science and the Cutco Vector Distinguished Marketing Educator Award from the Academy of Marketing Science.

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Dr. Ferrell is the co-author of 20 books and more than 100 published articles and papers. His articles have been published in the *Journal of Marketing Research*, *Journal of Marketing*, *Journal of Business Ethics*, *Journal of Business Research*, *Journal of the Academy of Marketing Science*, *AMS Review*, and the *Journal of Public Policy & Marketing*, as well as other journals.



## GEOFFREY A. HIRT

Geoffrey A. Hirt of DePaul University previously taught at Texas Christian University and Illinois State University, where he was chairman of the Department of Finance and Law. At DePaul, he was chairman of the Finance Department from 1987 to 1997 and held the title of Mesirow Financial Fellow. He developed the MBA program in Hong Kong and served as director of international initiatives for the College of Business, supervising overseas programs in Hong Kong, Prague, and Bahrain, and was awarded the Spirit of St. Vincent DePaul award for his contributions to the university. Dr. Hirt directed the Chartered Financial Analysts (CFA) study program for the Investment Analysts Society of Chicago from 1987 to 2003. He has been a visiting professor at the University of Urbino in Italy, where he still maintains a relationship with the economics department. He received his PhD in finance from the University of Illinois at Champaign-Urbana, his MBA at Miami University of Ohio, and his BA from Ohio Wesleyan University.

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Dr. Hirt is widely known for his textbook *Foundations of Financial Management*, published by McGraw-Hill/Irwin. This book, in its seventeenth edition, has been used in more than 31 countries and translated into more than 14 different languages. Additionally, Dr. Hirt is well known for his textbook *Fundamentals of Investment Management*, also published by McGraw-Hill/Irwin and now in its tenth edition. Dr. Hirt enjoys golf, swimming, music, and traveling with his wife, who is a pianist and opera coach.



## LINDA FERRELL

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Dr. Ferrell is the past president of the Academy of Marketing Science and a past president for the Marketing Management Association. She is a member of the NASBA Center for the Public Trust Board, on the Mannatech Board of Directors, and on the college advisory board for Cutco/Vector. She is also on the Board, Executive Committee, and Academic Advisory Committee of the Direct Selling Education Foundation. She has served as an expert witness in cases related to advertising, business ethics, and consumer protection.



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***M: Business***, seventh edition, offers faculty and students a **focused** resource that is **exciting, applicable, and happening!** What sets this learning program apart from the competition? An unrivaled mixture of exciting content and resources blended with application focused text and activities, and fresh topics and examples that show students what is happening in the world of business today!

Our product contains all of the essentials that most students should learn in a semester. *M: Business* has, since its inception, delivered a focused presentation of the essential material needed to teach introduction to business. An unrivaled mixture of exciting content and resources, application-focused content and activities, and fresh topics and examples that show students what is happening in the world of business today set this text apart!

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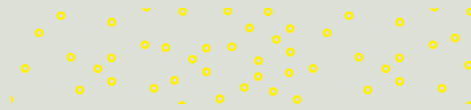
When students see how content applies to them, their life, their career, and the world around them, they are more engaged in the course. *M: Business* helps students maximize their learning efforts by setting clear objectives; delivering interesting cases and examples; focusing on core issues; and providing engaging activities to apply concepts, build skills, and solve problems.

## HAPPENING!

Because it isn't tied to the revision cycle of a larger book, *M: Business* inherits no outdated or irrelevant examples or coverage. Everything in the seventh edition reflects the very latest developments in the business world—such as the COVID-19 (coronavirus) pandemic which resulted in high unemployment, stress on small businesses, and disruption in supply chains. In addition, ethics and social responsibility have become much more important as firms are being rewarded for having a social conscience and addressing unrest and conflicts in society.



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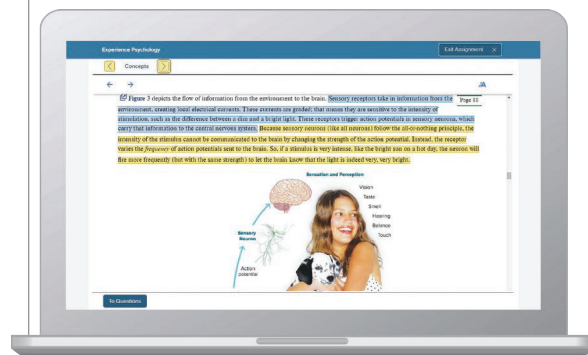
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# New to This Edition

As always, when revising this material for the current edition, all examples, figures, and statistics have been updated to incorporate any recent developments that affect the world of business. Additionally, content was updated to ensure the most pertinent topical coverage is provided.

Here are the highlights for each chapter:

## Chapter one

### THE DYNAMICS OF BUSINESS AND ECONOMICS

- New boxed features describing real-world business issues
- Updated unemployment and GDP data
- New stats on inflation
- New stats on women in the workforce
- New section on technology and the economy
- New examples related to the COVID-19 (coronavirus) pandemic
- New figure depicting artificial intelligence in relation to its enablers

## Chapter two

### BUSINESS ETHICS AND SOCIAL RESPONSIBILITY

- New boxed features describing issues in business ethics and social responsibility
- New data on global trust in different industries
- New examples about ethical issues in the sharing economy
- New content about aggressive financial or business objectives
- New example of a bribery scandal
- Expanded timeline of ethical and socially responsible activities

## Chapter two appendix:

### THE LEGAL AND REGULATORY ENVIRONMENT

- New boxed feature describing issues in the legal and regulatory environment
- New examples of ethical issues facing today's businesses
- New content about data privacy laws

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## Chapter three

### BUSINESS IN A BORDERLESS WORLD

- New boxed features describing issues in international business
- Updated list of top 10 countries with which the United States has trade deficits/surpluses
- New content on the United States–China trade war
- Updated Euro Zone details
- New details on the EU's General Data Protection Regulation (GDPR)
- New content about the United States–Mexico–Canada Agreement (USMCA)
- New table of U.S. top trading partners

## Chapter four

### OPTIONS FOR ORGANIZING BUSINESS

- New boxed features describing real-world business issues
- New table of world's biggest dividend payers
- Updated table of America's largest private companies

## Chapter five

### SMALL BUSINESS, ENTREPRENEURSHIP, AND FRANCHISING

- New boxed features describing current business issues
- Examples of innovative small businesses
- New information on artificial intelligence
- Updated table of the fastest growing franchises
- Updated table of the most business-friendly states
- New stats on small business
- New data on Gen Z in the workforce
- New data on minority-owned businesses

## Chapter six

### THE NATURE OF MANAGEMENT

- New boxed features describing current business issues
- New content about business models
- New table of compensation packages of CEOs
- New content on gender equality

## Chapter seven

### ORGANIZATION, TEAMWORK, AND COMMUNICATION

- New boxed features describing current business issues
- New examples of organizational culture
- New content on artificial intelligence
- New content on email and video conferencing usage in the workplace

## Chapter eight

### MANAGING OPERATIONS AND SUPPLY CHAINS

- New boxed features describing current business operational issues
- New content on marketing research and artificial intelligence
- New section on blockchain technology
- New content on drone technology
- Extensive overhaul of Managing the Supply Chain section
- Updated airline scorecard table
- New examples related to the COVID-19 pandemic and supply chains

## Chapter nine

### MOTIVATING THE WORKFORCE

- New boxed features describing current business issues
- New examples of organizational culture
- New table of best places for businesses and careers

## Chapter ten

### MANAGING HUMAN RESOURCES

- New boxed features describing current HR issues
- Updated common job interview questions
- New content on wage gap
- New example of how soft benefits inspire loyalty
- New section on employee relations and sexual harassment

## Chapter eleven

### CUSTOMER-DRIVEN MARKETING

- New boxed features describing current marketing issues
- New content on marketing orientation
- New content on supply chain management
- New content on marketing analytics dashboards
- New data on the buying power by race/ethnicity
- New table of companies with the best customer service

## Chapter twelve

### DIMENSIONS OF MARKETING STRATEGY

- New boxed features describing current marketing issues
- Logistics added as key term
- New definition for physical distribution key term
- Updated figure depicting a company's product mix
- Updated personal care and cleaning products customer satisfaction ratings
- New examples related to the impact of the COVID-19 pandemic on marketing strategy

## Chapter thirteen

### DIGITAL MARKETING AND SOCIAL MEDIA

- New boxed features describing current digital marketing issues
- New stats on social media use by platform
- New stats on mobile app activities
- New data on the main sources of identity theft
- New section on TikTok

## Chapter fourteen

### ACCOUNTING AND FINANCIAL STATEMENTS

- New boxed features describing current accounting issues
- Updated rankings of accounting firms in the United States
- New financial information for NVIDIA
- New content on net income and corporate tax rate

## Chapter fifteen

### MONEY AND THE FINANCIAL SYSTEM

- New boxed features describing current financial issues
- Updated life expectancy of money
- Updated cost to produce coins
- New content on cryptocurrency
- New content on interest rates
- New content on exchange-traded funds (ETFs)

## Chapter sixteen

### FINANCIAL MANAGEMENT AND SECURITIES MARKETS

- New boxed features describing current financial issues
- Updated short-term investment possibilities
- Updated U.S. corporate bond quotes
- New content on electronic markets
- Updated estimated common stock price-earnings, ratios, and dividends for selected companies
- New table of S&P 500 corrections
- New content on the impacts of the COVID-19 pandemic on financial management



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# business<sup>7e</sup>



## chapter 1

# one

## the dynamics of business and economics

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### LEARNING OBJECTIVES

*After reading this chapter, you will be able to:*

- |  |  |
|--|--|
| <p><b>LO 1-1</b> Define basic concepts such as business, product, profit, and economics.</p> <p><b>LO 1-2</b> Identify the main participants and activities of business.</p> <p><b>LO 1-3</b> Explain why studying business is important.</p> <p><b>LO 1-4</b> Compare the four types of economic systems.</p> | <p><b>LO 1-5</b> Describe the role of supply, demand, and competition in a free-enterprise system.</p> <p><b>LO 1-6</b> Specify why and how the health of the economy is measured.</p> <p><b>LO 1-7</b> Outline the evolution of the American economy.</p> <p><b>LO 1-8</b> Explain the role of the entrepreneur in the economy.</p> |
|--|--|



**W**e begin our study of business in this chapter by examining the fundamentals of business and economics. First, we introduce the nature of business, including

its goals, activities, and participants. Next, we describe the basics of economics and apply them to the U.S. economy. Finally, we establish a framework for studying business in this text. ■

**LO 1-1** Define basic concepts such as business, product, profit, and economics.

## THE NATURE OF BUSINESS

A **business** tries to earn a profit by providing products that satisfy people's needs. The outcomes of its efforts are **products** that have both tangible and intangible characteristics that provide satisfaction and benefits. When you purchase a product, you are buying the benefits and satisfaction you think the product will provide. A Subway sandwich, for example, may be purchased to satisfy hunger, while a Honda Accord may be purchased to satisfy the need for transportation and the desire to present a certain image.

Most people associate the word *product* with tangible goods—an automobile, smartphone, jeans, or some other tangible item. However, a product can also be a service, which occurs when people or machines provide or process something of value to customers. Dry cleaning, a telemedicine visit, a movie or sports event—these are examples of services. An Uber ride satisfies the need for transportation and is therefore a service. A product can also be an idea. Accountants and attorneys, for example, provide ideas for solving problems.

### The Goal of Business

The primary goal of all businesses is to earn a **profit**, the difference between what it costs to make and sell a product and what a customer pays for it. In addition, a business has to pay for all expenses necessary to operate. If a company spends \$8 to produce, finance, promote, and distribute a product that it sells for \$10, the business earns a profit of \$2 on each product sold. Businesses have the right to keep and use their profits as they choose—within legal limits—because profit is the reward for their efforts and for the risks they take in providing products. Earning profits contributes to society by creating resources that support our social institutions and government. Businesses that create profits, pay taxes, and create jobs are the foundation of our economy. In addition, profits must be earned in a responsible manner. Most businesses give back to the community to support social and economic causes. Not all organizations are businesses, however. **Nonprofit organizations**—such as National Public Radio (NPR), Habitat for Humanity, and other charities and social causes—do not have the fundamental purpose

of earning profits, although they may provide goods or services and engage in fund-raising. They also utilize skills related to management, marketing, and finance. Profits earned by businesses support nonprofit organizations through donations from employees.

To earn a profit, a person or organization needs management skills to plan, organize, and control the activities of the business and to find and develop employees so that it can make products consumers will buy. A business also needs marketing expertise to learn what products consumers need and want and to develop, manufacture, price, promote, and distribute those products. Additionally, a business needs financial resources and skills to fund, maintain, and expand its operations. A business must cover the cost of labor, operate facilities, pay taxes, and provide management. Other challenges for businesspeople include abiding by laws and government regulations, and adapting to economic, technological, political, and social changes. Even nonprofit organizations engage in management, marketing, and finance activities to help reach their goals. Nonprofits need employees with the same skills as businesses do.

To achieve and maintain profitability, businesses have found that they must produce quality products, operate efficiently, and be socially responsible and ethical in dealing with customers, employees, investors, government regulators, and the community. Because these groups have a stake in the success and outcomes of a business, they are sometimes called **stakeholders**. Many businesses, for example, are concerned about how the production and distribution of their products affect the environment. Automakers, for example, are working toward taking a bigger slice of the electric vehicle (EV) market. General Motors and Ford are fighting to catch up with Tesla, the leader in EVs, but it could take many years to achieve that goal.<sup>1</sup> Other businesses are concerned with

**business** individuals or organizations who try to earn a profit by providing products that satisfy people's needs.

**product** a good or service with tangible and intangible characteristics that provide satisfaction and benefits.

**profit** the difference between what it costs to make and sell a product and what a customer pays for it.

**nonprofit organizations**

organizations that may provide goods or services but do not have the fundamental purpose of earning profits.

**stakeholders** groups that have a stake in the success and outcomes of a business.



Alex's Lemonade Stand Foundation is a nonprofit organization that raises funds and awareness for childhood cancer.

Rebecca Sapp/Getty Images for L.A. Loves Alex's Lemonade

promoting science, engineering, and mathematics careers among women. Traditionally, these careers have been male dominated. According to Bloomberg, when the number of men and women on a team are evenly matched, the companies have a higher return on equity.<sup>2</sup>

**LO 1-2** Identify the main participants and activities of business.

## The People and Activities of Business

Figure 1.1 shows the people and activities involved in business. At the center of the figure are owners, employees, and customers; the outer circle includes the primary business activities—management, marketing, and finance. Owners have to put up resources—money or credit—to start a business. Employees are responsible for the work that goes on within a business. Owners can manage the business themselves or hire employees to accomplish this task. The president and chief executive officer (CEO) of Procter & Gamble, David S. Taylor, does not own P&G but is an employee who is responsible for managing all the other employees in a way that earns a profit for investors, who are the real owners. Finally, and most importantly, a business's major role is to satisfy the customers who buy its goods or services. Note also that forces beyond an organization's control—such as legal and regulatory forces, the economy, competition, technology, the political environment, and ethical and social concerns—all have an impact on the

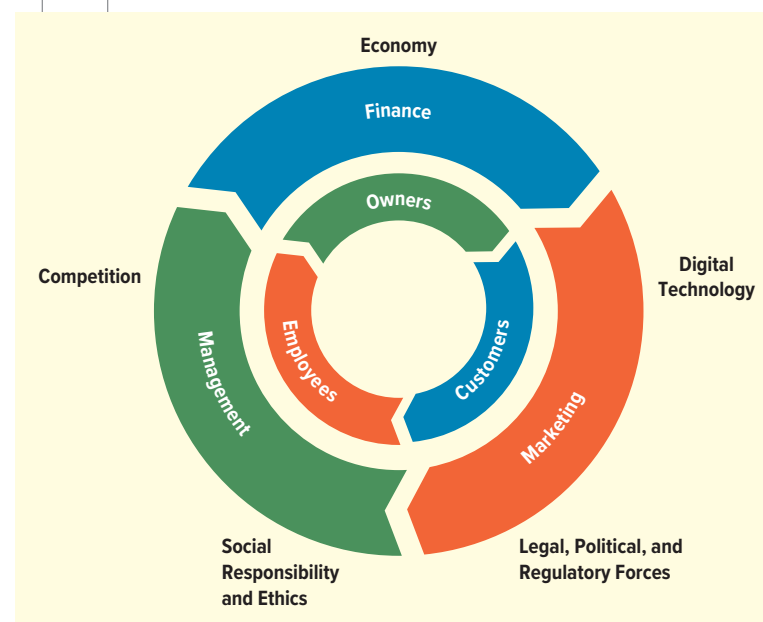
daily operations of businesses. You will learn more about these participants in business activities throughout this book. Next, we will examine the major activities of business.

**Management.** Notice that in Figure 1.1, management and employees are in the same segment of the circle. This is because management involves developing plans, coordinating employees' actions to achieve the firm's goals, organizing people to work efficiently, and motivating them to achieve the business's goals. Management involves the functions of planning, organizing, leading, and controlling. Effective managers who are skilled in these functions display effective leadership, decision making, and delegation of work tasks. Management is also concerned with acquiring, developing, and using resources (including people) effectively and efficiently.

Management involves organization, teamwork, and communication. Operations and supply chain management are also important. Motivating the workforce and managing human resources are necessary for success. Managers at the Ritz-Carlton, for instance, are concerned with transforming resources such as employee actions and hotel amenities into a quality customer service experience. In essence, managers plan, organize, staff, and control the tasks required to carry out the work of the company or nonprofit organization. We take a closer look at management activities in Parts 3 and 4 of this text.

**Marketing.** Marketing and customers are in the same segment of Figure 1.1 because the focus of all marketing activities is satisfying customers. Marketing includes all the activities designed to provide goods and services that satisfy consumers' needs and wants. Marketers gather information

▼ **FIGURE 1.1** Overview of the Business World





and conduct research to determine what customers want. Using information gathered from marketing research, marketers plan and develop products and make decisions about how much to charge for their products and when and where to make them available. They also analyze the marketing environment to understand changes in competition and consumers. The retail environment is changing based on competition from online retailing such as Amazon. This has caused many retail stores and malls to close.<sup>3</sup> Marketing focuses on the four P's—product, price, place (or distribution), and promotion—also known as the marketing mix. Product management involves such key management decisions as product adoption, development, branding, and product positioning. Selecting the right price for the product is essential to the organization as it relates directly to profitability. Distribution is an important management concern because it involves making sure products are available to consumers in the right place at the right time. For example, Stevia in the Raw uses advertising as part of its promotion mix to appeal to consumers who enjoy sweets but want a healthier alternative to sugar. In the advertisement, Stevia in the Raw communicates that its product, a zero-calorie sweetener, reduces sugar and calories for a more healthful recipe. Marketers use promotion—advertising, personal selling, sales promotion (coupons, games, sweepstakes, movie tie-ins), and publicity—to communicate the benefits and advantages of their products to consumers and to increase sales. We will examine marketing activities in Part 5 of this text.

**Finance.** Owners and finance are in the same part of Figure 1.1 because, although management and marketing have to deal with financial considerations, it is the primary responsibility of the owners to provide financial resources for the operation of the business. Accounting, money, and the financial system, as well as understanding the securities market, are important for business success. People who work as accountants, stockbrokers, investment advisors, or bankers are all part of the financial world. Owners sometimes have to borrow money from banks to get started or attract additional investors who become partners or stockholders. Owners of small businesses in particular often rely on bank loans for funding. Part 6 of this text discusses financial management.

**LO 1-3** Explain why studying business is important.

## Why Study Business?

Studying business can help you develop skills and acquire knowledge to prepare for your future career, regardless of whether you plan to work for a multinational *Fortune* 500 firm, start your own business, work for a government agency, or manage or volunteer

Cut the sugar calories in *half* and keep the whole cake.

**NO CONVERSION**  
1 Cup Sugar = 1 Cup Stevia In The Raw®

Reduce sugar, calories and confusion from your recipes by swapping out half the sugar for Stevia In The Raw®. Why only half? Keeping half the sugar is important for moisture, browning and rising. One cup of Stevia In The Raw has the same sweetness as one cup of sugar and pairs well with bold flavors like in this *Mocha Cake with Peanut Butter Frosting*. Get this sweet recipe and more at [InTheRaw.com](http://InTheRaw.com)

Advertising is one method for marketers to promote benefits and advantages of their products. This advertisement features Stevia in the Raw, a sugar alternative, and instructs consumers on how to make cake with half the sugar and calories.

Source: Stevia in the Raw

at a nonprofit organization. The field of business offers a variety of interesting and challenging career opportunities throughout the world, such as marketing, human resources management, information technology, finance, production, accounting, data analytics, and many more.



The Home Depot Foundation's Veteran Housing Grants Program awards grants to assist in the construction of housing and facilities for veterans.

Jill Braaten/McGraw-Hill Education

economics	natural resources	human resources	financial resources	economic system
the study of how resources are distributed for the production of goods and services within a social system.	land, forests, minerals, water, and other things that are not made by people.	(labor) the physical and mental abilities that people use to produce goods and services.	(capital) the funds used to acquire the natural and human resources needed to provide products.	a description of how a particular society distributes its resources to produce goods and services.

Studying business can also help you better understand the many business activities that are necessary to provide satisfying goods and services. Most businesses charge a reasonable price for their products to ensure that they cover their production costs, pay their employees, provide their owners with a return on their investment, and perhaps give something back to their local communities and societies. The Home Depot Foundation has provided grants to remodel and renovate homes of U.S. military veterans.<sup>4</sup> Thus, learning about business can help you become a well-informed consumer and member of society.

Business activities help generate the profits that are essential not only to individual businesses and local economies but also to the health of the global economy. Understanding how our free-enterprise economic system allocates resources and provides incentives for industry and the workplace is important to everyone.

**LO 1-4** Compare the four types of economic systems.

## THE ECONOMIC FOUNDATIONS OF BUSINESS

It is useful to explore the economic environment in which business is conducted. In this section, we examine economic systems, the free-enterprise system, the concepts of supply and demand, and the role of competition. These concepts play important roles in determining how businesses operate in a particular society.

**Economics** is the study of how resources are distributed for the production of goods and services within a social system. You are already familiar with the types of resources available. Land, forests, minerals, water, and other things that are not made by people are **natural resources**. **Human resources**, or **labor**, refer to the physical and mental abilities that people use to produce goods and services. **Financial resources**, or **capital**, are the funds used to acquire the natural and human resources needed to provide products. These resources are related to the *factors of production*, consisting of land, labor, capital, and enterprise used to produce goods and services. The firm can also have intangible resources such as a good reputation for quality

products or being socially responsible. The goal is to turn the factors of production and intangible resources into a competitive advantage.

### Economic Systems

An **economic system** describes how a particular society distributes its resources to produce goods and services. A central issue of economics is how to fulfill an unlimited demand for goods and services in a world with a limited supply of resources. Different economic systems attempt to resolve this central issue in numerous ways, as we shall see.

Although economic systems handle the distribution of resources in different ways, all economic systems must address three important issues:

1. What goods and services, and how much of each, will satisfy consumers' needs?
2. How will goods and services be produced, who will produce them, and with what resources will they be produced?
3. How are the goods and services to be distributed to consumers?

Communism, socialism, and capitalism, the basic economic systems found in the world today (Table 1.1), have fundamental differences in the way they address these issues. The factors of production in command economies are controlled by government planning. In many cases, the government owns or controls the production of goods and services. Communism and socialism are, therefore, considered command economies.

**Communism.** Karl Marx (1818–1883) first described **communism** as a society in which the people, without regard to class, own all the nation's resources. In his ideal political-economic system, everyone contributes according to ability and receives benefits according to need. In a communist economy, the people (through the government) own and operate all businesses and factors of production. Central government planning determines what goods and services satisfy citizens' needs, how the goods and services are produced, and how they are distributed. However, no true communist economy exists today that satisfies Marx's ideal.

On paper, communism appears to be efficient and equitable, producing less of a gap between rich and poor. In practice, however, communist economies have been marked by low standards of living, critical shortages of consumer goods, high prices, corruption, and little freedom. Russia, Poland, Hungary, and other eastern European nations have turned away from communism and toward economic systems governed by supply and demand



rather than by central planning. However, their experiments with alternative economic systems have been fraught with difficulty and hardship. Countries such as Venezuela have tried to incorporate communist economic principles without success. Even Cuba is experiencing changes to its predominately communist system. Similarly, China was the first communist country to make strong economic gains by adopting capitalist approaches to business. Economic prosperity has advanced in China with the government claiming to ensure market openness, equality, and fairness through state capitalism.<sup>5</sup> As a result of economic challenges, communism is declining and its future as an economic system is uncertain.

**Socialism.** Socialism is an economic system in which the government owns and operates basic industries—postal service, telephone, utilities, transportation, health care, banking, and some manufacturing—but individuals own most businesses. For example, in France the postal service industry La Poste is fully owned by the French government and makes a profit. Central planning determines what basic goods and services are produced, how they are produced, and how they are distributed. Individuals and small businesses provide other goods and services based on consumer demand and the availability of resources. Citizens are dependent on the government for many goods and services.

Most socialist nations, such as Norway, India, and Israel, are democratic and recognize basic individual freedoms. Citizens can vote for political offices, but central government planners usually make many decisions about what is best for the nation. For example, based on government policies and incentives, 60 percent of the new cars purchased in Norway are electric.<sup>6</sup> People are free to go into the occupation of their choice, but they often work in government-operated organizations. Socialists believe their system permits a higher standard of living than other economic systems, but the difference often applies to the nation as a whole rather than to its individual citizens. Socialist



Cuba's new constitution promotes socialism rather than communism.

Anton\_Ivanov/Shutterstock

economies profess egalitarianism—equal distribution of income and social services. They believe their economies are more stable than those of other nations. Although this may be true, taxes and unemployment are generally higher in socialist countries. However, countries like Denmark have a high standard of living and they rate high in being happy.

**Capitalism.** Capitalism, or free enterprise, is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Competition, supply, and demand determine which goods and services are produced, how

**communism** first described by Karl Marx as a society in which the people, without regard to class, own all the nation's resources.

**socialism** an economic system in which the government owns and operates basic industries but individuals own most businesses.

**capitalism (free enterprise)** an economic system in which individuals own and operate the majority of businesses that provide goods and services.

▼ **TABLE 1.1** Comparison of Communism, Socialism, and Capitalism

	Communism	Socialism	Capitalism
Business ownership	Most businesses are owned and operated by the government.	The government owns and operates some basic industries; individuals also own businesses.	Individuals own and operate all businesses.
Competition	Government controls competition and the economy.	Restricted in basic industries; encouraged in other businesses.	Encouraged by market forces and government regulations.
Profits	Excess income goes to the government. The government supports social and economic institutions.	Profits earned by businesses may be reinvested in the business; profits from government-owned industries go to the government.	Individuals and businesses are free to keep profits after paying taxes.
Product availability and price	Consumers have a limited choice of goods and services; prices are usually high.	Consumers have a choice of goods and services; prices are determined by supply and demand.	Consumers have a wide choice of goods and services; prices are determined by supply and demand.
Employment options	Little choice in choosing a career; most people work for government-owned industries or farms.	More choice of careers; many people work in government jobs.	Unlimited choice of careers.

### free-market system

pure capitalism, in which all economic decisions are made without government intervention.

### mixed economies

economies made up of elements from more than one economic system.

they are produced, and how they are distributed. The United States, Canada, Japan, and Australia are examples of economic systems based on capitalism.

There are two forms of capitalism: pure capitalism and modified capitalism. In pure capitalism, also called a **free-market system**, all economic decisions are made

without government intervention. This economic system was first described by Adam Smith in *The Wealth of Nations* (1776). Smith, often called the father of capitalism, believed that the “invisible hand of competition” best regulates the economy. He argued that competition should determine what goods and services people need. Smith’s system is also called *laissez-faire* (“let it be”) *capitalism* because the government does not interfere in business.

Modified capitalism differs from pure capitalism in that the government intervenes and regulates business to some extent. One of the ways in which the United States and Canadian governments regulate business is through laws. Laws such as the Federal Trade Commission Act, which created the Federal Trade Commission to enforce antitrust laws, illustrate the importance of the government’s role in the economy. In the United States, states have leeway to regulate business. For example, the state of California requires public companies to have at least one woman on the board of directors, and a number of states have legalized cannabis.<sup>7</sup>

“No country practices a pure form of communism, socialism, or capitalism, although most tend to favor one system over the others.”

**Mixed Economies.** No country practices a pure form of communism, socialism, or capitalism, although most tend to favor one system over the others. Most nations operate as **mixed economies**, which have elements from more than one economic system. In socialist Sweden, most businesses are owned and operated by private individuals. In capitalist United States, an independent federal agency operates the postal service and another independent agency operates the Tennessee Valley Authority, an electric utility. In Germany, the Deutsche Post is privatized and trades on the stock market. In once-communist Russia, Hungary, Poland, and other eastern European nations, capitalist ideas have been implemented, including private ownership of businesses.

Countries such as China and Russia have used state capitalism to advance the economy. State capitalism tries to integrate the powers of the state with the advantages of capitalism. It is led by

the government but uses capitalistic tools such as listing state-owned companies on the stock market and embracing globalization.<sup>8</sup> State capitalism includes some of the world’s largest companies such as Russia’s Gazprom, which has the largest reserves of natural gas. China’s ability to make huge investments to the point of creating entirely new industries puts many private industries at a disadvantage.<sup>9</sup>

## The Free-Enterprise System

Many economies—including those of the United States, Canada, and Japan—are based on free enterprise, and many communist and socialist countries, such as China and Russia, are applying more principles of free enterprise to their own economic systems. Free enterprise provides an opportunity for a business to succeed or fail on the basis of market demand. In a free-enterprise system, companies that can efficiently manufacture and sell products that consumers desire will probably succeed. Inefficient businesses and those that sell products that do not offer needed benefits will likely fail as consumers take their business to firms that have more competitive products.

A number of basic individual and business rights must exist for free enterprise to work. These rights are the goals of many countries that have recently embraced free enterprise.

1. Individuals must have the right to own property and to pass this property on to their heirs. This right motivates people to work hard and save to buy property.
2. Individuals and businesses must have the right to earn profits and to use the profits as they wish, within the constraints of their society’s laws, principles, and values.
3. Individuals and businesses must have the right to make decisions that determine the way the business operates. Although there is government regulation, the philosophy in countries like the United States and Australia is to permit maximum freedom within a set of rules of fairness.
4. Individuals must have the right to choose what career to pursue, where to live, what goods and services to purchase, and more. Businesses must have the right to choose where to locate, what goods and services to produce, what resources to use in the production process, and so on.

Without these rights, businesses cannot function effectively because they are not motivated to succeed. Thus, these rights make possible the open exchange of goods and services. In the countries that favor free enterprise, such as the United States, citizens have the freedom to make many decisions about the employment they choose and create their own productivity systems.

Many entrepreneurs are more productive in free-enterprise societies because personal and financial incentives are available that can aid in entrepreneurial success. For many entrepreneurs, their work becomes a part of their system of goals, values, and lifestyle. Consider the panelists (“sharks”) on the ABC program *Shark Tank* who give entrepreneurs a chance to receive funding to realize their dreams by deciding whether to invest in their projects. They include Barbara Corcoran, who built one of New York’s largest real estate companies; Mark Cuban, founder of MicroSolutions and Broadcast.com; and Daymond John, founder of clothing company FUBU, as well as others.<sup>10</sup>

**LO 1-5** Describe the role of supply, demand, and competition in a free-enterprise system.

## The Forces of Supply and Demand

In the United States and in other free-enterprise systems, the distribution of resources and products is determined by supply and demand. **Demand** is the number of goods and services that consumers are willing to buy at different prices at a specific time. From your own experience, you probably recognize that consumers are usually willing to buy more of an item as its price falls because they want to save money. Consider handmade rugs, for example. Consumers may be willing to buy six rugs at \$350 each, four at \$500 each, but only two at \$650 each. The relationship between the price and the number of rugs consumers are willing to buy can be shown graphically with a *demand curve* (see Figure 1.2).

**Supply** is the number of products that businesses are willing to sell at different prices at a specific time. In general, because the

**demand** the number of goods and services that consumers are willing to buy at different prices at a specific time.

**supply** the number of products—goods and services—that businesses are willing to sell at different prices at a specific time.

**equilibrium price** the price at which the number of products that businesses are willing to supply equals the amount of products that consumers are willing to buy at a specific point in time.

potential for profits is higher, businesses are willing to supply more of a good or service at higher prices. For example, a company that sells rugs may be willing to sell six at \$650 each, four at \$500 each, but just two at \$350 each. The relationship between the price of rugs and the quantity the company is willing to supply can be shown graphically with a *supply curve* (see Figure 1.2).

In Figure 1.2, the supply and demand curves intersect at the point where supply and demand are equal. The price at which the number of products that businesses are willing to supply equals the amount of products that consumers are willing to buy at a specific point in time is the **equilibrium price**. In our rug example, the company is willing to supply four rugs at \$500 each, and consumers are willing to buy four rugs at \$500 each. Therefore, \$500 is the equilibrium price for a rug at that point in time, and most rug companies will price their rugs at \$500. As you might imagine, a business that charges more than \$500 (or whatever the current equilibrium price is) for its rugs will not sell as many and might not earn a profit. On the other hand, a business that charges less than \$500 accepts a lower profit per rug than could be made at the equilibrium price.

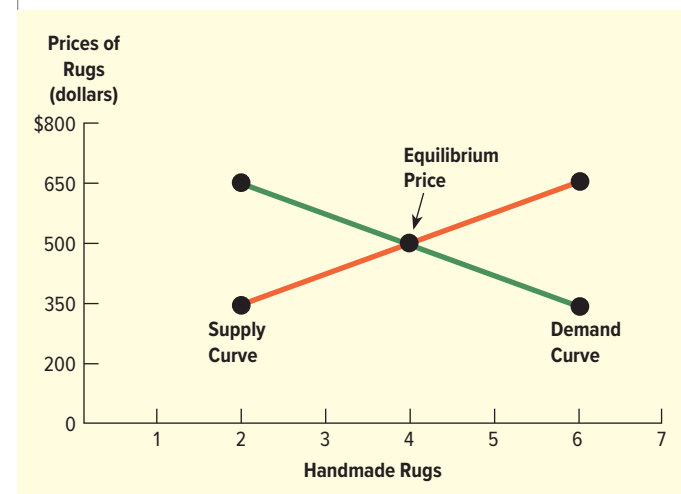
If the cost of making rugs goes up, businesses will not offer as many at the old price. Changing the price alters the supply curve, and a new equilibrium price results. This is an ongoing process, with supply and demand constantly changing in response to changes in economic conditions, availability of resources, and degree of competition. For example, the price of oil can change rapidly and has been between \$0 and \$113 a barrel over the last 10 years. Oil prices dropped below \$0 when demand went down rapidly and supply



Oprah Winfrey, with a net worth of more than \$3 billion, is one of the world’s most famous entrepreneurs. Entrepreneurs are more productive in free-enterprise systems.

Frederic J. Brown/AFP/Getty Images

**FIGURE 1.2**  
Equilibrium Price of Handmade Rugs





## TAYLOR SWIFT FIGHTS SCALPERS

For fans of popular singers like Taylor Swift, the demand for concert tickets is high. Fans must often hurry to purchase tickets before they are sold out. Because there are a limited number of seats, when demand is high the equilibrium price is high as well. While this is profitable for the performer, it also creates opportunities for ticket scalpers.

Because of high demand for certain performers and a limited supply of seats, scalpers know there is a market of fans willing to pay much more than the original price online. This gives them opportunities to purchase large numbers of ticket and sell at a premium on sites like Stub Hub. It is estimated that ticket scalping cost Taylor Swift \$85 million during one tour.

Two scalpers in the United Kingdom used bot software and multiple identities to illegally buy and sell tickets, making more than £10.8 million (\$14 million). The duo received a collective jail sentence of six and half years from a U.K. court. It was a landmark ruling as it was the first prosecution of its kind in the United Kingdom. As technology advances, it becomes increasingly difficult to fend off cybercriminals.

To fight against scalpers, Swift joined with Ticketmaster to use its Verified Fan system to locate fans less likely to resell their tickets. Fans register and—if they are identified by Ticketmaster's Verified Fan system—they are sent a link that gives them early access to tickets. Swift also added boosters to the system, giving

fans a better chance of being selected if they buy albums, watch music videos, or post about her on social media. The system offers a solution to reward fans and fight against a practice that takes advantage of high demand and limited supply.<sup>a</sup>

### Critical Thinking Questions

1. Describe how the supply-demand problem is offering opportunities for scalpers.
2. Scalpers raise the equilibrium price once they control the supply. How do you think this Ticketmaster Verified Fan System will affect this ability?
3. As a service provider, do you think performers like Taylor Swift should take an active role in fighting against scalpers? Why or why not?

**competition** the rivalry among businesses for consumers' dollars.

**pure competition** the market structure that exists when there are many small businesses selling one standardized product.

**monopolistic competition** the market structure that exists when there are fewer businesses than in a pure-competition environment and the differences among the goods they sell are small.

“Competition allows for open markets and provides opportunities for both individuals and businesses to successfully compete.”

increased during the COVID-19 pandemic. Oil prices returned to more than \$30 a barrel about a month later when supply and demand were more balanced. Prices for goods and services vary according to these changes in supply and demand. Supply and demand is the force that drives the distribution of resources (goods and services, labor, and money) in a free-enterprise economy.

Critics of supply and demand say the system does not distribute resources equally. The forces of supply and demand prevent sellers who have to sell at higher prices (because their costs are high) and buyers who cannot afford to buy goods at the equilibrium price from participating in the market. According to critics, the wealthy can afford to buy more than they need, but the poor may be unable to buy enough of what they need to survive.

## The Nature of Competition

**Competition**, the rivalry among businesses for consumers' dollars, is another vital element in free enterprise. According to Adam Smith, competition fosters efficiency and low prices by forcing producers to offer the best products at the most reasonable price; those who fail to do so are not able to stay in business. Thus, competition should improve the quality of the goods and services available and reduce prices. Competition allows for open markets and provides opportunities for both individuals and businesses to successfully compete. Entrepreneurs can discover new technology, ways to lower prices, as well as methods for providing better distribution or services. Founder Jeff Bezos of Amazon is a prime example. Amazon is able to offer products online at competitive prices. Today, Amazon competes against such retail giants as Walmart and Target in a number of industries, including cloud computing, entertainment, food, and most consumer products found in retail stores. Bezos's Blue Origin rocket company along with Elon Musk's SpaceX and Richard Branson's Virgin Galactic have turned space tourism into a reality.<sup>11</sup>

Within a free-enterprise system, there are four types of competitive environments: pure competition, monopolistic competition, oligopoly, and monopoly.

**Pure competition** exists when there are many small businesses selling one standardized product, such as agricultural commodities like wheat, corn, and cotton. No one business sells enough of the product to influence the product's price. And, because there is no difference in the products, prices are determined solely by the forces of supply and demand.

**Monopolistic competition** exists when there are fewer businesses than in a pure-competition environment and the

differences among the goods they sell are small. Aspirin, soft drinks, and jeans are examples of such goods. These products differ slightly in packaging, warranty, name, and other characteristics, but all satisfy the same consumer need. Businesses have some power over the price they charge in monopolistic competition because they can make consumers aware of product differences through advertising. Consumers value some features more than others and are often willing to pay higher prices for a product with the features they want. For example, many consumers are willing to pay a higher price for organic fruits and vegetables rather than receive a bargain on nonorganic foods. The same holds true for non-genetically modified foods.

An **oligopoly** exists when there are very few businesses selling a product. In an oligopoly, individual businesses have control over their products' price because each business supplies a large portion of the products sold in the marketplace. Nonetheless, the prices charged by different firms stay fairly close because a price cut or increase by one company will trigger a similar response from another company. In the airline industry, for example, when one airline cuts fares to boost sales, other airlines quickly follow with rate decreases to remain competitive. On the other hand, airlines often raise prices at the same time. Oligopolies exist when it is expensive for new firms to enter the marketplace. Not just anyone can acquire enough financial capital to build an automobile production facility or purchase enough airplanes and related resources to build an airline.

When there is one business providing a product in a given market, a **monopoly** exists. Utility companies that supply

**oligopoly** the market structure that exists when there are very few businesses selling a product.

**monopoly** the market structure that exists when there is only one business providing a product in a given market.

**economic expansion** the situation that occurs when an economy is growing and people are spending more money; their purchases stimulate the production of goods and services, which in turn stimulates employment.

electricity, natural gas, and water are monopolies. The government permits such monopolies because the cost of creating the good or supplying the service is so great that new producers cannot compete for sales. Government-granted monopolies are subject to government-regulated prices. Some monopolies exist because of technological developments that are protected by patent laws. This monopoly allows the developer to recover research, development, and production expenses and to earn a reasonable profit. A drug can receive a 17-year patent from the time it is discovered or the chemical is identified. For example, Tamiflu lost its patent, and now the generic version can be made by other firms.

## Economic Cycles and Productivity

**Expansion and Contraction.** Economies are not stagnant; they expand and contract. **Economic expansion** occurs when an economy is growing and people are spending more money. Their purchases stimulate the production of goods and services, which in turn stimulates employment. The standard of living rises because more people are employed and have money to spend. Rapid expansions of the economy, however, may

## COMPETITION IS BREWING IN KOMBUCHA MARKET

Kombucha might be fizzy like a soft drink, but it has health benefits that soft drinks lack. Kombucha is made by brewing tea, then adding sugar. Afterward the mixture is fermented with a blend of yeast and bacteria called scoby. The bacteria the drink contains makes kombucha a probiotic that helps digestion and gut health. Scoby cultures can produce an endless supply of kombucha, reducing waste and enabling consumers to brew kombucha in their homes.

Kombucha manufacturers operate in a monopolistic competitive industry. Because kombucha is relatively easy to produce, manufacturers take steps to differentiate their

products, such as developing drinks in a variety of unique, fruity flavors. With consumer interest in the beverage skyrocketing, the demand is encouraging the entrance of new competitors.

PepsiCo spent around \$200 million to acquire KeVita, and Coca-Cola has a stake in Health-Ade. Starbucks has its own line of kombucha under its Evolution Fresh brand. These steps are prompting traditional kombucha manufacturers to become more competitive. For instance, Brew Dr., one of the leading kombucha brands, has advertised its drinks with Portland's soccer teams to increase awareness.

Analysts have compared kombucha to yogurt not only for its probiotic qualities, but for

its market qualities. The industry is expected to grow and diversify in the future. The competition between smaller kombucha manufacturers and more established rivals is heating up.<sup>b</sup>

### Critical Thinking Questions

1. Why is the competition in the kombucha industry an example of monopolistic competition?
2. How are the forces of supply and demand convincing more established brands like PepsiCo to enter the industry?
3. If more and more entrants enter the industry, what do you think will happen to the price of kombucha?

<b>inflation</b> a condition characterized by a continuing rise in prices	<b>economic contraction</b> a slowdown of the economy characterized by a decline in spending and during which businesses cut back on production and lay off workers.	<b>recession</b> a decline in production, employment, and income.	<b>unemployment</b> the condition in which a percentage of the population wants to work but is unable to find jobs.	<b>depression</b> a condition of the economy in which unemployment is very high, consumer spending is low, and business output is sharply reduced.
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result in **inflation**, a continuing rise in prices. Inflation can be harmful if individuals' incomes do not increase at the same pace as rising prices, reducing their buying power. Venezuela inflation reached 10 million percent in 2019.<sup>12</sup>

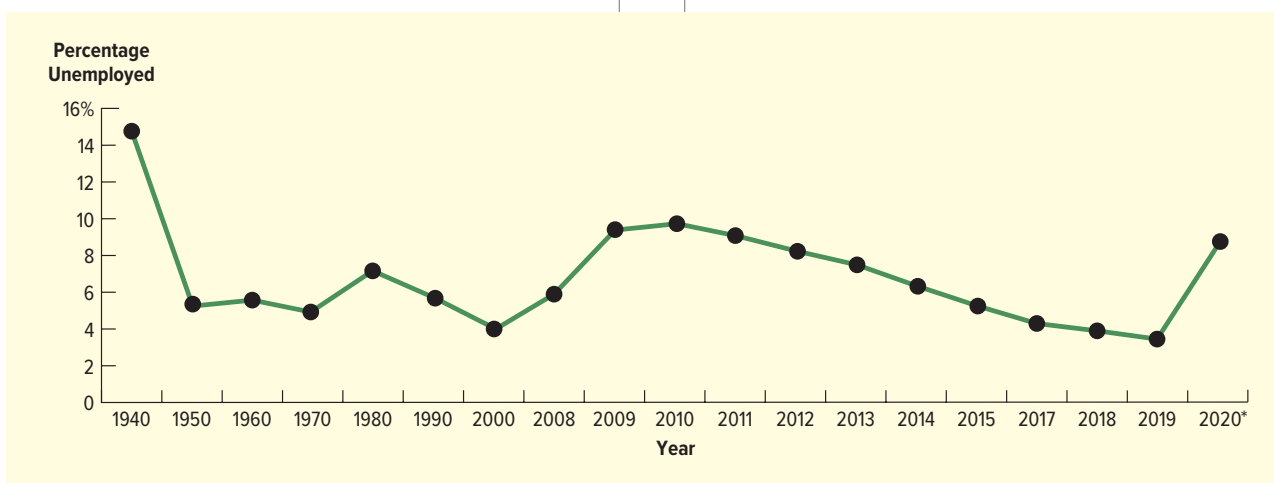
**Economic contraction** occurs when spending declines. Businesses cut back on production and lay off workers, and the economy as a whole slows down. Contractions of the economy lead to **recession**—a decline in production, employment, and income. Recessions are often characterized by rising levels of **unemployment**, which is measured as the percentage of the population that wants to work but is unable to find jobs. Figure 1.3 shows the overall unemployment rate in the civilian labor force over the past 75 years. Rising unemployment levels tend to stifle demand for goods and services, which can have the effect of forcing prices downward, a condition known as *deflation*. Deflation poses a serious economic problem because price decreases could result in consumers delaying purchases. If consumers wait for lower prices, the economy could fall into a recession.

The United States has experienced numerous recessions, the most recent ones occurring in 1990–1991, 2002–2003, 2008–2011, and 2020. The Great Recession of 2008–2011 was caused by the collapse in housing prices and consumers' inability to stay current on their mortgage and credit card payments. This caused a crisis in the banking industry, with the government bailing out banks to keep them from failing. This in turn caused a slowdown in spending on

consumer goods and a decrease in employment. Unemployment reached 10 percent of the labor force. Ten years later, unemployment was nearing a 50-year low, but during the COVID-19 (coronavirus) pandemic, the unemployment rate skyrocketed to a record 14.7 percent in 2020, the worst since the Great Depression.<sup>13</sup> As Americans were urged to stay home to prevent the spread of the virus, nonessential businesses—such as clothing stores, gyms, and salons—shuttered and many were forced to layoff employees. Even restaurants, many of which remained open for pickup and delivery, suffered greatly. Though online and non-store sales were up 21.2 percent year over year, overall retail sales were down 21.6 percent, according to the U.S. Census Bureau.<sup>14</sup> Don't forget that personal consumption makes up almost 70 percent of gross domestic product, so consumer engagement is extremely important for economic activity. A severe recession may turn into a **depression**, in which unemployment is very high, consumer spending is low, and business output is sharply reduced, such as what occurred in the United States in the early 1930s.

Economies expand and contract in response to changes in consumer, business, and government spending. War also can affect an economy, sometimes stimulating it (as in the United States during World Wars I and II) and sometimes stifling it (as during the Vietnam, Persian Gulf, and Iraq wars). Although fluctuations in the economy are inevitable and to a certain extent predictable, their effects—inflation and unemployment—disrupt lives and thus governments try to minimize them.

▼ **FIGURE 1.3** Annual Average Unemployment Rate, Civilian Labor Force, 16 Years and Over

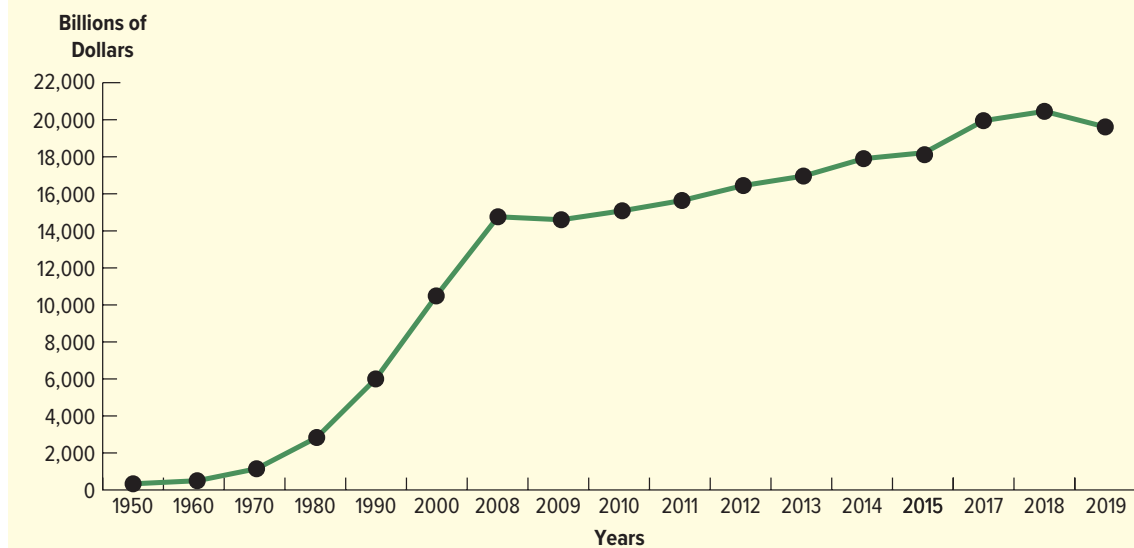


Sources: Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey," <http://data.bls.gov/timeseries/LNS14000000> (accessed May 14, 2020).

\*Average based on data available from January–July, 2020.



**FIGURE 1.4**  
Change in U.S.  
Gross Domestic  
Product



**Source:** U.S. Department of Commerce Bureau of Economic Analysis, "National Economic Accounts," [www.bea.gov/national/index.htm#gdp](http://www.bea.gov/national/index.htm#gdp) (accessed May 14, 2020).

**LO 1-6** Specify why and how the health of the economy is measured.

**Measuring the Economy.** Countries measure the state of their economies to determine whether they are expanding or contracting and whether corrective action is necessary to minimize the fluctuations. One commonly used measure is **gross domestic product (GDP)**—the sum of all goods and services produced in a country during a year. GDP measures only those goods and services made within a country and therefore does not include profits from companies' overseas operations; it does include profits earned by foreign companies within the country being measured. However, it does not take into account the concept of GDP in relation to population (GDP per capita). Figure 1.4 shows the increase in U.S. GDP over several years.

Another important indicator of a nation's economic health is the relationship between its spending and income (from taxes). When a nation spends more than it takes in from taxes, it has a **budget deficit**. In the 1990s, the U.S. government eliminated its long-standing budget deficit by balancing the money spent for social, defense, and other programs with the amount of money taken in from taxes.

In recent years, however, the budget deficit has reemerged and grown to record levels. Because many Americans

do not want their taxes increased and Congress has difficulty agreeing on appropriate tax rates, it is difficult to increase taxes and reduce the deficit. Like consumers and businesses, when the government needs money, it borrows from the public, banks, and even foreign investors. The national debt is more than \$25 trillion.<sup>15</sup> This figure

is especially worrisome because to reduce the debt to a manageable level, the government either has to increase its revenues (raise taxes) or reduce spending on social, defense, and legal programs, neither of which is politically popular. The national debt figure changes daily and can be seen at the Department of the Treasury, Bureau of the Public Debt, website. Table 1.2 describes some of the other ways we evaluate our nation's economy.

**gross domestic product (GDP)** the sum of all goods and services produced in a country during a year.

**budget deficit** the condition in which a nation spends more than it takes in from taxes.

**TABLE 1.2** How Do We Evaluate Our Nation's Economy?

Unit of Measure	Description
Trade balance	The difference between our exports and our imports. If the balance is negative, as it has been since the mid-1980s, it is called a trade deficit and is generally viewed as unhealthy for our economy.
Consumer Price Index	Measures changes in prices of goods and services purchased for consumption by typical urban households.
Per capita income	Indicates the income level of "average" Americans. Useful in determining how much "average" consumers spend and how much money Americans are earning.
Unemployment rate	Indicates how many working-age Americans are not working who otherwise want to work.
Inflation	Monitors price increases in consumer goods and services over specified periods of time. Used to determine if costs of goods and services are exceeding worker compensation over time.
Worker productivity	The amount of goods and services produced for each hour worked.

**standard of living** refers to the level of wealth and material comfort that people have available to them.

**open economy** an economy in which economic activities occur between the country and the international community.

**LO 1-7** Outline the evolution of the American economy.

## THE AMERICAN ECONOMY

As we said previously, the United States is a mixed economy with a foundation based on capitalism. The answers to the three basic economic issues are determined primarily by competition and the forces of supply and demand, although the federal government does intervene in economic decisions to a certain extent. For instance, the federal government exerts oversight over the airline industry to make sure airlines remain economically viable as well as for safety and security purposes.

**Standard of living** refers to the level of wealth and material comfort that people have available to them. The United States, Germany, Australia, and Norway all have a high standard of living, meaning that most of their citizens are able to afford basic necessities and some degree of comfort. These nations are often characterized by a high GDP per capita. However, a higher GDP per capita does not automatically translate into a higher standard of living. Costs of goods and services are also factors. The European Union and Japan, for instance, tend to have higher costs of living than in the United States. Higher prices mean that it costs more to obtain a certain level of comfort than it does in other countries. Countries with low standards of living are usually characterized by poverty, higher unemployment, and lower education rates. To understand the current state of the American economy and its effect on business practices, it is helpful to examine its history and the roles of the entrepreneur and the government.

### The Importance of the American Economy

The American economy is an **open economy**, or an economy in which economic activities occur between the country and the international community. As an open economy, the United States is a major player in international trade. Open economies tend to grow faster than economies that do not engage in international trade. This is because international trade is positively related to efficiency and productivity. Companies in the United States have greater access to a wider range of resources and knowledge, including technology. In today's global environment, the ability to harness technology is critical toward increased innovation.<sup>16</sup> In contrast, research indicates a negative relationship between regulatory actions and innovation in firms, suggesting that too much regulation hinders business activities and their contribution to the American economy.<sup>17</sup>

When looking at the American economy, growth in GDP and jobs are the two primary factors economists consider. A positive relationship exists between a country's employment rate and economic growth. A nation's output depends on the amount of labor used in the production process, so there is also a positive correlation between output and employment. In general, as the labor force and productivity increase, so does GDP. Profitable companies tend to hire more workers than those that are unprofitable. Therefore, companies that hire employees not only improve their profitability but also drive the economic well-being of the American economy.<sup>18</sup>

Government public policy often moves quickly to protect the economy. For example, during the COVID-19 pandemic, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act to provide financial assistance to small business, state and local governments, as well as some larger firms. For individuals, each adult with an income of less than \$99,000 received a direct payment of up to \$1,200 and \$500 per child or up to \$3,400 for a family of four. This historic action was designed to protect the economy while many businesses had to close to prevent the spread of the virus.<sup>19</sup>

Government public policy also drives the economy through job creation. In order for any nation to ensure the social and economic health of the country, there must be a tax base to provide for the public interest. The vast majority of taxes come from individuals. It is estimated that the U.S. government obtains \$2.6 trillion in individual income taxes annually.<sup>20</sup> Individuals who earn more than \$510,300 pay 37 percent of individual income taxes.<sup>21</sup>

Businesses are also an important form of tax revenue. Those that are classified as sole proprietorships, partnerships, and S corporations (discussed further in the chapter titled "Options for Organizing Business") pay taxes according to the individual income tax code. Corporations are taxed differently. Approximately 4.4 percent of the government's total revenues comes from corporate income taxes.<sup>22</sup> In 2017, the largest tax reform in the U.S. tax rate in over 30 years changed the corporate tax rate from 35 percent to 21 percent.<sup>23</sup> The average global corporate tax rate is 24 percent, while some countries such as Ireland have a corporate tax rate as low as 12.5 percent. The U.S. tax reform lowered the highest individual tax rate from 39.6 percent to 37 percent, but the reform capped the deduction of state and local taxes at \$10,000.<sup>24</sup>

### A Brief History of the American Economy

**The Early Economy.** Before the colonization of North America, Native Americans lived as hunter/gatherers and farmers, with some trade among tribes. The colonists who came later operated primarily as an *agricultural economy*. People were self-sufficient and produced everything they needed at home, including food, clothing, and furniture. Abundant natural resources

and a moderate climate nourished industries such as farming, fishing, shipping, and fur trading. A few manufactured goods and money for the colonies' burgeoning industries came from England and other countries.

As the nation expanded slowly toward the West, people found natural resources such as coal, copper, and iron ore and used them to produce goods such as horseshoes, farm implements, and kitchen utensils. Farm families who produced surplus goods sold or traded them for things they could not produce themselves, such as coffee, salt, and farm equipment. Some families also spent time turning raw materials into clothes and household goods. Because these goods were produced at home, this system was called the domestic system.

**The Industrial Revolution.** The 19th century and the Industrial Revolution brought the development of new technology and factories. The factory brought together all the resources needed to make a product—materials, machines, and workers. Work in factories became specialized as workers focused on one or two tasks. As work became more efficient, productivity increased, making more goods available at lower prices. Railroads brought major changes, allowing farmers to send their agricultural products all over the nation to markets.

Factories began to spring up along the railways to manufacture farm equipment and products such as textiles, clothing, and household items to be shipped by rail. Eli Whitney revolutionized the cotton industry with his cotton gin. John Deere's farm equipment increased farm production and reduced the number of farmers required to feed the young nation. Farmers began to move to cities to find jobs in factories and a higher standard of living. Henry Ford developed the assembly-line system to produce automobiles. Workers focused on one part of an automobile and then pushed it to the next stage until it rolled off the assembly line as a finished automobile. Ford's assembly line could manufacture many automobiles efficiently, and the price of his cars was \$200, making them affordable to many Americans.

### The Manufacturing and Marketing Economies.

Industrialization brought increased prosperity, and the United States gradually became a *manufacturing economy*—one devoted to manufacturing goods and providing services rather than producing agricultural products. Businesses became more concerned with the needs of the consumer and entered the *marketing economy*. Marketing advanced when Alexander Turney Stewart built one of the first department stores in the 1860s. Aaron Montgomery Ward developed a catalog with 10,000 items that could be shipped by train in 1872. The development of retail institutions created the demand for more manufactured products. Companies conducted research to find out what products consumers needed and wanted. Advertising



#### DID YOU KNOW?

Approximately 70 percent of women with children under the age of 18 are involved in the workforce.<sup>c</sup>

made consumers aware of products and important information about features, prices, and other competitive advantages.

Because these developments occurred in a free-enterprise system, consumers determined what goods and services were produced. They did this by purchasing the products they liked at prices they were willing to pay. The United States prospered, and American citizens had one of the highest standards of living in the world.

### The Service and New Digital Economy.

After World War II, with the increased standard of living, Americans had more money and more time. They began to pay others to perform services that made their lives easier. Beginning in the 1960s, more and more women entered the workforce. The United States began experiencing major shifts in the population. The U.S. population experienced the slowest pace of growth since the Great Depression, with the South leading the population gains. While the birth rate in the United States is declining, new immigrants help with population gains.<sup>25</sup> The profile of the family is also changing: Today there are more single-parent families and individuals living alone, and in two-parent families, both parents often work.

One result of this trend is that time-pressed Americans are increasingly paying others to do tasks they used to do at home, like cooking, laundry, landscaping, and child care. These trends have gradually changed the United States to a *service economy*—one devoted to the production of services that make life easier for busy consumers. Businesses increased their demand for services, especially in the areas of finance and information technology. Service industries such as restaurants, banking, health care, child care, auto repair, leisure-related industries, and even education are growing rapidly and may account for as much as 80 percent of the U.S. economy. These trends continue with advanced technology contributing to new service products based on technology and digital media that provide smartphones, social networking, and virtual worlds. This has led to the growth of e-commerce, or transactions involving goods and services over the Internet. E-commerce has led to firms that would have been unheard of a few decades ago, such as eBay, Shopify, Etsy, and Amazon. More about the digital world, business, and new online social media can be found in the chapter titled “Digital Marketing and Social Media.”

The economy experienced a major shift in 2020 as a result of the COVID-19 pandemic. Travel bans were issued, people across the globe were ordered to stay at home, nonessential businesses were closed, students attended school online, major events were canceled, and many people began to work remotely. Even as businesses began to reopen, the world experienced a new normal. As working from home became mainstream, many companies reevaluated their real estate needs and permanently shuttered offices in major cities, impacting the commercial

**technology** includes the methods and processes creating applications to solve problems, perform tasks and make decisions.

**artificial intelligence (AI)** relates to machine (computer) learning that is able to perform activities and tasks that usually require human intelligence.

**big data** refers to large volumes of structured and unstructured data this is transmitted at very fast speeds.

**blockchain** a decentralized record-keeping technology that stores linked block of ordered transactions over time.

real-estate market.<sup>26</sup> Online grocery ordering gained popularity, telemedicine became widespread, and shopping shifted online. In fact, roughly 100,000 stores are estimated to close before 2025, according to UBS, an investment banking company.<sup>27</sup> Additionally, the virus accelerated the adoption of certain technologies in business such as cloud technology, cybersecurity, and artificial intelligence.<sup>28</sup>

## Technology and the Economy

Technology is rapidly accelerating and is changing the environment of business. **Technology** includes the methods and processes creating applications to solve problems, perform tasks and make decisions. New technology associated with artificial intelligence enabled by

big data and advanced computing systems are changing the way work is accomplished. The result is disruptive technology such as smart buildings, digital wallets, and drones, robotics, and machines that can communicate and make decisions like humans. This creates opportunities for new business models and job opportunities.

**Artificial intelligence (AI)** relates to machine (computer) learning that is able to perform activities and tasks that usually require human intelligence such as decisions, visual perception, and speech recognition. In short, it makes computers act like humans. Although it's estimated AI will disrupt

25 percent of U.S. jobs, the timeline is uncertain. However, the World Economic Forum predicts that AI will create more jobs than it takes, including new roles that do not exist today. Because of this, education institutions and business will need to keep employment dynamic by providing individuals with the soft skills need to work alongside AI and its enablers.<sup>29</sup> AI's enablers, as seen in Figure 1.5, include big data, blockchain, drones, robotics, and more.

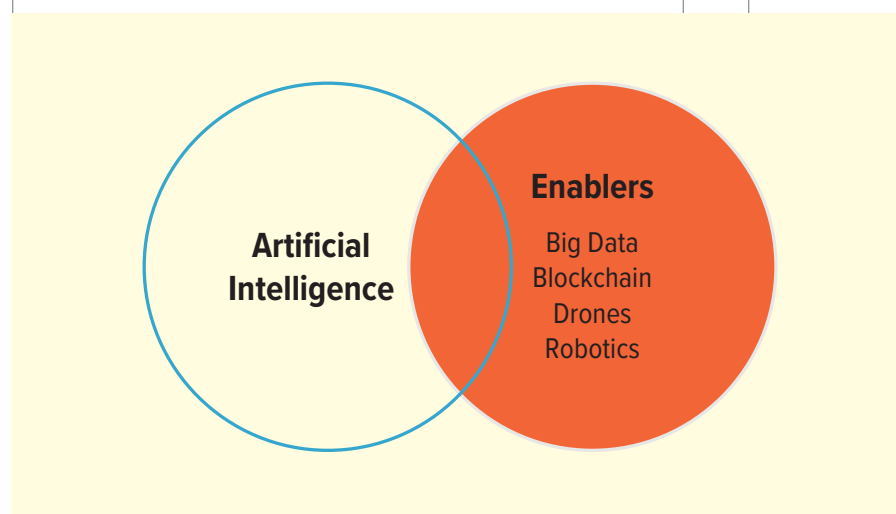
AI is moving rapidly across business functions because it can resolve predictable business activities. For example, using machine technology to analyze thousands of emails with customer service concerns can create a response that is faster and more accurate than using humans to respond. Delta uses an AI-powered business chat tool to supplement its customer service team, allowing its agents to handle more complex tasks while responding to a higher volume of inquiries.<sup>30</sup> Approximately 40 percent of Americans that use the internet indicate they would rather use digital customer services than speak to a service provider on the phone.<sup>31</sup> Additionally, AI has the potential to make the world more efficient in predictable, physical work such as assembly lines, food preparation, packaging, welding, and other repetitive tasks.

While it has the potential to provide greater productivity and higher quality service, it also creates new challenges.<sup>32</sup> For instance, AI has the potential to be just as biased as humans since it can adopt pre-existing human biases and engage in unintentional discrimination.<sup>33</sup> Surveillance is another sensitive issue that is related to privacy. Facial recognition has been found to falsely identify Asian and African American faces 10 to 100 times more often than Caucasian faces, according to the National Institute of Standards and Technology.<sup>34</sup> Tracking communication, profiles, and other searchable information will accelerate with AI.

Business have an unprecedented amount of data at their fingertips. **Big data** refers to large volumes of structured and unstructured data this is transmitted at very fast speeds. AI systems learn from big data, such as consumer shopping habits, web browsing history, and social media activity. Insights from big data can improve decision making and inform business strategies. For example, Johnson & Johnson uses big data to determine the likelihood of success for new drugs.<sup>35</sup> However, the amount of data available to businesses creates consumer privacy concerns. Half of business ethics violations are related to the improper use of big data analytics, according to Gartner.<sup>36</sup> It's important for businesses to consider the best ways to collect, store, and share consumer data.

Blockchain will enable AI with the development of databases that can be used in AI learning. **Blockchain** is a decentralized

▼ **FIGURE 1.5** AI in Relation to Its Enablers





record-keeping technology that stores linked block of ordered transactions over time. The distinguishing feature of a blockchain are the ordered rules of how the data goes into the database. The data is locked into a system without a central person controlling it. The key is no single authority can make changes to fit their needs. The finance industry, supply chain, marketing, human resource management, and most other areas of business will become more efficient in developing and tracking information.<sup>37</sup>

Blockchain has the potential to make databases and the digital infrastructures more secure and trustworthy. For example, scanning data in a blockchain database and tracking products from a point of production to consumption. For this reason, blockchain is especially important in managing the supply chain. It can track product history, generate invoices, detect counterfeit products, manage returned products, and help find and reuse materials rather than new resources. It can enable firms to trace deliveries, verify transactions, and handle payments. It is transforming the supply side of business.<sup>38</sup> This means that the movement of agricultural products, for instance, can be tracked from the farm to the table. Walmart uses the technology to track their products through the entire supply chain to the store. According to Walmart, the time it takes to trace the origin of an item decreased from seven days to 2.2 seconds.<sup>39</sup>

**Drones**, unmanned aerial devices, can be programmed with AI to perform human tasks such as delivering products or collecting environmental data and imagery. Drones can be beneficial in a variety of industries such as construction, farming, defense, insurance, outdoor entertainment, and retail. During the COVID-19 pandemic, UPS used drones to deliver prescription medication from CVS to retirees in Florida.<sup>40</sup> As of now, adoption of this technology is limited because few companies have permission to fly drones beyond visual line of sight from the Federal Aviation Administration (FAA).<sup>41</sup> Drones pose a challenge not only to airspace but privacy as well. Though businesses may not intentionally surveil on the population, drones with cameras have the potential to take photos and videos of people without their consent.

In addition to drones, robots can be programmed with AI to perform human-like actions by learning, reasoning, and using language through machine learning. Lowe's, for instance, has a customer service robot called OSHbot which can speak with customers in multiple languages and help locate items in the store. Robots used in this type of application can efficiently and effectively assist customers. As with AI's other enablers, privacy is a concern with robots because they have the potential to collect sensitive data that could violate an individual's privacy.<sup>42</sup>

AI and its enablers are rapidly changing the world of business. Big data can be combined with AI machine learning to provide important information and help leaders make decisions on key issues. Blockchain combined with AI can enable new business models. For example, cryptocurrency such as bitcoin is based on blockchain technology. Drones can help extend the reach of businesses, and robots can create a personalized shopping experience. These advanced technologies will make it possible to create entrepreneurs that will develop new business.

**drones** unmanned aerial devices.

**entrepreneur** an individual who risks his or her wealth, time, and effort to develop for profit an innovative product or way of doing something.

**LO 1-8** Explain the role of the entrepreneur in the economy.

## The Role of the Entrepreneur

An **entrepreneur** is an individual who risks his or her wealth, time, and effort to develop for profit an innovative product or way of doing something. Heidi Ganahl is a true American entrepreneur. She took the unusual concept of a day care center for dogs and turned it into a successful \$85 million franchise operation with Camp Bow Wow which offers boarding, playtime, grooming, and other services for dogs. Additionally, Ganahl founded a startup incubator called Fight Back Foundation to support social entrepreneurs.<sup>43</sup>

The free-enterprise system provides the conditions necessary for entrepreneurs like Ganahl to succeed. In the past, entrepreneurs



*Ripe.io aims to use blockchain technology to address issues like food fraud and food safety in the restaurant industry. The agritech startup has worked with restaurants like Sweetgreen to track produce from farm to restaurant.*

Jeffrey MacMillan/Getty Images



Apple Pay is a mobile payment system that allows users to store credit card or debit card information on their phones. When checking out at stores, users can bring up their credit card with two taps and use the information to pay for their purchases.

How Hwee Young/Epa/REX/Shutterstock

were often inventors who brought all the factors of production together to produce a new product. Thomas Edison, whose inventions include the record player and light bulb, was an early American entrepreneur. Henry Ford was one of the first persons to develop mass assembly methods in the automobile industry. Other entrepreneurs, so-called captains of industry, invested in the country's growth. John D. Rockefeller built Standard Oil out of the fledgling oil industry, and Andrew Carnegie invested in railroads and founded the United States Steel Corporation. Andrew Mellon built the Aluminum Company of America and Gulf Oil. J. P. Morgan started financial institutions to fund the business activities of other entrepreneurs. Although these entrepreneurs were born in another century, their legacy to the American economy lives on in the companies they started, many of which still operate today. Consider the history of Eli

Lilly. Colonel Eli Lilly in Indianapolis, Indiana, was continually frustrated with the quality of pharmaceutical products sold at the time. As a pharmaceutical chemist, he decided to start his own firm that would offer the highest-quality medicines. His firm, Eli Lilly and Company, would go on to make landmark achievements, including being one of the first pharmaceutical firms to mass-produce penicillin. Today, Eli Lilly is one of the largest pharmaceutical firms in the world.<sup>44</sup>

Entrepreneurs are constantly changing American business practices with new technology and innovative management techniques. Bill Gates, for example, built Microsoft, a software company whose products include Word and Windows, into a multibillion-dollar enterprise. Frederick Smith had an idea to deliver packages overnight, and now his FedEx Company plays an important role in getting documents and packages delivered all over the world for businesses and individuals. Steve Jobs co-founded Apple and turned the company into a successful consumer electronics firm that revolutionized many different industries, with products such as the iPod. Entrepreneurs have been associated with such uniquely American concepts as Walt Disney, Spanx, Tesla, McDonald's, SpaceX, Google, Facebook, and Walmart. We will examine the importance of entrepreneurship further in the chapter "Small Business, Entrepreneurship, and Franchising."

## The Role of Government in the American Economy

The American economic system is best described as modified capitalism because the government regulates business to preserve competition and protect consumers and employees.

## UP IN THE AIR: DRONES AND AIR TRAFFIC CONTROL

The U.S. practices modified capitalism, where free enterprise is encouraged, but the government intervenes and regulates business to some extent. Air traffic control, for instance, is run by the government to regulate and manage air space. While this type of government control works for airplanes, the rise of a new type of product taking to the skies calls for a more autonomous type of control.

As drones increase in popularity, the need for a new air traffic control system has increased. As many as 7 million drones could be in the sky at once, according to the Federal Aviation Administration (FAA). Drones are used to take pictures, deliver packages, inspect infrastructure, and more.

Companies like Amazon, Airbus, and Google are leading the charge for a private, nationwide drone air traffic control system. Unlike the air traffic control system for airplanes, this drone system is private. Eight companies, including T-Mobile and Intel, have been selected to develop the technology that will enable remote drone identification. The FAA will define a drone traffic management framework that commercial operators will follow.

Drones would use sensors to scan their surroundings and broadcast that information to other drones around them. This proposed system could lead to an overhaul of the air traffic control system, which has remained largely

unchanged since the 1940s, because the same infrastructure could be applied to airplanes. Technology is evolving fast, and a future where the skies are filled with drones is not far away.<sup>d</sup>

### Critical Thinking Questions

1. How does this situation demonstrate a modified capitalist economic system?
2. What is the difference between the current air traffic control system and the proposed air traffic control system for drones?
3. Why would it be harder for the government to maintain as much control over drones as it does for airplanes?

Federal, state, and local governments intervene in the economy with laws and regulations designed to promote competition and to protect consumers, employees, and the environment. Many of these laws are discussed in the Chapter 2 Appendix.

Additionally, government agencies such as the U.S. Department of Commerce measure the health of the economy (GDP, productivity, etc.) and, when necessary, take steps to minimize the disruptive effects of economic fluctuations and reduce unemployment. When the economy is contracting and unemployment is rising, the federal government through the Federal Reserve Board (see chapter titled “Money and the Financial System”) tries to spur growth so that consumers will spend more money and businesses will hire more employees. To accomplish this, it may reduce interest rates or increase its own spending for goods and services. When the economy expands so fast that inflation results, the government may intervene to reduce inflation by slowing down economic growth. This can be accomplished by raising interest rates to discourage spending by businesses and consumers. Techniques used to control the economy are discussed in “Money and the Financial System.”

## The Role of Ethics and Social Responsibility in Business

In the past few years, there have been a number of scandals at well-known corporations, including Fifth Third Bank, Airbus, and the University of Phoenix. In many cases, misconduct by individuals within these firms had an adverse effect on employees, investors, and others associated with these firms. These scandals undermined public confidence in corporate America and sparked a new debate about ethics in business. *Business ethics* generally refers to the standards and principles used by society to define appropriate and inappropriate conduct in the workplace. In many cases, these standards have been codified as laws prohibiting actions deemed unacceptable.

Society is increasingly demanding that businesspeople behave socially responsibly toward their stakeholders, including customers, employees, investors, government regulators, communities, and the natural environment. Diversity in the workforce is not only socially responsible, but also highly beneficial to the financial performance of companies. According to a McKinsey consulting firm study, organizations that have diverse leadership are more likely to report higher financial returns. This study defined diversity as women and minorities. Diversity creates increased employee satisfaction and improved decision making.<sup>45</sup> When actions are heavily criticized, a balance is usually required to support and protect various stakeholders.

While one view is that ethics and social responsibility are a good supplement to business activities, there is an alternative viewpoint. Ethical behavior can not only enhance a company's reputation, but can also drive profits.<sup>46</sup> The ethical and socially responsible conduct of companies such as Microsoft, Patagonia, and Ben & Jerry's provides evidence that good ethics is good business. There is growing recognition that

the long-term value of conducting business in an ethical and socially responsible manner that considers the interests of all stakeholders creates superior financial performance.<sup>47</sup>

To promote socially responsible and ethical behavior while achieving organizational goals, businesses can monitor changes and trends in society's values. Businesses should determine what society wants and attempt to predict the long-term effects of their decisions. While it requires an effort to address the interests of all stakeholders, businesses can prioritize and attempt to balance conflicting demands. The goal is to develop a solid reputation of trust and avoid misconduct to develop effective workplace ethics.

## CAN YOU LEARN BUSINESS IN A CLASSROOM?

Obviously, the answer is yes, or there would be no purpose for this textbook or course! To be successful in business, you need knowledge, skills, experience, and good judgment. The topics covered in this chapter and throughout this book provide some of the knowledge you need to understand the world of business. In addition, the “Building Your Soft Skills” exercise will help you develop skills that may be useful in your future career. However, good judgment is based on knowledge and experience plus personal insight and understanding. Therefore, you need more courses in business, along with some practical experience in the business world, to help you develop the special insight necessary to put your personal stamp on knowledge as you apply it. The challenge in business is in the area of judgment, and judgment does not develop from memorizing an introductory business textbook. If you are observant in your daily experiences as an employee, as a student, and as a consumer, you will improve your ability to make good business judgments.

### BUILDING YOUR SOFT SKILLS

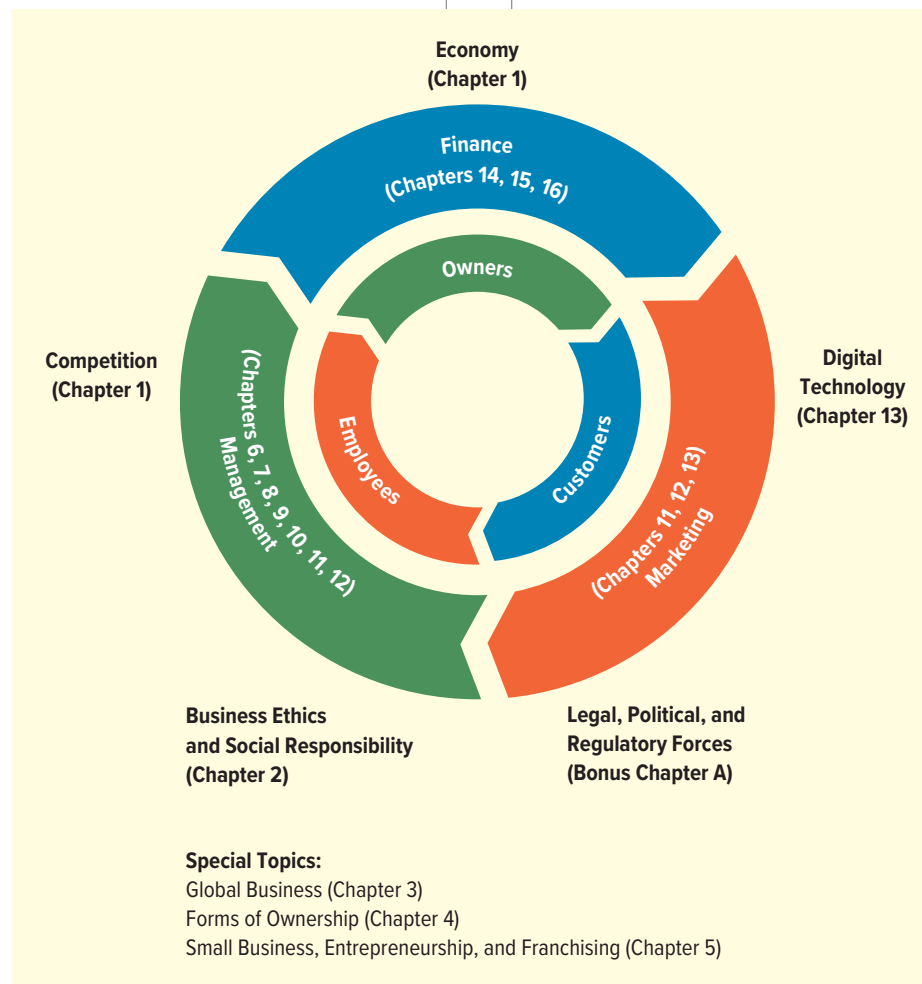
#### BY SETTING GOALS

Employers today want employees with strong soft skills—skills such as communication, leadership, teamwork, self-management, critical thinking, and people skills. You learned in this chapter that all businesses have goals. Consider your own goals for taking this course. What do you hope to learn or gain? Next, set a *specific* goal for yourself related to this course. For example, your goal might be to earn a grade of B or higher or to determine which particular field of business you are most interested in pursuing. Finally, list three *specific* steps you can take to ensure you meet your goal by the end of the course.





▼ **FIGURE 1.6** The Organization of This Book



Whether you choose to work at an organization or become an entrepreneur, you will be required to know the basic concepts and principles in this book. You need to be prepared for changes in the way business will be conducted in the future. New business models or ways businesses create value will emerge based on the Internet, connected technologies, drones, driverless cars, and artificial intelligence. It should be exciting to think about your opportunities and the challenges of creating a successful career. Our society needs a strong economic foundation to help people develop a desired standard of living.

### Team Exercise


Major economic systems, including capitalism, socialism, and communism, as well as mixed economic systems were discussed in this chapter. Assuming that you want an economic system that is best for the majority, not just a few members of society, defend one of the economic systems as the best system. Form groups and try to reach an agreement on one economic system. Defend why you support the system that you advance.

Our world economy is becoming more digital and competitive, requiring new skills and job positions. Individuals like you can become leaders in business, nonprofits, and government to create a better life.

Figure 1.6 is an overview of how the chapters in this book are linked together and how the chapters relate to the participants, the activities, and the environmental factors found in the business world. The topics presented in the chapters that follow are those that will give you the best opportunity to begin the process of understanding the world of business. ■



## ARE YOU PREPARED // to Take Advantage of Emerging Job Opportunities? /



When most people think of a career in business, they see themselves entering the door to large companies and multinationals that they read about in the news and that are discussed in class. In a national survey, students indicated they would like to work for Google, Ernst & Young, and PricewaterhouseCoopers. In fact, most jobs are not with large corporations, but are in small companies, nonprofit organizations, government, and even as self-employed individuals. There will continue to be an increase in independent workers. With more than 77 percent of the economy based on services, there are many jobs available in industries such as health care, finance, education, hospitality, and entertainment. E-commerce has led to the evolution of supply chain jobs related to purchasing, transportation, and operations. The world is changing quickly and large corporations replace

the equivalent of their entire workforce every four years.

The fast pace of technology today means that you have to be prepared to take advantage of emerging job opportunities and markets. You must also become adaptive and recognize that business is becoming more global, with job opportunities around the world. If you want to obtain such a job, you shouldn't miss a chance to spend some time overseas. To get you started on the path to thinking about job opportunities, consider all of the changes in business today that might affect your possible long-term track and that could bring you lots of success. Companies are looking for employees with skills that can be used to address the changing business environment. For example, the demand for graduates that are good at analyzing data is on the rise.

You're on the road to learning the key knowledge, skills, and trends that you can use to be a star in business. Business's impact on our society, especially in the area of sustainability and improvement of the environment, is a growing challenge and opportunity. Green businesses and green jobs in the business world are provided to give you a glimpse at the possibilities. Along the way, we will introduce you to some specific careers and offer advice on developing your own job opportunities. Research indicates that you won't be that happy with your job unless you enjoy your work and feel that it has a purpose. Because you spend most of your waking hours every day at work, you need to seriously think about what is important to you in a job.<sup>e</sup>

## chapter 2

## two

# business ethics and social responsibility

Simon Jarratt/Corbis/VCG/Getty Images

## LEARNING OBJECTIVES

*After reading this chapter, you will be able to:*

- LO 2-1** Describe the importance of business ethics and social responsibility.
- LO 2-2** Detect some of the ethical issues that may arise in business.
- LO 2-3** Specify how businesses can promote ethical behavior.

- LO 2-4** Explain the four dimensions of social responsibility.
- LO 2-5** Evaluate an organization's social responsibilities to owners, employees, consumers, the environment, and the community.

Any organization, including nonprofits, has to manage the ethical behavior of employees and participants in the overall operations of the organization. Firms that are highly ethical tend to be more profitable with more satisfied employees and customers.<sup>1</sup> Therefore, there are no conflicts between profits and ethics—in fact, unethical conduct is more likely to lower profits than raise them. For instance, Volkswagen pleaded guilty to criminal charges for cheating on U.S. emissions tests, and the company faced \$25 billion in the United States for fines, vehicle buybacks, and repairs.<sup>2</sup> Wrongdoing by some businesses has focused public attention and government involvement on encouraging more acceptable business conduct. Any

organizational decision may be judged as right or wrong, ethical or unethical, legal or illegal.

In this chapter, we take a look at the role of ethics and social responsibility in business decision making. First, we define *business ethics* and examine why it is important to understand ethics' role in business. Next, we explore a number of business ethics issues to help you learn to recognize such issues when they arise. Finally, we consider steps businesses can take to improve ethical behavior in their organizations. The second half of the chapter focuses on social responsibility and unemployment. We describe some important issues and detail how companies have responded to them. ■

**LO 2-1** Describe the importance of business ethics and social responsibility.

## BUSINESS ETHICS AND SOCIAL RESPONSIBILITY

In this chapter, we define **business ethics** as the principles and standards that determine acceptable conduct in business organizations. Personal ethics, on the other hand, relates to an

individual's values, principles, and standards of conduct. The acceptability of behavior in business is determined by not only the organization but also stakeholders such as customers, competitors, government regulators, interest groups, and the public, as well as each individual's personal principles and values. The publicity and debate surrounding highly visible legal and ethical issues at a number of well-known firms, including Wells Fargo and Volkswagen, highlight the need for businesses to integrate ethics and responsibility into all business decisions. For instance, Wells Fargo provided incentives to its sales department that resulted in opening 3.5 million accounts without customer knowledge. This resulted in lowering customers' credit ratings and additional expenses for customers. Most unethical activities within organizations are supported by an organizational culture that encourages employees to bend the rules. On the other hand, trust in business is the glue that holds relationships together. In Figure 2.1, you can see that trust in financial services is lower than in other industries. While the majority of the population trusts business, a significant portion does not.

**business ethics**  
principles and standards that determine acceptable conduct in business.

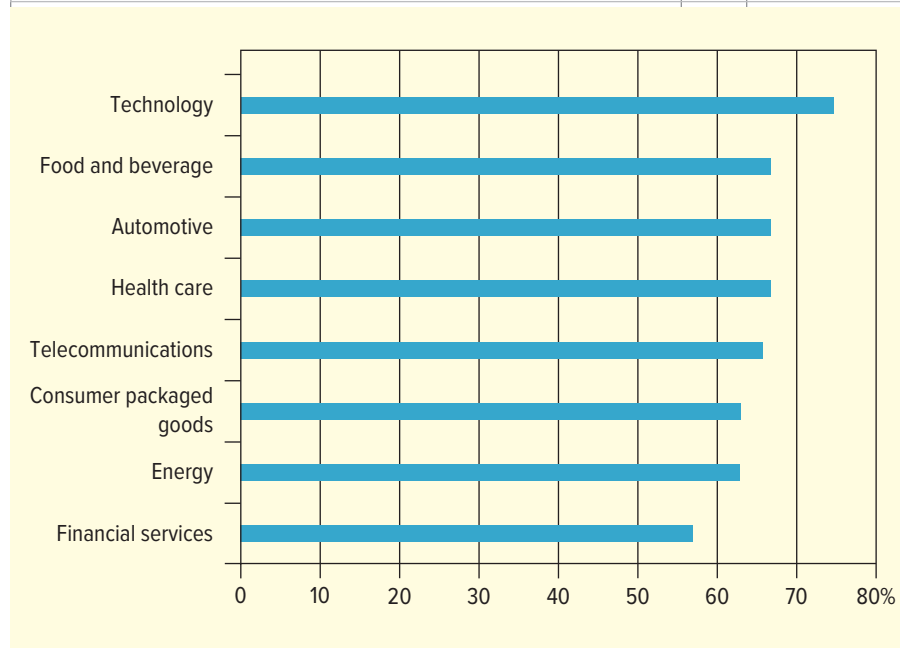


Wells Fargo opened 3.5 million fake accounts that hurt customers credit ratings.

Kristi Blokhin/Shutterstock

Organizations that exhibit a high ethical culture encourage employees to act with integrity and adhere to business values. For example, Illycaffè, an Italian family business, has been recognized as an ethical leader in quality, sustainability, and supply chain practices. The company is a leader in the science and technology of coffee and the world's most global coffee brand.<sup>3</sup> Many experts agree that ethical leadership, ethical values, and

▼ **FIGURE 2.1** Global Trust in Different Industries



**Source:** Edelman, 2020 *Edelman Trust Barometer Global Report*, [https://www.edelman.com/sites/g/files/aatuss191/files/2020-01/2020%20Edelman%20Trust%20Barometer%20Global%20Report\\_LIVE.pdf](https://www.edelman.com/sites/g/files/aatuss191/files/2020-01/2020%20Edelman%20Trust%20Barometer%20Global%20Report_LIVE.pdf) (accessed May 22, 2020).

### social responsibility

a business's obligation to maximize its positive impact and minimize its negative impact on society.

compliance are important in creating good business ethics. To truly create an ethical culture, however, managers must show a strong commitment to ethics and compliance. This "tone at the top" requires top managers to acknowledge their own role in supporting ethics and compliance, clearly communicate

company expectations for ethical behavior to all employees, educate all managers and supervisors in the business about the company's ethics policies, and train managers and employees on what to do if an ethics crisis occurs.<sup>4</sup>

**"Businesses should not only make a profit, but also consider the social implications of their activities."**

Businesses should not only make a profit, but also consider the social implications of their activities. For instance, Walmart to date has donated more than 1.5 billion pounds of food and \$2 billion to fight hunger.<sup>5</sup> However, profits permit businesses to contribute to society. The firms that are more well known for their strong social contributions tend to be those that are more profitable. We define **social responsibility** as a business's obligation to maximize its positive impact and minimize its

negative impact on society. Although many people use the terms *social responsibility* and *ethics* interchangeably, they do not mean the same thing. Business ethics relates to an *individual's* or a *work group's* decisions that society evaluates as right or wrong, whereas social responsibility is a broader concept that concerns the impact of the *entire business's* activities on society. From an ethical perspective, for example, we may be concerned about a health care organization overcharging the government for Medicare services. From a social responsibility perspective, we might be concerned about the impact that this overcharging will have on the ability of the health care system to provide adequate services for all citizens.<sup>6</sup>

The most basic ethical and social responsibility concerns have been codified by laws and regulations that encourage businesses to conform to society's standards, values, and attitudes. Laws and regulations attempt to institutionalize ethical conduct and prevent harm to customers, the environment, and other stakeholders. Accounting, finance,

and marketing professionals have to understand laws and regulations that apply to their work. For example, the Dodd-Frank Act was passed to reform the financial industry and offer consumers protection against complex and/or deceptive financial products. At a minimum, managers are expected to obey all laws and regulations. Most legal issues arise as choices that society deems unethical, irresponsible, or otherwise unacceptable. However, all actions deemed unethical by society are not necessarily illegal, and both legal and ethical concerns change over time (see Table 2.1). More recently, identity theft has become the number-one consumer complaint with the Federal Trade Commission, and companies have an ethical responsibility to protect customer data. *Business law* refers to the laws and

regulations that govern the conduct of business. Many problems and conflicts in business could be avoided if owners, managers, and employees knew more about business law and the legal system. Business ethics, social responsibility, and laws together act as a compliance system, requiring that businesses and employees act responsibly in society. In this chapter, we explore ethics and social responsibility. Chapter 2 Appendix provides an overview of the legal and regulatory environment.



▼ **TABLE 2.1** Timeline of Ethical and Socially Responsible Activities

1960s	1970s	1980s
<ul style="list-style-type: none"> <li>• Social issues</li> <li>• Consumer Bill of Rights</li> <li>• Disadvantaged consumer</li> <li>• Environmental issues</li> <li>• Product safety</li> </ul>	<ul style="list-style-type: none"> <li>• Business ethics</li> <li>• Social responsibility</li> <li>• Diversity</li> <li>• Bribery</li> <li>• Discrimination</li> <li>• Identifying ethical issues</li> </ul>	<ul style="list-style-type: none"> <li>• Standards for ethical conduct</li> <li>• Financial misconduct</li> <li>• Self-regulation</li> <li>• Codes of conduct</li> <li>• Ethics training</li> </ul>
1990s	2000s	2010s
<ul style="list-style-type: none"> <li>• Corporate ethics programs</li> <li>• Regulation to support business ethics</li> <li>• Health issues</li> <li>• Safe working conditions</li> <li>• Detecting misconduct</li> </ul>	<ul style="list-style-type: none"> <li>• Transparency in financial markets</li> <li>• Cyber security</li> <li>• Intellectual property</li> <li>• Regulation of accounting and finance</li> <li>• Executive compensation</li> <li>• Identity theft</li> </ul>	<ul style="list-style-type: none"> <li>• Sustainability</li> <li>• Supply chain transparency</li> <li>• Sexual misconduct</li> <li>• Data protection</li> <li>• Disruptive technologies</li> </ul>

## THE ROLE OF ETHICS IN BUSINESS

You have only to pick up *The Wall Street Journal* or *USA Today* to see examples of the growing concern about legal and ethical issues in business. For example, Apple CEO Tim Cook has called for stronger U.S. data protection regulation to help prevent the sharing of personal information. Many other tech firms have joined the call for stronger U.S. legislation that creates comprehensive laws similar to the European Union's General Data Protection Regulation which created several laws preventing companies from collecting and sharing personal data.<sup>7</sup> Regardless of what an individual believes about a particular action, if society judges it to be unethical or wrong, whether correctly or not, that judgment directly affects the organization's ability to achieve its business goals.<sup>8</sup>

Many firms are recognized for their ethical conduct. 3M is consistently placed on the World's Most Ethical Companies list. Furthermore, 3M's chief compliance officer states, "it is not enough to just win in business—it matters how you do it." 3M sees ethics as a competitive advantage.<sup>9</sup> The mass media frequently report about firms that engage in misconduct related to bribery, fraud, and unsafe products. However, the good ethical conduct of the vast majority of firms is not reported as often. Therefore, the public often gets the impression that misconduct is more widespread than it is in reality.

Often, misconduct starts as ethical conflicts but evolves into legal disputes when cooperative conflict resolution cannot be accomplished. This is because individuals may have different ethical beliefs and resort to legal activities to resolve issues. Also, there are many ethical gray areas, which occur when a new, undetermined or ambiguous situation arises. There may be no values, codes, or laws that answer the question about appropriate action. The sharing economy with peer-to-peer

relationships like Uber, Lyft, and Airbnb provide new business models where existing regulations were inadequate, ambiguous, or in some cases blocking progress. For example, Uber has been accused of price gouging, endangering riders' safety, sexual harassment, stealing secret information on self-driving cars from Google, and violating local regulations on public transportation in some countries, states, and cities.<sup>10</sup>

However, it is important to understand that business ethics goes beyond legal issues. Ethical conduct builds trust among individuals and in business relationships, which validates and promotes confidence in business relationships. Establishing trust and confidence is much more difficult in organizations that have reputations for acting unethically. If you were to discover, for example, that a manager had misled you about company benefits when you were hired, your trust and confidence in that company would probably diminish. And if you learned that a colleague had lied to you about something, you probably would not trust or rely on that person in the future.

Ethical issues are not limited to for-profit organizations either. Ethical issues include all areas of organizational activities. In government, politicians and some high-ranking officials have faced disciplinary actions over ethical indiscretions. There has been ethical misconduct in sports, and even ethical lapses in well-known nonprofits, such as the American Red Cross. Whether made in science, politics, sports, or business, most decisions are judged as right or wrong, ethical or unethical. Negative judgments can affect an organization's ability to build relationships with customers and suppliers, attract investors, and retain employees.<sup>11</sup>

Although we will not tell you in this chapter what you ought to do, others—your superiors, co-workers, and family—will make judgments about the ethics of your actions and decisions. Learning how to recognize and resolve ethical issues is a key step in evaluating ethical decisions in business.

**LO 2-2** Detect some of the ethical issues that may arise in business.

## Recognizing Ethical Issues in Business

Recognizing ethical issues is the most important step in understanding business ethics. An **ethical issue** is an identifiable problem, situation, or opportunity that requires a person to choose from among several actions that may be evaluated as

right or wrong, ethical or unethical. Learning how to choose from alternatives and make a decision requires not only good personal values, but also knowledge competence in the business area of concern. Employees also need to know when to rely on their organizations' policies and codes of ethics or have discussions with co-workers or managers on appropriate conduct. Ethical decision making is not always easy because there are always gray areas that create dilemmas, no matter how decisions are made. For instance, should an employee report on a co-worker engaging in time theft?

Or should you report a friend cheating on a test? Should a salesperson omit facts about a product's poor safety record in his presentation to a customer? Such questions require the decision maker to evaluate the ethics of his or her choice and decide whether to ask for guidance.

One of the principal causes of unethical behavior in organizations is rewards for overly aggressive financial or business objectives. It is not possible to discuss every issue, of course. However, a discussion of a few issues can help you begin to recognize the ethical problems with which businesspersons must deal. Many ethical issues in business can be categorized in the context of their relation with abusive and intimidating behavior, conflicts of interest, fairness and honesty, communications, misuse of company resources, and business associations. The Global Business Ethics Survey found that workers witness many instances of ethical misconduct in their organizations and sometimes feel pressured to compromise standards (see Table 2.2). Overall, 47 percent of employees surveyed observed misconduct. Many observed multiple issues including abusive behavior (26 percent), lying (22 percent), and conflict of interest (15 percent). During the COVID-19 (coronavirus) pandemic in 2020, many companies shifted to remote workforces. While the increased number of people working from home likely reduced incidences of bullying and sexual harassment, many companies were unable to effectively

**ethical issue** an identifiable problem, situation, or opportunity that requires a person to choose from among several actions that may be evaluated as right or wrong, ethical or unethical.

**bribes** payments, gifts, or special favors intended to influence the outcome of a decision.

**TABLE 2.2** Organizational Misconduct in the United States

Misconduct Facts	Percentage
Observed misconduct	47
Abusive behavior	26
Lying to stakeholders	22
Conflict of interest	15
Internet abuse	16
Health violations	15
Pressure to compromise standards	16
Report observed misconduct	69
Experience retaliation for reporting	44

**Source:** Ethics and Compliance Initiative, 2018 Global Business Ethics Survey™: The State of Ethics and Compliance in the Workplace (Arlington, VA: Ethics and Compliance Initiative, 2018).

monitor employees to identify misconduct. As working from home becomes increasingly mainstream, companies will have to adjust their monitoring programs to better identify potential compliance violations.<sup>12</sup>

To help you understand ethical issues that perplex businesspeople today, we will take a brief look at some of them in this section. Ethical issues can be more complex now than in the past. The vast number of news-format investigative programs has increased consumer and employee awareness of organizational misconduct. In addition, the multitude of cable channels and Internet resources has improved the awareness of ethical problems among the general public.

**Bribery.** Many business issues seem straightforward and easy to resolve on the surface, but are, in reality, very complex. A person often needs several years of experience in business to understand what is acceptable or ethical. For example, it is considered improper to give or accept **bribes**, which are payments, gifts, or special favors intended to influence the outcome of a decision. A bribe benefits an individual or a company at the expense of other stakeholders. Companies that do business overseas should be aware that bribes are a significant ethical issue and are, in fact, illegal in many countries. In the United States, the Foreign Corrupt Practices Act imposes heavy penalties on companies found guilty of bribing foreign government officials.

Ethics is also related to the culture in which a business operates. In the United States, for example, it would be inappropriate for a businessperson to bring an elaborately wrapped gift to a prospective client on their first meeting—the gift could be viewed as a bribe. In Japan, however, it is considered impolite *not* to bring a gift. Experience with the culture in which a business operates is critical to understanding what is ethical or unethical. On the other hand, firms must also abide by the values and policies of global business.

South Korea's president, Park Geun-hye was removed from office over a bribery scandal. The heir to the Samsung Group



*A former Siemens executive plead guilty in a \$100 million Argentina bribery case. The engineering firm itself was involved in a decades long legal investigation.*

LUKAS BARTH/EPA-EFE/REX/Shutterstock

was sentenced to 25 years in prison for bribery and embezzlement though the sentence was reduced due to a retrial. There was a “donation” of \$25 million to the National Pension Fund at the time of a Samsung merger. This case heightens the awareness of the political risks associated with bribery.<sup>13</sup> Such political scandals demonstrate that political ethical behavior must be proactively practiced at all levels of public service.

**Misuse of Company Time.** Theft of time is a common area of misconduct observed in the workplace.<sup>14</sup> One example of misusing time in the workplace is by engaging in activities that are not necessary for the job. Some companies have chosen to block certain sites such as Facebook, YouTube, or Pandora from employees. In this case, the employee is misusing not only time, but also company resources by using the company’s computer and Internet access for personal use. Time theft costs can be difficult to measure but are estimated to cost companies hundreds of billions of dollars annually. It is widely believed that the average employee “steals” 4.5 hours a week with late arrivals, leaving early, long lunch breaks, inappropriate sick days, excessive socializing, and engaging in personal activities such as online shopping and watching sports while on the job. For example, on Cyber Monday, nearly 25 percent of employees say they shop online while at work.<sup>15</sup> All of these activities add up to lost productivity and profits for the employer—and relate to ethical issues in the area of time theft.

**Abusive and Intimidating Behavior.** Abusive or intimidating behavior is the most common ethical problem for employees. These concepts can mean anything from physical threats, false accusations, profanity, insults, yelling, harshness, and unreasonableness to ignoring someone or simply being annoying; and the meaning of these words can differ by person—you probably have some ideas of your own. Abusive behavior can be placed on a continuum from a minor distraction to a disruption of the workplace. For example, what one person may define as yelling might be another’s definition of normal speech. Civility in our society is a concern, and the workplace is no exception. The productivity level of many organizations has been diminished by the time spent unraveling abusive relationships.

Abusive behavior is difficult to assess and manage because of diversity in culture and lifestyle. What does it mean to speak profanely? Is profanity only related to specific words or other such terms that are common in today’s business world? If you are using words that are normal in your language but that others consider to be profanity, have you just insulted, abused, or disrespected them?

Within the concept of abusive behavior, intent should be a consideration. If the employee was trying to convey a compliment but the comment was considered abusive, then it was probably a mistake. The way a word is said (voice inflection) can be important. Add to this the fact that we now live in a multicultural environment—doing business and working with many different cultural groups—and the businessperson soon realizes the depth of the ethical and legal issues that may arise. There are problems of word meanings by age and within cultures. For example, an expression such as “Did you guys hook up last night?” can have various meanings, including some that could be considered offensive in a work environment.

Bullying is associated with a hostile workplace when a person or group is targeted and is threatened, harassed, belittled, verbally abused, or overly criticized. Bullying may create what some consider a hostile environment, a term generally associated with sexual harassment. Recently there has been an explosion of concern about sexual harassment. Ethical misconduct has been unveiled with exposure of sexual harassment that has been part of the culture of the entertainment and hospitality industries, as well as other areas such as government and many corporations.<sup>16</sup> Google employees staged a walkout over Google’s treatment of sexual harassment claims for several senior executives,

“Bullying is a widespread problem in the United States and can cause psychological damage that can result in health-endangering consequences to the target.”



▼ **TABLE 2.3** Actions Associated with Bullies

1. Spreading rumors to damage others
2. Blocking others' communication in the workplace
3. Flaunting status or authority to take advantage of others
4. Discrediting others' ideas and opinions
5. Using e-mail to demean others
6. Failing to communicate or return communication
7. Insults, yelling, and shouting
8. Using terminology to discriminate by gender, race, or age
9. Using eye or body language to hurt others or their reputation
10. Taking credit for others' work or ideas

including one who received a \$90 million exit package after being accused of sexual misconduct. Employee protestors called for Google to improve transparency for sexual misconduct cases and demanded equal pay and opportunity for employees.<sup>17</sup> Although sexual harassment has legal recourse, bullying has little legal recourse at this time. Bullying is a widespread problem in the United States and can cause psychological damage that can result in health-endangering consequences to the target. Surveys reveal that bullying in the workplace is on the rise.<sup>18</sup> As Table 2.3 indicates, bullying can use a mix of verbal, nonverbal, and manipulative threatening expressions to damage workplace productivity. One may wonder why workers tolerate such activities. The problem is that bullies often outrank their victims.

**Misuse of Company Resources.** Misuse of company resources has been identified by the Ethics Resource Center as a leading issue in observed misconduct in organizations. Issues might include spending an excessive amount of time on personal e-mails, submitting personal expenses on company expense reports, or using the company copier for personal use. Six Howard University employees were fired after they allegedly stole nearly \$1 million via grants and tuition remission from the financial aid department.<sup>19</sup> While serious resource abuse can result in firing, some abuse can have legal repercussions.

Employee internal theft or the misuse of the employer's assets is a major loss of resources for many firms, especially retailers. For example, employees may hide company items in a handbag, backpack, or briefcase. Customers may be overcharged while the employees keep the extra money. Employees may ship personal items using a firm's account number. Contract maintenance personnel may steal materials or office equipment. Food service employees may provide free drinks or food to friends or even customers hoping for an extra tip. Estheticians or hair stylists may pocket money when clients pay with cash. There are many other ways to steal from the company. Firms need a good monitoring system and employee training to prevent the theft of resources.

The most common way that employees abuse resources is by using company computers for personal use. Typical examples of using a computer for personal use include shopping on the Internet, downloading music, doing personal banking, surfing



*Upset by alleged financial aid embezzlement by Howard University employees, students occupied the administration building to protest the misuse of university resources.*

Astrid Riecken For The Washington Post/Getty Images

the Internet for entertainment purposes, or visiting Facebook. Some companies choose to take a flexible approach to addressing this issue. For example, many have instituted policies that allow for some personal computer use as long as the use does not detract significantly from the workday.

No matter what approach a business chooses to take, it must have policies in place to prevent company resource abuse. Because misuse of company resources is such a widespread problem, many companies, like Coca-Cola, have implemented official policies delineating acceptable use of company resources. Coca-Cola's policy states that company assets should not be used for personal gain or outside business or for anything illegal or unethical.<sup>20</sup> This kind of policy is in line with that of many companies, particularly large ones that can easily lose millions of dollars and thousands of hours of productivity to these activities.

**Conflict of Interest.** A conflict of interest, one of the most common ethical issues identified by employees, exists when an individual must choose whether to advance the individual's own personal interests or those of others. For example, a manager in a corporation is supposed to ensure that the company is profitable so that its stockholder-owners receive a return on their investment. In other words, the manager has a responsibility to investors. If she instead makes decisions that give her more power or money but do not help the company, then she has a conflict of interest—she is acting to benefit herself at the expense of her company and is not fulfilling her responsibilities as an employee. To avoid conflicts of interest, employees must be able to separate their personal financial interests from their business dealings. Adam Neumann, one of the founders of WeWork, is an example of an executive who engaged in self-serving behavior when he was the CEO. Neumann leased buildings to WeWork that he had a personal investment in. This was a conflict of interest because





*The Office of Government Ethics decided cryptocurrency, such as bitcoin, should be covered by conflict of interest laws for federal employees who must now report virtual money on their financial disclosure statements.*

Omar Marques/SOPA Images/LightRocket/Getty Images

he stood to profit at the company's expense. Additionally, he reserved the "We" trademark through an entity he owned then sold the rights to WeWork for \$5.9 million in stock.<sup>21</sup> Conflict of interest can be particularly problematic in the finance industry because bad decisions can result in significant financial losses.

Insider trading is an example of a conflict of interest. Insider trading is the buying or selling of stocks by insiders who possess material that is still not public. Bribery can also be a conflict of interest. While bribery is an increasing issue in many countries, it is more prevalent in some countries than in others. Transparency International has developed a Corruption Perceptions Index (Table 2.4). Note that the United States, ranked at 23, does not appear in the top 20. The five countries rated by Transparency International as most corrupt include Yemen, Syria, Venezuela, South Sudan, and Somalia.<sup>22</sup>

## Fairness and Honesty

Fairness and honesty are at the heart of business ethics and relate to the general values of decision makers. At a minimum, businesspersons are expected to follow all applicable laws and regulations. But beyond obeying the law, they are expected not to harm customers, employees, clients, or competitors knowingly through deception, misrepresentation, coercion, or discrimination. Honesty and fairness can relate to how the employees use the resources of the organization. In contrast, dishonesty is usually associated with a lack of integrity, lack of disclosure, and lying. One common example of dishonesty is theft of office supplies. Although the majority of office supply thefts involve small things such as pencils or Post-it Notes, some workers admit to stealing more expensive items or equipment such as computers or software. Employees should be aware of policies on stealing items and recognize how these decisions relate to ethical behavior.

▼ **TABLE 2.4** Least Corrupt Countries

Rank	Country
1	Denmark
1	New Zealand
3	Finland
4	Sweden
4	Singapore
4	Switzerland
7	Norway
8	Netherlands
9	Germany
9	Luxembourg
11	Iceland
12	Austria
12	Australia
12	United Kingdom
12	Canada
16	Hong Kong
17	Belgium
18	Estonia
18	Ireland
20	Japan

**Source:** Corruption Perceptions Index 2019, Transparency International, <https://www.transparency.org/en/cpi/2019/results/table> (accessed May 20, 2020).

One aspect of fairness relates to competition. For example, a former Apple employee was charged with stealing secrets related to its autonomous car technology for a Chinese startup, Xiaopeng Motors.<sup>23</sup> Although numerous laws have been passed to foster competition and make monopolistic practices illegal, companies sometimes gain control over markets by using questionable practices that harm competition. For instance, the U.S. Justice Department is filing antitrust charges against Google because of the company's dominance and alleged anticompetitive behavior in the online advertising industry. Because Google holds 90 percent of the search engine market globally, the controversy over how it abuses its dominance to remain ahead of the competition is likely to intensify.<sup>24</sup>

Another aspect of fairness and honesty relates to disclosure of potential harm caused by product use. Health-Ade, a kombucha company based in Los Angeles, paid a \$4 million settlement due to discrepancies between the actual sugar and alcohol levels of its drinks and the amounts stated on its packaging. In addition to implementing a formula change to make its product more consistent, the company also agreed to add a disclosure to its product labels.<sup>25</sup>

Dishonesty has become a significant problem in the United States. The Houston Astros were fined \$5 million after it was discovered the team used video surveillance to steal catchers' signals to pitchers. Coaches and players could see what pitch was coming next

**plagiarism** the act of taking someone else's work and presenting it as your own without mentioning the source.

and then beat on a trash can to alert the team's player at bat.<sup>26</sup> In another example, Philip Esformes bribed the University of Pennsylvania's basketball coach to help his son

get admitted to the university. This college admissions scandal was part of a large cheating scheme, dubbed Operation Varsity Blues, by more than 50 people across the United States who paid money to William Rick Singer, the organizer. Parents included celebrities Felicity Huffman and Lori Loughlin. Loughlin and husband Mossimo Giannulli plead guilty and received short-term prison sentences. Singer used money to fraudulently inflate college entrance exam scores and bribe college officials. Participants attempted to cheat the admissions system, giving their children an unfair advantage over other applicants.<sup>27</sup>

**Communications.** Communications is another area in which ethical concerns may arise. False and misleading advertising, as well as deceptive personal-selling tactics, anger consumers and can lead to the failure of a business. Truthfulness about product

safety and quality is also important to consumers. Takata, a former automotive parts company, pleaded guilty to fraud and providing false data and agreed to pay \$1 billion in a settlement to victims and car manufacturers for exploding airbags.<sup>28</sup>

Another important aspect of communications that may raise ethical concerns relates to product labeling. This becomes an even greater concern with potentially harmful products like cigarettes. The FDA warned three cigarette manufacturers against using "additive-free" or "natural" on their labeling out of concern that consumers would associate these terms as meaning that their products were healthier.<sup>29</sup> In the advertisement, American Spirit labels its cigarettes as "natural" but includes a warning that its product is not safer than other cigarettes. However, labeling of other products raises ethical questions when it threatens basic rights, such as freedom of speech and expression. This is the heart of the controversy surrounding the movement to require warning labels on movies and videogames, rating their content, language, and appropriate audience age. Although people in the entertainment industry claim that such labeling violates their First Amendment right to freedom of expression, other consumers—particularly parents—believe that labeling is needed to protect children from harmful influences. Internet regulation, particularly regulation designed to protect children and the elderly, is on the forefront in consumer protection legislation. Because of the debate surrounding the acceptability of these business activities, they remain major ethical issues.

**Business Relationships.** The behavior of businesspersons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behavior within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically. Managers in particular, because of the authority of their position, have the opportunity to influence employees' actions.

It is the responsibility of managers to create a work environment that helps the organization achieve its objectives and fulfill its responsibilities. However, the methods that managers use to enforce these responsibilities should not compromise employee rights. Organizational pressures may encourage a person to engage in activities that he or she might otherwise view as unethical, such as invading others' privacy or stealing a competitor's secrets. The firm may provide only vague or lax supervision on ethical issues, creating the opportunity for misconduct. Managers who offer no ethical direction to employees create many opportunities for manipulation, dishonesty, and conflicts of interest. This happened to Wells Fargo in creating 3.5 million fake accounts that hurt customers' credit ratings as well as other misconduct that damaged customers. The Federal Reserve restricted the bank's ability to grow until they could provide more oversight and reduce risks.<sup>30</sup>

**Plagiarism**—taking someone else's work and presenting it as your own without mentioning the source—is another ethical issue. As a student, you may be familiar with plagiarism in school—for example, copying someone else's term paper

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**SURGEON GENERAL'S WARNING:** Smoking By Pregnant Women May Result in Fetal Injury, Premature Birth, And Low Birth Weight.

Natural American Spirit cigarettes are not safer than other cigarettes.

*The FDA has strict labeling requirements for tobacco products. American Spirit advertises its cigarettes as being natural with a superior taste but is also required to include a warning that these cigarettes are no safer than other cigarettes.*

Source: American Spirit



▼ **TABLE 2.5** Questions to Consider in Determining Whether an Action Is Ethical

Are there any potential legal restrictions or violations that could result from the action?
Does your company have a specific code of ethics or policy on the action?
Is this activity customary in your industry? Are there any industry trade groups that provide guidelines or codes of conduct that address this issue?
Would this activity be accepted by your co-workers? Will your decision or action withstand open discussion with co-workers and managers and survive untarnished?
How does this activity fit with your own beliefs and values?

attention at all.<sup>31</sup> Managers make intuitive decisions sometimes without recognizing the embedded ethical issue.

Table 2.5 lists some questions you may want to ask yourself and others when trying to determine whether an action is ethical. Open discussion of ethical issues does not eliminate ethical problems, but it does promote both trust and learning in an organization.<sup>32</sup> When people feel that they cannot discuss what they are doing with their co-workers or superiors, there is a good chance that an ethical issue exists. Once a person has recognized an ethical issue and can openly discuss it with others, he or she has begun the process of resolving that issue.

**LO 2-3** Specify how businesses can promote ethical behavior.

## Improving Ethical Behavior in Business

Understanding how people make ethical choices and what prompts a person to act unethically may result in better ethical decisions. Ethical decisions in an organization are influenced by three key factors: individual moral standards and values, the influence of managers and co-workers, and the opportunity to engage in misconduct (Figure 2.2). While you have great control over your personal ethics outside the workplace, your co-workers and superiors exert significant control over your choices at work through authority and example. In fact, the activities and examples set by co-workers, along with rules and policies established by the firm, are critical in gaining consistent ethical compliance in an organization. If the company fails to provide good examples and direction for appropriate conduct, confusion and conflict will develop and result in the opportunity for misconduct. If your boss or co-workers leave work early, you may be tempted to do so as well. If you see co-workers engaged in personal activities such as shopping online or if they ignore the misconduct of others, then you may be more likely to do so also. Having sound personal values is important because you will be responsible for your own conduct.

Because ethical issues often emerge from conflict, it is useful to examine the causes of ethical conflict. Business managers and employees often experience some tension between their own ethical beliefs and their obligations to the organizations in which

Turnitin is an Internet service that allows teachers to determine if their students have plagiarized content.

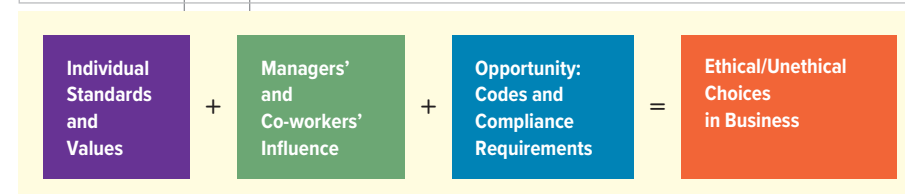
Sharaf Maksumov/Shutterstock

or quoting from a published work or Internet source without acknowledging it. In business, an ethical issue arises when employees copy reports or take the work or ideas of others and present it as their own. A manager attempting to take credit for a subordinate's ideas is engaging in another type of plagiarism.

## Making Decisions about Ethical Issues

It can be difficult to recognize specific ethical issues in practice. Managers, for example, tend to be more concerned about issues that affect those close to them, as well as issues that have immediate rather than long-term consequences. Thus, the perceived importance of an ethical issue substantially affects choices. However, only a few issues receive scrutiny, and most receive no

▼ **FIGURE 2.2** Three Factors That Influence Business Ethics



### codes of ethics

formalized rules and standards that describe what a company expects of its employees.

**whistleblowing** the act of an employee exposing an employer's wrongdoing to outsiders, such as the media or government regulatory agencies.

they work. Many employees utilize different ethical standards at work than they do at home. This conflict increases when employees feel that their company is encouraging unethical conduct or exerting pressure on them to engage in it.

It is difficult for employees to determine what conduct is acceptable within a company if the firm does not have established ethics policies and standards. And with-

out such policies and standards, employees may base decisions on how their peers and superiors behave. Professional **codes of ethics** are formalized rules and standards that describe what the company expects of its employees. Codes of ethics do not have to be so detailed that they take into account every situation, but they should provide guidelines and principles that can help employees achieve organizational objectives and address risks in an acceptable and ethical way. The development of a code of ethics should include not only a firm's executives and board of directors, but also legal staff and employees from all areas of a firm.<sup>33</sup> Table 2.6 lists why a code of ethics is important.

Codes of ethics, policies on ethics, and ethics training programs advance ethical behavior because they prescribe which activities are acceptable and which are not, and they limit the opportunity for misconduct by providing punishments for violations of the rules and standards. This creates compliance requirements to establish uniform behavior among all employees. Codes and policies on ethics encourage the creation of an ethical culture in the company. According to the Global Business Ethics Survey, employees in organizations that have written codes of conduct and ethics training, ethics offices or hotlines, and systems for reporting are more likely to report misconduct when they observe it. The survey found that a company's ethical culture is the greatest determinant of future misconduct.<sup>34</sup>

The enforcement of ethical codes and policies through rewards and punishments increases the acceptance of ethical standards by employees. One of the most important components of an ethics program is a means through which employees can report observed misconduct anonymously. Although the risk of retaliation is still a major factor in whether an employee will report illegal conduct, the Global Business Ethics Survey found that whistleblowing



Kim Gwang-ho, an automotive engineer, was a whistleblower who exposed Hyundai for allegedly hiding defects in its vehicles from the public.

emirhankaramuk/Shutterstock

has increased in the past few years. Approximately 69 percent of respondents said they reported misconduct when they observed it.<sup>35</sup> **Whistleblowing** occurs when an employee exposes an employer's wrongdoing to outsiders, such as the media or government regulatory agencies. Howard Wilkinson, a trader for a Danske Bank branch in Estonia, discovered massive fraud through his branch after he downloaded a report for a London business that reported that it had no assets. Wilkinson reported his findings to Danske officials, which kicked off the investigation that discovered the money laundering scheme. The internal investigation exonerated top management and shifted blame onto dozens of low-level employees, but CEO Thomas Borgen decided to resign nonetheless.<sup>36</sup> More companies are establishing programs to encourage employees to report illegal or unethical practices internally so that they can take steps to remedy problems before they result in legal action or generate negative publicity. Unfortunately, whistleblowers are often treated negatively in organizations. The government, therefore, tries to encourage employees to report observed misconduct. Congress has also taken steps to close a legislative loophole in whistleblowing legislation that has led to the dismissal of many whistleblowers. Congress passed the Dodd-Frank Act, which includes a "whistleblower bounty program." The Securities and Exchange Commission can now award whistleblowers between 10 and 30 percent of monetary sanctions over \$1 million. The hope is that incentives will encourage more people to come forward with information regarding corporate misconduct.

#### ▼ TABLE 2.6 Why a Code of Ethics Is Important

- Alerts employees about important issues and risks to address.
- Provides values such as integrity, transparency, honesty, and fairness that give the foundation for building an ethical culture.
- Gives guidance to employees when facing gray or ambiguous situations or ethical issues that they have never faced before.
- Alerts employees to systems for reporting or places to go for advice when facing an ethical issue.
- Helps establish uniform ethical conduct and values that provide a shared approach to dealing with ethical decisions.
- Serves as an important document for communicating to the public, suppliers, and regulatory authorities about the company's values and compliance.
- Provides the foundation for evaluation and improvement of ethical decision making.



The current trend is to move away from legally based ethical initiatives in organizations to cultural- or integrity-based initiatives that make ethics a part of core organizational values. Organizations recognize that effective business ethics programs are good for business performance. Firms that develop higher levels of trust function more efficiently and effectively and avoid damaged company reputations and product images. Organizational ethics initiatives have been supportive of many positive and diverse organizational objectives, such as profitability, hiring, employee satisfaction, and customer loyalty.<sup>37</sup> Conversely, lack of organizational ethics initiatives and the absence of workplace values such as honesty, trust, and integrity can have a negative impact on organizational objectives and employee retention. According to one survey, companies with a weak ethical culture experience fewer favorable outcomes.<sup>38</sup>

**LO 2-4** Explain the four dimensions of social responsibility.

## THE NATURE OF SOCIAL RESPONSIBILITY

For our purposes, we classify four stages of social responsibility: financial, legal compliance, ethics, and philanthropy (Table 2.7). Another way of categorizing these four dimensions of social responsibility include economic, legal, ethical, and voluntary (including philanthropic).<sup>39</sup> Earning profits is the financial or economic foundation, and complying with the law is the next step. However, a business whose *sole* objective is to maximize profits is not likely to consider its social responsibility, although its activities will probably be legal. (We looked at ethical responsibilities in the first half of this chapter.) Voluntary responsibilities are additional activities that may not be required but which promote human welfare or goodwill. Legal and economic concerns have long been acknowledged in business, and voluntary and ethical issues are now being addressed by most firms.

**Corporate citizenship** is the extent to which businesses meet the legal, ethical, economic, and voluntary responsibilities placed

on them by their various stakeholders. It involves the activities and organizational processes adopted by businesses to meet their social responsibilities. A commitment to corporate citizenship by a firm indicates a strategic focus on fulfilling

the social responsibilities expected of it by its stakeholders. For example, CVS demonstrated corporate citizenship by eliminating tobacco products from its pharmacies. Although this cost the firm \$2 billion in sales, CVS believed it was contradictory to market itself as a health care services business while still selling a dangerous product.<sup>40</sup> Corporate citizenship involves action and measurement of the extent to which a firm embraces the corporate citizenship philosophy and then follows through by implementing citizenship and social responsibility initiatives. One of the major corporate citizenship issues is the focus on preserving the environment. The majority of people agree that climate change is a global emergency, but there is no agreement on how to solve the problem.<sup>41</sup> Another example of a corporate citizenship issue might be animal rights—an issue that is important to many stakeholders. As the organic and local foods movements grow and become more profitable, more and more stakeholders are calling for more humane practices in factory farms as well.<sup>42</sup> Large factory farms are where most Americans get their meat, but some businesses are looking at more animal-friendly options in response to public outcry.

Part of the answer to climate change issues is alternative energy such as solar, wind, biofuels, and hydro applications. The drive for alternative fuels such as ethanol from corn has added new issues such as food price increases and food shortages. A survey revealed that 73 percent of American consumers feel that it is important for the government to invest in renewable energy.<sup>43</sup>

**corporate citizenship** the extent to which businesses meet the legal, ethical, economic, and voluntary responsibilities placed on them by their stakeholders.

▼ **TABLE 2.7** Social Responsibility Requirements

Stages	Examples
Stage 1: Financial and economic viability	Starbucks offers investors a healthy return on investment, including paying dividends.
Stage 2: Compliance with legal and regulatory requirements	Starbucks specifies in its code of conduct that payments made to foreign government officials must be lawful according to the laws of the United States and the foreign country.
Stage 3: Ethics, principles, and values	Starbucks' mission and values create ethical culture with ethical leaders.
Stage 4: Philanthropic activities	Starbucks created the Starbucks College Achievement Plan that offers eligible employees full tuition to earn a bachelor's degree in partnership with Arizona State University.

“A COMMITMENT TO CORPORATE CITIZENSHIP BY A FIRM INDICATES A STRATEGIC FOCUS ON FULFILLING THE SOCIAL RESPONSIBILITIES EXPECTED OF IT BY ITS STAKEHOLDERS.”

## TYSON LOOKS FOR SUSTAINABLE MEAT

As the producer of 20 percent of meat consumed in the United States, Tyson is crazy about meat. Yet with 14 percent of U.S. consumers indicating they use plant-based meat alternatives to get more protein in their diet, the market for alternative meats is increasing. Of these consumers, 86 percent do not consider themselves vegetarian or vegan.

For this reason, Tyson is invested in manufacturing plant-based food that tastes like meat, launching a new brand called Raised & Rooted. Benefits of these meat alternatives are that they use fewer resources and contribute to less environmental pollution.

A more sustainable solution to meat production could be highly beneficial. Tyson's annual

greenhouse gas emissions are thought to be equivalent to those emitted by the country of Ireland. Tyson does not have the best track record with sustainability; it was forced to pay a fine of \$2 million for contaminating a river with chicken waste from a processing plant. The inhumane treatment of animals has been another criticism levied against the company.

Tyson has responded by working with critics to improve its operations. For instance, Tyson CEO Tom Hayes added the position of a chief sustainability officer and promised to better the treatment of animals. Tyson has adopted the goal to cut its greenhouse gas emissions by 30 percent by 2030. In addition to investing in meat alternatives, Tyson is also launching a

vegetarian brand, Green Street. The company is hoping self-regulation will improve its operations and public perceptions of the firm.<sup>47</sup>

### Critical Thinking Questions

1. What were some of the sustainability mishaps Tyson has faced in the past?
2. What are some ways Tyson hopes to improve its sustainability and the ethical treatment of animals?
3. Do you think Tyson is investing more in alternative meats because it is beneficial to the environment or because the market is increasing in demand? Explain your reasoning.

To respond to these developments, most companies are introducing eco-friendly products and marketing efforts. Dell introduced laptops that come in sustainably sourced packaging made from 25 percent recycled ocean-bound plastics and locally recycled plastics. This is part of a greater effort for Dell to increase its use of sustainable packaging from 85 percent to 100 percent by 2030. Since 2012, Dell has used more than 100 million pounds of sustainable materials in its commitment to recycled packaging.<sup>44</sup> Almost 40 percent of consumers have bought a product for the first time due to the brand taking a stance on an important societal or political issue. About 64 percent chose to switch or abandon brands based on the company's stance on an issue. An example of a high-profile company taking a stance is when Audi promoted gender pay equality in a commercial that aired during the Super Bowl.<sup>45</sup> This is because many businesses are promoting themselves as green-conscious



Nike released a series of controversial ads featuring Colin Kaepernick, a former NFL quarterback who knelt during the national anthem to call attention to racial injustice. The campaign resulted in record-breaking brand engagement.

Angela Weiss/AFP/Getty Images

and concerned about the environment without actually making the necessary commitments to environmental health.

The Ethisphere Institute selects an annual list of the world's most ethical companies based on the following criteria: corporate citizenship and responsibility; corporate governance; innovation that contributes to the public well-being; industry leadership; executive leadership and tone from the top; legal, regulatory, and reputation track record; and internal systems and ethics/compliance program.<sup>46</sup> Table 2.8 shows 26 from that list.

Although the concept of social responsibility is receiving more and more attention, it is still not universally accepted. Table 2.9 lists some of the arguments for and against social responsibility.

▼ **TABLE 2.8** A Selection of the World's Most Ethical Companies

L'Oréal	HASBRO Inc.
Sony	Intel
Microsoft	Xcel Energy
3M Company	General Motors
T-Mobile	Cummins Inc.
PepsiCo	John Deere
ManpowerGroup	LinkedIn
Colgate-Palmolive Company	Prudential
International Paper Co.	Thrivent Financial
Visa Inc.	Western Digital
USAA	Kellogg Company
Accenture	Aflac Incorporated
Wyndham Hotels & Resorts	Dell

**Source:** Ethisphere Institute, "The 2020 World's Most Ethical Companies® Honoree List," <http://www.worldsmoethicalcompanies.com/honorees/> (accessed May 20, 2020).

## BUILDING A BETTER EVERYDAY LIFE WITH IKEA

IKEA was founded in Sweden in 1943 by Ingvar Kamrad. A favorite among customers searching for well-designed products at a low price, it has become the largest furniture retailer in the world. The culture of IKEA heavily reflects Swedish cultural values of hard-working, friendly, and helpful people. These values helped create IKEA's vision, which is "to create a better everyday life for the many people."

Corporate social responsibility (CSR) is a large factor in IKEA's company culture. Employees are encouraged to mentor young students, assist senior citizens, and more. By volunteering for these tasks, employees learn valuable skills that can transfer over to their jobs. IKEA has also found that CSR is a powerful

recruiting tool. Through CSR, IKEA can help communities while attracting better talent.

In 1982, IKEA opened the IKEA foundation. Initially, the foundation focused on architecture and interior design, but the foundation expanded to fight for children's rights and education. The IKEA Foundation awarded a grant of \$2.3 million to the World Resources Institute to help bring clean electricity to a million people in India and East Africa.

Another focus for IKEA is reducing carbon emissions. In fact, IKEA's long-term goal is to become "carbon positive," which means removing more carbon dioxide emissions than it creates. IKEA is already moving toward this goal by switching to electric delivery trucks. The

company is committed to completely switching over to electric trucks in every location within the next several years. IKEA has invested around \$2 billion in renewable energy and expects to be climate positive—producing more energy than they use—by 2030.<sup>b</sup>

### Critical Thinking Questions

1. Describe the strides IKEA is attempting to take in sustainability.
2. How does IKEA display corporate social responsibility? How does this differ from ethical conduct?
3. Why do you think a culture of volunteerism might be helpful in recruiting new employees?

**LO 2-5** Evaluate an organization's social responsibilities to owners, employees, consumers, the environment, and the community.

## Social Responsibility Issues

Managers consider and make social responsibility decisions on a daily basis. Among the many social issues that managers must consider are their firms' relations with stakeholders, including owners and stockholders, employees, consumers, regulators, communities, and environmental advocates.

Social responsibility is a dynamic area with issues changing constantly in response to society's demands. There is much evidence that social responsibility is associated with improved business performance. Consumers are refusing to buy from businesses that receive publicity about misconduct. A number of studies have found a direct relationship between social responsibility and profitability, as well as a link that exists between employee commitment and customer loyalty—two major concerns of any firm trying to increase profits.<sup>47</sup> This section highlights a few of the many social responsibility issues that managers face; as managers become aware of and work toward the solution of current social problems, new ones will certainly emerge.

▼ **TABLE 2.9** The Arguments For and Against Social Responsibility

### For:

1. Social responsibility rests on stakeholder engagement and results in benefits to society and improved firm performance.
2. Businesses are responsible because they have the financial and technical resources to address sustainability, health, and education.
3. As members of society, businesses and their employees should support society through taxes and contributions to social causes.
4. Socially responsible decision making by businesses can prevent increased government regulation.
5. Social responsibility is necessary to ensure economic survival: If businesses want educated and healthy employees, customers with money to spend, and suppliers with quality goods and services in years to come, they must take steps to help solve the social and environmental problems that exist today.

### Against:

1. It sidetracks managers from the primary goal of business—earning profit. The responsibility of business to society is to earn profits and create jobs.
2. Participation in social programs gives businesses greater power, perhaps at the expense of concerned stakeholders.
3. Does business have the expertise needed to assess and make decisions about social and economic issues?
4. Social problems are the responsibility of the government agencies and officials, who can be held accountable by voters.
5. Creation of nonprofits and contributions to them are the best ways to implement social responsibility.



**consumerism** the activities that independent individuals, groups, and organizations undertake to protect their rights as consumers.

### Relations with Owners and Stockholders.

Businesses must first be responsible to their owners, who are primarily concerned with earning a profit or a return on their investment in a

company. In a small business, this responsibility is fairly easy to fulfill because the owner(s) personally manages the business or knows the managers well. In larger businesses, particularly corporations owned by thousands of stockholders, ensuring responsibility becomes a more difficult task.

A business's obligations to its owners and investors, as well as to the financial community at large, include maintaining proper accounting procedures, providing all relevant information to investors about the current and projected performance of the firm, and protecting the owners' rights and investments. In short, the business must maximize the owners' investments in the firm.

**Employee Relations.** Another issue of importance to a business is its responsibilities to employees. Without employees, a business cannot carry out its goals. Employees expect businesses to provide a safe workplace, pay them adequately for their work, and keep them informed of what is happening in their company. They want employers to listen to their grievances and treat them fairly. After increased criticism about pay and benefits for its warehouse workers, Amazon raised the minimum wage paid to U.S. workers to \$15 an hour. This pay increase boosted the wage of 250,000 current employees and 100,000 seasonal employees.<sup>48</sup>



OSHA ordered its inspectors to crack down on employers who fail to file the necessary electronic paperwork to document injury reports.

Herdik Herlambang/Shutterstock

Congress has passed several laws regulating safety in the workplace, many of which are enforced by the Occupational Safety and Health Administration (OSHA). Labor unions have also made significant contributions to achieving safety in the workplace and improving wages and benefits. Most organizations now recognize that the safety and satisfaction of their employees are critical ingredients in their success, and many strive to go beyond what is legally expected of them. Healthy, satisfied employees also supply more than just labor to their employers. Employers are beginning to realize the importance of obtaining input from even the lowest-level employees to help the company reach its objectives.

A major social responsibility for business is providing equal opportunities for all employees regardless of their sex, age, race, religion, or nationality. Diversity is also helpful to a firm financially. Corporations that raised the share of female executives to 30 percent saw a 15 percent increase in profitability.<sup>49</sup> Also, it has been found that when men and women managers are evenly matched, there is a better chance of generating stronger profits. Thus, many firms are trying to become more inclusive, embracing diversity.<sup>50</sup> Yet, despite these benefits, women and minorities have been slighted in the past in terms of education, employment, and advancement opportunities; additionally, many of their needs have not been addressed by business. After a U.K. High Court ruling, Lloyds Banking Group was ordered to equalize pension benefits for men and women. This ruling occurred after a dispute was filed by a female employee who pointed out that pensions for women were increasing at a lower rate than male pension plans for the company. The ruling is estimated to cost nearly €150 million and could result in additional costs and liabilities for the bank. Lloyds welcomed the ruling and claimed that the issue occurs industrywide and should be resolved.<sup>51</sup> Women, who continue to bear most child-rearing responsibilities, often experience conflict between those responsibilities and their duties as employees. Consequently, day care has become a major employment issue for women, and more companies are providing day care facilities as part of their effort to recruit and advance women in the workforce. A class-action lawsuit was filed against Avon, alleging the company discriminated against pregnant women.<sup>52</sup> Many Americans today believe business has a social obligation to provide special opportunities for women and minorities to improve their standing in society.

**Consumer Relations.** A critical issue in business today is business's responsibility to customers, who look to business to provide them with satisfying, safe products and to respect their rights as consumers. The activities that independent individuals, groups, and organizations undertake to protect their rights as consumers are known as **consumerism**. To achieve their objectives, consumers and their advocates write letters to companies, lobby government agencies, make public service announcements, and boycott companies whose activities they deem irresponsible.

Many of the desires of those involved in the consumer movement have a foundation in John F. Kennedy's 1962 consumer bill of rights, which highlighted four rights. The *right to safety*



means that a business must not knowingly sell anything that could result in personal injury or harm to consumers. Defective or dangerous products erode public confidence in the ability of business to serve society. They also result in expensive litigation that ultimately increases the cost of products for all consumers. The right to safety also means businesses must provide a safe place for consumers to shop.

The *right to be informed* gives consumers the freedom to review complete information about a product before they buy it. This means that detailed information about risks and instructions for use are to be printed on labels and packages. The *right to choose* ensures that consumers have access to a variety of goods and services at competitive prices. The assurance of both satisfactory quality and service at a fair price is also a part of the consumer's right to choose. The *right to be heard* assures consumers that their interests will receive full and sympathetic consideration when the government formulates policy. It also ensures the fair treatment of consumers who voice complaints about a purchased product.

The role of the Federal Trade Commission's Bureau of Consumer Protection exists to protect consumers against unfair, deceptive, or fraudulent practices. The bureau, which enforces a variety of consumer protection laws, is divided into five divisions. The Division of Enforcement monitors legal compliance and investigates violations of laws, including unfulfilled holiday delivery promises by online shopping sites, employment opportunities fraud, scholarship scams, misleading advertising for health care products, and more.

**Sustainability Issues.** Most people probably associate the term *environment* with nature, including wildlife, trees, oceans, and mountains. Until the 20th century, people generally thought of the environment solely in terms of how these resources could be harnessed to satisfy their needs for food, shelter, transportation, and recreation. As the earth's population swelled throughout the 20th century, however, humans began to use more and more of these resources and, with technological advancements,



*The Federal Trade Commission's Bureau of Consumer Protection protects consumers against unfair, deceptive, or fraudulent practices.*

Mark Van Scyoc/Shutterstock

to do so with ever-greater efficiency. Although these conditions have resulted in a much-improved standard of living, they come with a cost. Plant and animal species, along with wildlife habitats, are disappearing at an accelerated rate. For example, the bumblebee population has suffered almost 90 percent decline in the past 20 years. Bees are important to pollinating most fruits and vegetables. The bumblebee was placed on the endangered species list and its habitats were protected.<sup>53</sup>

Although the scope of the word *sustainability* is broad, in this book we discuss the term from a strategic business perspective. Thus, we define **sustainability** as conducting activities in such a way as to provide for the long-term well-being of the natural environment, including all biological entities. Sustainability involves the interaction among nature and individuals, organizations, and business strategies and includes the assessment and improvement of business strategies, economic sectors, work practices, technologies, and lifestyles so that they maintain the health of the natural environment. In recent years, business has played a significant role in adapting, using, and maintaining the quality of sustainability.

Environmental protection emerged as a major issue in the 20th century in the face of increasing evidence that pollution, uncontrolled use of natural resources, and population growth were putting increasing pressure on the long-term sustainability of these resources. In recent years, companies have been increasingly incorporating these issues into their overall business strategies. Some nonprofit organizations have stepped forward to provide leadership in gaining the cooperation of diverse groups in responsible environmental activities.

In the following sections, we examine some of the most significant sustainability and environmental health issues facing business and society today, including pollution and alternative energy.

### **Pollution.**

A major issue in the area of environmental responsibility is pollution. Water pollution results from dumping toxic chemicals and raw sewage into rivers and oceans, oil spills, and the burial of industrial waste in the ground where it may filter into underground water supplies. Fertilizers and insecticides used in farming and grounds maintenance also run off into water supplies with each rainfall. Water pollution problems are especially notable in heavily industrialized areas. Society is demanding that water supplies be clean and healthful to reduce the potential danger from these substances.

Air pollution is usually the result of smoke and other pollutants emitted by manufacturing facilities, as well as carbon monoxide

### **sustainability**

conducting activities in a way that allows for the long-term well-being of the natural environment, including all biological entities; involves the assessment and improvement of business strategies, economic sectors, work practices, technologies, and lifestyles so that they maintain the health of the natural environment.

and hydrocarbons emitted by motor vehicles. In addition to the health risks posed by air pollution, when some chemical compounds emitted by manufacturing facilities react with air and rain, acid rain results. Acid rain has contributed to the deaths of many forests and lakes in North America as well as in Europe. Air pollution may also contribute to global warming; as carbon dioxide collects in the earth's atmosphere, it traps the sun's heat and prevents the earth's surface from cooling. It is indisputable that the global surface temperature has been increasing over the past 35 years. Worldwide passenger vehicle ownership has been growing due to rapid industrialization and consumer purchasing power in China, India, and other developing countries with large populations. The most important way to contain climate change is to control carbon emissions. For example, some utilities charge more for electricity in peak demand periods, which encourages behavioral changes that reduce consumption.

More and more consumers are recognizing the need to protect the planet. Figure 2.3 shows consumers' likelihood to personally address social responsibility and environmental issues. Although most consumers admit that sustainable products are important and that they bear responsibility for properly using and disposing of the product, many admit that they fail to do this.

Land pollution is tied directly to water pollution because many of the chemicals and toxic wastes that are dumped on the land eventually work their way into the water supply. A study conducted by the Environmental Protection Agency found residues of prescription

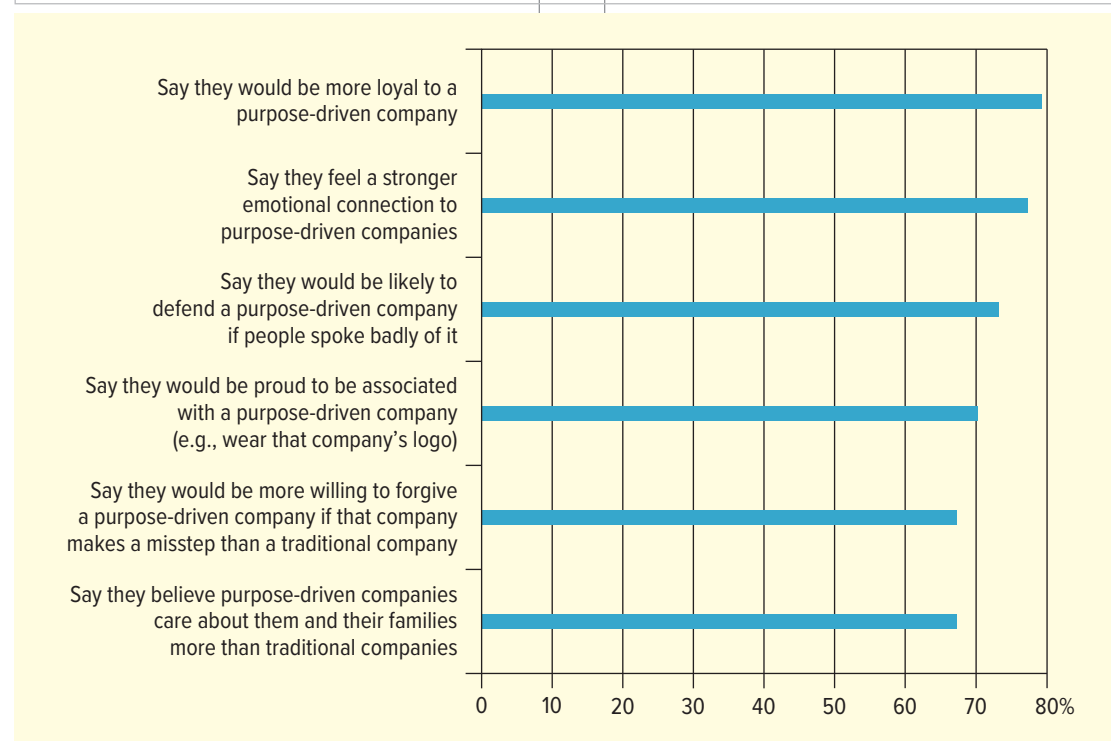
drugs, soaps, and other contaminants in virtually every waterway in the United States. Effects of these pollutants on humans and wildlife are uncertain, but there is some evidence to suggest that fish and other water-dwellers are starting to suffer serious effects. Land pollution results from the dumping of residential and industrial waste, strip mining, forest fires, and poor forest conservation. The world's forests cover more than 30 percent of the planet, but over the past 25 years, forests shrank by 502,000 square miles. In Brazil, more than 89,000 fires started by humans burned the Amazon in 2019, the most biodiverse rainforest on the planet.<sup>54</sup> During the COVID-19 pandemic in 2020, which prompted lockdowns and job loss in many countries, rainforest deforestation doubled.<sup>55</sup> Scientists fear the Amazon is close to a tipping point where it will enter an irreversible cycle of collapse.<sup>56</sup> Large-scale deforestation also depletes the oxygen supply available to humans and other animals.

Related to the problem of land pollution is the larger issue of how to dispose of waste in an environmentally responsible manner. Americans use approximately 100 billion plastic bags per year.<sup>57</sup> Some states and many other countries are also in the process of phasing out lightweight plastic bags.

### **Alternative Energy.**

With ongoing plans to reduce global carbon emissions, countries and companies alike are looking toward alternative energy sources. Traditional fossil fuels are problematic because of their emissions, but also because stores have been greatly depleted.

▼ **FIGURE 2.3** Consumer Loyalty to Purpose-Driven Companies



**Source:** Cone/Porter Novelli, "2018 Cone/Porter Novelli Purpose Study: How to Build Deeper Bonds, Amplify Your Message and Expand Your Consumer Base," <http://www.conecomm.com/2018-purpose-study-pdf> (accessed May 20, 2020).

Foreign fossil fuels are often imported from politically and economically unstable regions, often making it unsafe to conduct business there. However, the United States is becoming an energy powerhouse with its ability to drill for natural gas in large shale reserves. This is allowing the United States to move forward on its goals to reach energy independence. On the other hand, concerns over how these drilling methods are affecting the environment make this a controversial topic.

The U.S. government has begun to recognize the need to look toward alternative forms of energy as a source of fuel and electricity. There have been many different ideas as to which form of alternative energy would best suit the United States' energy needs. These sources include wind power, solar power, nuclear power, biofuels, electric cars, and hydro- and geothermal power. As of yet, no "best" form of alternative fuel has been selected to replace gasoline. Additionally, there are numerous challenges with the economic viability of alternative energy sources. For instance, wind and solar power cost significantly more than traditional energy. Alternative energy will likely require government subsidies to make any significant strides. However, the news for solar power might be getting brighter. Electric cars are also gaining importance. Most automobile companies such as Tesla, BMW, General Motors, Nissan, and Toyota are introducing electric cars to help with sustainability.



### DID YOU KNOW?

About 50 million tons of electronic waste is generated each year, including discarded laptops, mobile phones, and televisions.<sup>c</sup>

**Response to Environmental Issues.** Many firms are trying to eliminate wasteful practices, the emission of pollutants, and/or the use of harmful chemicals from their manufacturing processes. In response to a plastic straw ban in Seattle, McDonald's began testing plastic straw alternatives, such as paper straws, in its restaurants.<sup>58</sup> Other companies are seeking ways to improve their products. Utility providers, for example, are increasingly supplementing their services with alternative energy sources, including solar, wind, and geothermal power.

Environmentalists are concerned that some companies are merely *greenwashing*, or "creating a positive association with environmental issues for an unsuitable product, service, or practice."

Indeed, a growing number of businesses and consumers are choosing green power sources where available. New Belgium Brewing Company, the fourth-largest craft brewer in the United States, is the first all-wind-powered brewery in the country. Many businesses have turned to *recycling*, the reprocessing of materials—aluminum, paper, glass, and some plastic—for reuse. Such efforts to make products, packaging, and processes more environmentally friendly have been labeled "green" business or marketing by the public and media. For example, lumber products at The Home Depot may carry a seal from the Forest Stewardship Council to indicate that they were harvested from sustainable forests using environmentally friendly methods.<sup>59</sup>

## SHERWIN-WILLIAMS PAINTS ITSELF IN A CORNER

Most would agree that companies advertising a dangerous product should be held accountable. However, what if the advertisement was more than a century old? This is the dilemma paint makers like Sherwin-Williams are facing from a California lawsuit seeking damages for the firms' marketing of lead paint in homes.

For nearly two decades, California counties have demanded that paint manufacturers pay more than \$1 billion into a state fund for investigating and removing lead paint from as many as 1.6 million homes. The courts initially ruled that Sherwin-Williams, NL Industries, and ConAgra were liable for the cleanup. Later, the damages were limited to paint used in houses prior to 1950, after which paint manufacturers began publicly acknowledging the dangers of

lead paint. Lead paint in homes would not officially become illegal until 1978.

After the ruling, paint manufacturers tried to fund a ballot initiative for taxpayers to fund the cleanup efforts but abandoned it after public outcry. After nearly 20 years of litigation, the final settlement was reduced to \$305 million to be paid by Sherwin-Williams, NL Industries, and ConAgra over a period of six years, and the companies were not required to admit any wrongdoing.

A major consideration is how long these companies knew about the dangers. Some maintain Sherwin-Williams knew about the hazards since 1900. Sherwin-Williams denies it knew about the health risks before they were scientifically accepted. This case has important implications for the industry. This case could set a precedent that could increase potential

liability for advertisers, making them liable if their products are found to be hazardous further down the road—even if they are currently legal.<sup>d</sup>

### Critical Thinking Questions

1. Describe the ethical issue in this case. Why do you think it has been so difficult to come to a solid verdict?
2. If Sherwin-Williams knew about the dangers of lead paint more than a century ago (it denies this claim), how would this violate the concepts of fairness and honesty? Do you think this should affect the verdict?
3. Recall that lead paint in homes was not made illegal until 1978. Yet knowledge that it was toxic inside the home was accepted since the 1950s. Do you think other stakeholders should be held liable for the cleanup?