SOLUTIONS MANUAL

2 Entrepreneurial Integrity and Ethics

– CHAPTER 2 LECTURE NOTES

LO1 Define integrity and understand its importance to small businesses.

A. **Integrity and Entrepreneurship**

1. **What is integrity?**
   - What one believes to be right and proper
   - Values such as honesty, reliability and fairness are hallmark of integrity
2. **Doing the right thing**
   - Ethical issues involve questions of right and wrong
   - Self-interest versus the needs of others
   - It may not pay to be ethical, at least in the short run.

LO2 Explain how integrity applies to various stakeholder groups, including owners, customers, employees, the community, and the government.

B. **A framework for Integrity**

- Note: The most common ethical issues faced by small business owners in exhibit 2-2.
- Stakeholders such as owners, customers, employees, government, and the community must be considered when making ethical decision.

1. **Promoting the Owners' Interest**
   - Opinions vary regarding the social responsibility of businesses.
   - Multiple business owners complicate the decision-making process.
   - Entrepreneurs must protect others' investments in the business.
2. **Respecting Customers**
   - Trust customers with respect and build relationships.
   - Advertising and direct selling can cause ethical issues to arise.
3. **Valuing Employees**
   - The level of integrity in a firm is reflected in how much respect it gives its employees.

- Management decisions affect employees' private and family lives.
- Treating employees with respect is good business as well as the right thing to do

4. **Social Responsibility and Small Business**
   🗝 Have students provide examples of socially responsible businesses. Do they feel this helps create a competitive advantage?
   a. Examples of Citizenship in the Community
      - Hall Financial Group of Dallas, TX.
      - PAR Educational Technologies.
   b. Varying Views on Social Responsibility
      - Small business owners are more focused on profits than CEOs in large companies
      - Small business owners must spend their own money rather than corporate funds.
      - Small businesses must balance social obligations with the need to earn profits.
      - Social responsibility is consistent with a long-term business perspective
      - Goodwill within a community has value to a small business.
5. **Government Laws and Regulations**
      - Small business must comply with laws to maintain integrity

LO3 Identify challenges to integrity that arise in small businesses and explain the benefits of integrity to small firms.

C. **The Challenges and Benefits of Acting Ethically**
1. **The Vulnerability of Small Companies**
   - Many small firms are vulnerable to temptation because of marginality.
   - Bribery may be rationalized as an effort to create a level playing field.
   - Responses to vignettes compare the ethics of entrepreneurs and others.
   - Entrepreneurs were less moral on some issues but more moral on others.
2. **The Integrity Edge**
   - Integrity is crucial to small business success.
   - Firms perform better when they focus in the needs of all stakeholders
   - Greatest benefit of integrity is the trust it generates.

LO4 Explain the impact of the Internet and globalization on the integrity of small businesses.

D. **Integrity in an Expanding Economy**
   🗝 Discuss how ethical standards maybe different across national boundaries.
1. **Integrity and the Internet**
   - Ethical issues abound in the Internet world.
   - Using personal information—the privacy issue
   - Respecting intellectual property rights
   - Is it okay to monitor employees' email?

2. **International Issues of Integrity**
   - Some countries face higher levels of unethical behavior than others.
   - Determining what constitutes ethical behavior is more difficult across different cultures.
   - Ethical relativism is troublesome.
   - Ethical imperialism—impose US standards on other societies.

LO5 Describe practical approaches for building a business with integrity.

E. **Building a Business with Integrity**

1. **A Strong Foundation**
   - Strongly held values lead to difficult choices – *have students discuss a difficult ethical dilemma they faced at work*
   - Discuss how Veggie Tales combines its strong underlying values into a successful business.
2. **Leading with Integrity**
   - What we believe affects what we do.
   - The underlying values that govern the integrity of business practices are often based on religious foundations or personal values.
   - Absolute, not situational, ethics help business people resist temptation and choose the honest, the good, and the right, rather than the most expedient or the most profitable, whenever there is a conflict.
   - The personal Integrity of the founder or owner is key to a firm's ethical performance.
3. **A Supportive Organizational Culture**
   - As the influence of the entrepreneur is reduced, a code of ethics is necessary for the growing firm.
   - A code should include both principles to be followed and examples.
   - *Discuss the student's experiences with Codes of Ethics at jobs they have had.*
4. **An Ethical Decision-Making Process**
   - Their purpose is to promote ethical conduct of businesses in a community.
   - Their functions are to give guidelines and information about a company to consumers before they do business with the company and to resolve questions and disputes over purchases after the fact.

LO6 Describe social entrepreneurship and the costs and opportunities of environmentalism to small businesses.

F. **Social Entrepreneurship: A Fast Emerging Trend**

🗝 *Environmentalism is an effort to preserve and redeem the natural environment.*

1. **The Burden of Environmentalism**
   - How can firms negatively impact the environment?
   - Which types of firms may be adversely affected by efforts to protect the environment?
   - Difficult for small firms to pass on the increased costs associated with environmentalism.

2. **The Potential of Environmentalism**
   - Environmentalism creates opportunity for some small businesses.
   - Doing well by doing good.
   - *Have students share examples of how environmentalism creates business opportunities. (ex. Disposal of used tires)*

— SOURCES OF VIDEO AND OTHER INSTRUCTIONAL MATERIALS

INTELECOM offers a series called *Taking the Lead: The Management Revolution*, which includes two 28-minute videotapes entitled *Making Choices: Managerial Ethics* and *For the Common Good: Social and Management Responsibility*. The two videos cost about $100. Email http://www.intelecom.org/catalog_n.asp, or call (626) 796-7300.

Insight Media distributes a series of videotapes on business ethics. Email http://www.insight-media.com/IMGroupDispl.asp, call (800) 233-9910 for information, or write to Insight Media, 2162 Broadway, New York, NY 10024-0621.

— ANSWERS TO END-OF-CHAPTER DISCUSSION QUESTIONS

1. *The owner of a small business felt an obligation to pay $15,000 to a subcontractor, even though, because of an oversight, the subcontractor had never submitted a bill. Can willingness to pay under these circumstances be reconciled with the profit goal of a business in a free enterprise system?*
   Of course, this is obviously the "right" thing to do, but it may also be the prudent response as well. First of all, just because the subcontractor has not submitted the bill does not necessarily forgotten about the small firms legal obligation to pay. Failing to follow through would certainly raise suspicions about the small company in this case. Secondly, if the subcontractor has indeed forgotten about the obligation, paying the bill will leave a great impression on the subcontractor and ensure perceptions that the small firms is trustworthy, which may lead to favorable business dealings between the two parties in the future. Finally, if the small business does not pay and word of this gets out, it is likely to damage the reputation of the firm, which can lead to a loss of business in the future, less favorable credit terms on the part of future lenders, etc. Doing the wrong thing can create some very negative fallout over time.

2. *Give an example of an unethical business practice that you have personally encountered.*
   Most students, if they think a moment, can describe some personal business experience that struck them as unethical.

3. *Based on your experience as an employee, customer, or observer of some particular small business, how would you rate its ethical performance? On what evidence or clues do you base your opinion?*

No doubt students will report examples of both ethical and unethical performance. It should be interesting to observe the overall effect of conduct they sense and the clues on which they base their opinions.

4. *Give some examples of the practical application of a firm's basic commitment to supporting the family life of its employees.*
   One example cited in the chapter was a bus driver who refused to take poor people away to gambling facilities. Other examples would include policies restricting excessive overtime work that interferes with family life, setting adequate wage levels, and allowing flexibility in leave policies to permit employees to deal with family emergencies.

5. *What is skimming? How do you think owners of small firms might attempt to rationalize such a practice?*
   Skimming is a method of reducing income taxes by falsifying tax returns through under-reporting of income. It might be rationalized in many ways—for example, "We're already paying too many taxes," "It provides compensation for unnecessary paperwork required by the government," "Others do it," or "It's the only way we can survive."

6. *What are some of the advantages of conducting business with integrity? Some people say they have no responsibility beyond maximizing the value of the firm in financial terms-can this position be defended? If so, how?*
   There are many advantages to conducting business with integrity, beginning with maintaining a clear conscience! Integrity suggests that due attention will be given to the interests of the owners who, after all, have put up their personal resources to make the business possible, and more investment is likely to follow that which is appropriately managed. Integrity generates trust, which leads to repeat business by customers, low levels of turnover among employees, and a positive reputation in the community. These are all likely to lead to a financial edge for the company, but the primary motivation should run deeper, established on the knowledge that operating with integrity is simply the right thing to do, regardless of the outcomes. It should also be noted, though, that conducting business with integrity (e.g., paying all taxes owed under the law) can offer the important advantage of keeping the entrepreneur out of jail. Economist Milton Friedman, among others, argues that the only purpose of the business is to generate profits in an honest way, and this position seems sound. However, the path to profitability is not as clear as most people think. For example, the chapter cites research suggesting that companies perform best when they focus on all of the important stakeholders of the firm. In fact, the differences in performance levels are substantial. Those who accept Friedman's position argue that it is not the right of decision makers in the firm to redirect the investment of the firm's owners to community needs and other causes with which the owners may not have an interest, and this is a valid concern. It should be noted, however, that small

companies often face a different situation since they are usually owned by a single person—or a small group of investors—who can legitimately decide to spend their resources in any way they choose.

7. *Explain the connection between underlying values and ethical business behavior.*
   A person's basic values show in ethical or unethical behavior. If a business leader deals unscrupulously with employees or customers, for example, it is evident that he or she lacks a strong internalized value system. Judeo-Christian values are the most widely accepted framework of values in our business world.

8. *Why might small business CEOs focus more attention on profit and less on social goals than large business CEOs do?*
   Most small business CEOs are close to the action. They must often work aggressively to earn profits. Large business CEOs often have more abundant resources and can afford to be more socially conscious. Also, they face greater pressure to be socially responsible as a result of their size. Small firm CEOs are spending their own money, and they may be making contributions from their personal rather than their business resources (which makes them conscious of costs).

9. *Give some examples of expenditures required on the part of small business firms to protect the environment.*
   Numerous examples are possible; students should be encouraged to cite examples of which they are personally aware. Some of those mentioned in the chapter refer to added costs borne by livestock feed lots, cement plants, and pet-food processors.

10. *Should all firms use biodegradable packaging? Would your answer be the same if you knew that using such packaging added 25 percent to the price of the product?*
    Before we think about costs, the answer is an easy "yes." If it costs 25 percent more, however, the answer is less clear. Society benefits and suffers in different ways from each solution. Creative solutions may avoid this either/or choice—perhaps the company could use less packaging or returnable packaging, such as The Body Shop uses. Opinions will differ concerning the best solution in such a case.

— COMMENTS ON CHAPTER "YOU MAKE THE CALL" SITUATIONS

Situation 1

1. *What decision on Sally's part would contribute most to the success of her business?*
   Hiring Julie seems to be the best choice. The fact that she is superior to the other candidates, based on experience and ability, suggests that she should be

able to contribute most to the business. (Of course, one might also argue that hiring Julie is more ethical and that ethical decisions pay off in the long run.)

2. *What ethical reasoning would support hiring Mary?*

   Sally has given her word to applicant Mary. She has told Mary that she has the job. The starting time has been specified. Since the instructions were verbal, it is probably not legally enforceable. However, does the principle of keeping ones promise allow for backing down at this stage? Mary may already have made commitments in view of the new job, and that fact that Mary needs the job to support her family makes this especially difficult.

3. *What ethical reasoning would support hiring Julie?*

   Can the instructions to Mary be construed as merely tentative? If the agreement with Mary is not yet finalized, the job is still open until Monday. It might be argued that Sally can hire Julie and still be ethical. The welfare of Sally's own family would pull in this direction, even though it would be a big disappointment to Mary. Which of these positions or arguments is more persuasive?

Situation 2

1. *Is the project manager acting with integrity if he purchases unauthorized copies of the software on the black market?*

   Based on the position taken in the chapter, the project manager would not be acting with integrity if he purchased unauthorized copies of the software, though it may be expensive to make the right choice in this situation. The logic behind intellectual property rights is that these offer protections that encourage the development of more innovations that can benefit all of society, so there is a greater purpose behind making the "right" decision.

2. *What might be the long-term effects of deciding to buy the pirated software? Of insisting on buying only legitimate copies of the software?*

   As mentioned above, buying pirated goods discourages new innovation, which leads to less economic development and lower quality of life for society over the long run. It also encourages others to do the same thing, which could spill over to one's own customers. In other words, if it is widely known that you engage in this activity, then your customers may follow your example and buy counterfeit versions of the products you sell (assuming these exist). In any case, your customers, lenders, and other important stakeholders could legitimately conclude that the standards of integrity of the company are low and thus come to distrust the firm, which could have serious effects on the company. On the other hand, refusing to buy illegitimate goods would avoid these potential problems, despite short-term costs. It is also important to mention that the purchase of counterfeit goods is against the law (even in the Ukraine), though enforcement of the law is usually very weak.

3. *What are the important questions to ask in a situation like this? Follow the ethical decision-making process outlined in the chapter. Does it work in this scenario?*

There are many questions that could be asked in an ethical decision making situation, and some of these are covered in Step 3 of the ethical decision making process provided by the Ethics Resource Center in Washington, D.C. and as outlined on pages 51 and 52 of the chapter. For example, the Rotary Club framework asks, "Is it fair to all concerned?" The answer in this situation is that it obviously is not. Though that conclusion may not be so obvious to the average Ukrainian on the street, who comes at this from a different legal and moral perspective, it should be very apparent to the American manager in question. It would not be fair to expect a company (in this case, Microsoft) to spend millions of dollars on a software development project that many pay for, while others simply take it for free. Indeed, the fairness insured by intellectual property rights creates the financial incentive that drives the innovations that improve work and society in general. Other Rotary Club questions also apply. For example, will this action build goodwill and better friendships? It will certainly not build goodwill with Microsoft, a major vendor to most businesses. And there is a real risk related to friendship-building in this. If a person shows a friend that he or she is willing to cheat others, what is the friend to think about what that person will do to them? The act breeds distrust (or worse). And while a Ukrainian may not be so quick to see it that way, the act may be revealed to friends back in the U.S. and elsewhere who are more likely to see things differently. The last Rotary Club question is, "Will it be beneficial to all concerned?" The decision to use cheap, unauthorized software may be good for those who buy it, but it is not beneficial to the producing company, its shareholders, its employees, and their families. Beyond the Rotary Club framework, the other questions in that section of the chapter are worth asking. Some of these are as follows:

- How would I feel if my decision were reported in the daily newspaper?
- How well could I explain this decision to my mother or children?
- Would this be acting in line with the Golden Rule?
- How would it be if everyone decided to do what you intended to do?

The answers to these questions could be very uncomfortable for the manager facing this software purchasing decision if he decides to do the "wrong" thing.

The ethical decision making process outlined in the chapter involves the following six steps:

1. Define the problem.
2. Identify alternative solutions to the problem.
3. Evaluate the identified alternatives.
4. Make the decision.

5. Implement the decision.
6. Evaluate the decision.

Starting from the beginning of this framework, the problem is not the availability of pirated software (though that contributes to it)—the problem is really the performance pressure that is tied to his decision. The financial performance of his office, annual bonuses, the fierce competitive environment, and even the potential closing of the office and relocation of his family hang in the balance of Brad's choice (at least that is his read of the situation). That is enough to cause any manager to consider cutting corners. Step 2 asks about alternatives. Brad has many, though he may not be apt to think about them. For example, he should make it clear to management in the home office that his competitors do not feel compelled to obey the law, as he does, and that will weigh on the performance of the office in Ukraine. But necessity is the mother of invention, so he needs to think broadly about alternatives that may help to make up for his increased costs from this purchase. For example, are there other places that cut costs? Being forced to find these might help Brad identify cost savings that will help out his office on a continuing basis, not as a one-time purchase savings. Step 3 has already been covered above. Step 4 pushes the manager to choose the <u>best</u> ethical response. There is no perfect answer here because any solution involves a cost to the company, but the "right" and legal thing to do seems pretty obvious. Brad may not need to make the decision right away, because his office can probably "limp along" on the version of the software that it already uses, but that may not be the best thing for productivity. Delaying would also expose him to the temptation to buy the bootleg software day after day, which makes life more uncomfortable than it needs to be. He should probably implement the decision soon (Step 5). Finally, it would be good for Brad to remember to evaluate the impact of his decision at some point in the future (Step 6). Though there is no way to know for sure what that outcome will be, we can only hope that making the right decision will be an obvious benefit to the company as time goes on, which will be likely to reinforce appropriate behavior when other decision come up.

4. *What course of action do you recommend? Why?*

Hopefully, students will choose, on principle, to avoid the purchase of unauthorized goods. However, it will seem proper to some students to decide to purchase the pirated software with the thought that doing so will boost the competitive position of the firm and thus protect the financial interests of the owners of the company. Other justifications for both courses of action are likely to vary considerably.

Situation 3

1. *Is the need to survive a reasonable defense for the practice described here?*

The explanation offered by the commercial artist sounds more like a rationalization than a defense. Even if the firm is fighting for its very survival, the practice described is clearly illegal. It is difficult to justify a clearly illegal practice as being ethical.

2. *If the practice of concealing income is widespread, as implied by the phrase "underground economy," is it really wrong?*

   In other words, is it wrong if everybody is doing it? The answer is yes—the practice is wrong. She is violating the law and would be subject to fines and/or imprisonment. It appears that this person is concealing substantial amounts, although this is not spelled out. The illegal conduct of others does not excuse flagrant violation of the law.

— SUGGESTED SOLUTION TO CASE 2: JOSEPH'S LITE COOKIES

1. Based on what you saw in the videos, describe how Joseph Semprevivo reveals his underlying values and applies them to building a strong business.

As you learned in the chapter, what a firm's leaders or employees consider acceptable business practice reflects their underlying values. An individual's beliefs affect what that person does on the job and how she or he acts toward customers and colleagues. Joseph's actual behavior provides the best clues to his underlying system of basic values. He understands the need people have for security and respect in their work life and that people want to be treated fairly. Accordingly, Joseph displays a commitment to his employees that is nearly unparalleled in today's business environment: he offers them a job for life. Joseph also values inclusion. He calls his employees team members and encourages them to participate collectively in all aspects of the business. Because Joseph is running his business from a strong ethical and empathetic foundation, his employees repay him in kind, with loyalty and honest work.

2. Identify the components of business that make up a "framework for integrity". Explain how the framework upon which Joseph's Lite Cookies is built may contribute to the company's position in a competitive environment.

Entrepreneurs must consider the interests of a number of groups when making decisions. These groups, called stakeholders, have a vested interest in the activities of the firm. The framework for building a business with integrity, then, involves promoting the owners' interests, respecting customers, valuing employees, and being socially responsible.

A company's commitment to financial performance and protection of the firm's reputation is essential to promoting the owners' interests. Semprevivo's profit-sharing incentive means his employees share in the proceeds of their work and participate in the financial success of the company. Because employees have a job for life, they have a strong commitment to the long-term viability of the firm and a personal interested in its continued financial success..

Joseph's excitement for producing a good-tasting, quality product for the diabetic market is a testament to his respect for his customers. (Recall that Joseph started his business to share a delicious treat – sugar-free ice cream – with other diabetics.) Customers know that Joseph takes pride in his product, and they regularly encourage him to expand the business into other sugar-free products. Today, the company produces many more products than the oatmeal cookie it started with, and this is a direct reflection on Joseph listening to customers' feedback and respecting their ideas..

Joseph also listens to and respects his employees. Once hired, employees of Joseph's Lite Cookies know they have a job for life. This level of commitment illustrates Semprevivo's managerial integrity and his belief in the value of his employees. In addition, he trusts his employees to initiate improvements in products and processes and grow into other positions in the company. Each employee is fully engaged in the teamwork that has made the company a success.

Recall that a company's social contribution starts with creating jobs and adding to local tax revenues. Clearly, growing a company from manufacturing thousands of cookies to billions of cookies means tremendous job growth – not only at Joseph's Lite Cookies, but most likely at the company's suppliers as well. Although the video doesn't indicate Semprevivo's efforts outside his company, Joseph's integrity and respect for his fellow team members is surely evidence of his social citizenship. The response of small business owners to their social obligations varies. Some small businesses emphasize environmentalism, minority contracting, or regional economic development, while others focus their attention on volunteerism, philanthropy, or even day care for employees' dependents. Such efforts can be rewarding in their own right, however, businesses that participate in bettering their community often see financial reward as well as community goodwill.

3. Review what you learned in Chapter 1 about building an entrepreneurial team and the advantages in doing so. Explain how this relates to the video segment in which Joseph Semprevivo says an employee will perform well if *empowered*.

In Chapter 1 you learned that an **entrepreneurial team** consists of two or more individuals who combine their efforts to function in the capacity of entrepreneurs. In this way, the talents, skills, and resources of two or more entrepreneurs can be concentrated on one endeavor. Thus, the advantage of an entrepreneurial team is that it fosters a culture of mutual trust and reliance. This kind of interdependence is a hallmark of the work environment at Joseph's Lite Cookies. Each team member trusts in and respects the contribution made by fellow team members. In addition, employees are empowered to take responsibility and initiative for improving and innovating processes and products, which creates a feeling of ownership in the performance of the firm. The synergy resulting from empowered employees is greater than any single contribution made by an individual employee.

Activities

Purpose: The purpose of these activities is to give students the opportunity to see how companies express ethical principles and then to think about their own personal ethics. Understanding their own underlying values will then help students to see how those values can inform and support their business ventures.

Setting it up: These three activities are organized so that you can move students from the familiar (what they saw in the video) to the unfamiliar (working on a set of values for their own business venture). The first activity can be done in class as group work after watching the video. Let students spend about 10 minutes in groups of three to four working on mission and values statements for Joseph's Lite Cookies. After the allotted time is up, reconvene as an entire class to share results and discuss differences of perspectives.

For the second activity, it is probably best to have students work independently. If they have a business venture in mind, they may be reluctant to share it with another student, particularly if they are passionate about it. The purpose of the second activity is to have students think about what mission statements will drive their own business.

Likewise, the third activity is best used as an assignment. Many businesspeople use their companies to express their own values. For example, Howard Shultz, the entrepreneur who founded Starbucks, shows his commitment to the company's employees by offering full health care benefits to part-time workers, offering a tuition reimbursement plan, and by working to create coffee growing technologies that don't deplete the rainforest areas of the world. By doing activity number 3, students will explore the possibilities – and the limitations – of using a business to express core personal values.

1. It is not uncommon for large corporations to have documents that provide ethics guidelines. The world's leading producer of cereal and a leading producer cookies and convenience foods, Kellogg's, is one such corporation. At the company's Web site, **http://www.kellogcompany.com**, you will find Kellogg's Corporate Social Responsibility commitment statement and a long list of what it terms "K Values"—written very much like a mission statement. Review the commitment statement and values statement on the Web site. Draft a mission and values statement for Joseph's Lite Cookies that reflects what you have seen in the videos. (At the time of publication, there was no such document posted on the Joseph's Lite Cookies Web site.) Share your work with your classmates or study group partners.
2. Now practice writing mission and values for your own business enterprise. Even if you don't currently have a business concept or plan, you can still organize your thoughts on the values that will guide your future business ventures. How detailed do you think you want to be? Dow Chemical's Code of Business Conduct is 35 pages; Nordstrom's fits on a 3 x 5 index card.
3. Once you have written down your own underlying values, indicate ways that you will act on them. You may find the following list of questions a good starting place for thinking about on how your business will reflect your personal values:
    - Will your business give to charities? If so, how will you select groups that receive donations?
    - Will you be involved in the community? How so? If not, why not?
    - How will you find employees? For example, will your recruitment efforts take into account the disabled, low-income, minorities, and others in underrepresented groups?
    - How will you manage your company's waste? If it costs more to recycle, will you do it?

- Will you reward employees for their community involvement with non-profit organizations or civic groups? Will you encourage your employees to become active in their community?
- How will you determine pay levels?
- What kinds of benefits will you offer?
- Where will you locate?

Sources: Small Business School video; company Web site at http://www.josephslitecookies.com; April Y. Pennington, "Making Their Mark," *Entrepreneur*, February 15, 2006, online; The American Business Awards: The Stevies, stevieawards.com, online; Kellogg's Web site, http://www.kelloggcompany.com/company.aspx?id=35 and http://www.kelloggcompany.com/social.aspx?id=56