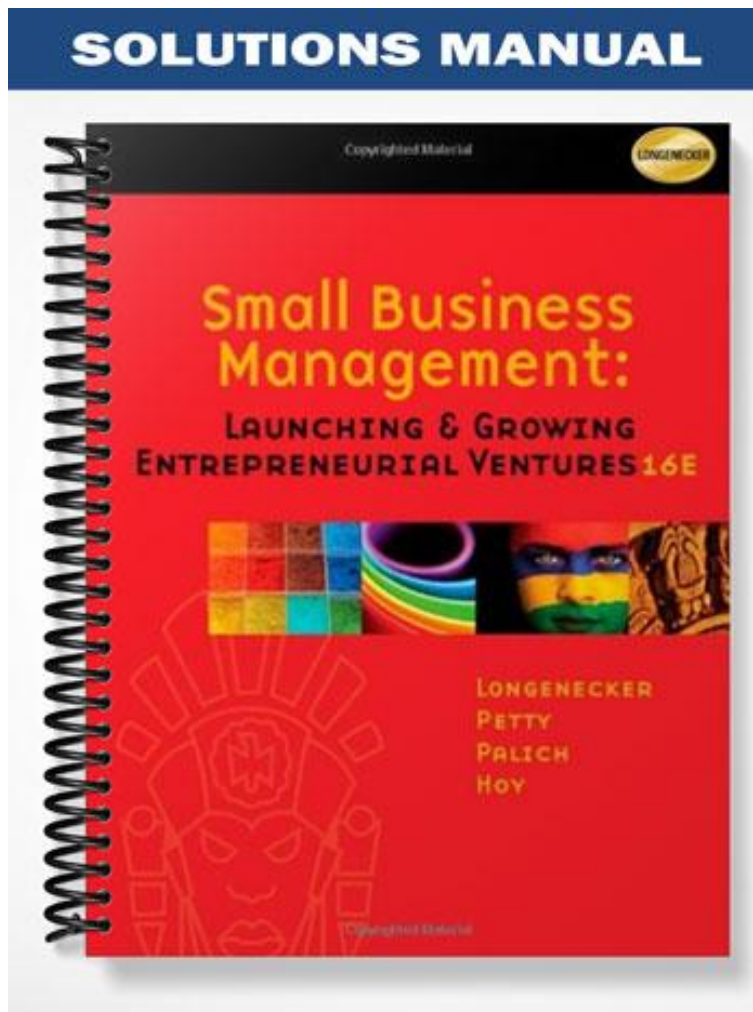


SOLUTIONS MANUAL



Chapter 2 Entrepreneurial Integrity and Ethics

CHAPTER OUTLINE

Spotlight: PortionPac Chemicals

(<http://www.portionpaccorp.com>)

1 Integrity and Entrepreneurship

Define integrity and understand its importance to small businesses

➤ What Is Integrity?

- An uncompromising adherence to the lofty values, beliefs, and principles that an individual claims to hold
- Acting with integrity means considering the welfare of others

2 Integrity and the Interests of Major Stakeholders

➤ *Explain how integrity applies to various stakeholder groups*

➤ Ethical Issues

- Questions of right and wrong
 - Category One – related to customers and competitors
 - Category Two – the way a company treats its employees
 - Category Three – obligations of employees to their employers
- Stakeholders – those who either can affect or are affected by the performance of the company (see Exhibit 2-2)
- The Most Challenging Ethical Issues for Small Businesses – Exhibit 2-1

➤ Promoting the Owners' Interests

- Business owners have an obligation to make choices that protect the financial investment that others have in the company

➤ Caring about Customers

- Customers are the most important stakeholder groups – without customers there is no business

➤ Valuing Employees

- Fairness, honesty and impartiality inherent in decisions and practices
- Fairness works both ways – FBI statistics indicate employees who steal supplies, merchandise, tools, or equipment from work may cost employers as much as \$150 billion each year (figure doesn't include embezzlement)

➤ Social Responsibility and Small Business

- Social Responsibilities – A company's ethical obligations to the community
 - Contribution starts with creating jobs and adding to local tax revenues causing goodwill in the community
 - Examples of Citizenship in the community (see page 45-46 in text)
 - Differing Views on Social Responsibility - Survival of small businesses may cause social responsibility to be looked at as a luxury they cannot afford – however the owners often spend their own money rather than corporate funds

➤ Governmental Laws and Regulations

- Entrepreneurs must comply with government laws and regulations

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- Unethical behavior includes fraudulent reporting of income and expenses for income tax purposes
 - Skimming
 - Tax evasion
 - Casual accounting systems

3 The Challenges and Benefits of Acting with Integrity

Identify challenges and benefits to integrity that arise in small business.

➤ **Small Companies and the Legitimacy Lie**

- Small, privately held firms may face greater pressures to act unethically and to rationalize situations and actions
- Most entrepreneurs exercise great integrity, but some are vulnerable when ethical issues directly affect profits

➤ **The Integrity Edge**

- Price of integrity high, potential payoff incalculable
- Study by John Kotter and James Heskett found that the more a company focuses on the needs of shareholders alone, the lower its performance—all stakeholders must be considered to perform better
- Integrity generates trust—the greatest benefit

Integrity in an Expanding Economy

4 Integrity and the New Economy

➤ **Describe the impact of the Internet and globalization on the integrity of small businesses. Integrity and the Online World**

- Honesty, deception, and fraud affect the Internet as well as traditional commerce
- Intellectual property has become a larger issue due to the Internet
 - Original intellectual creations, including inventions, literary creations, and works of art, that are protected by patents or copyrights
- eBay example provided that deals with sale of counterfeit goods

➤ **International Business and Integrity**

- Rogue businesses may be tolerated by local governments, but labor activists and human rights organizations have condemned them
- Ethical imperialism
 - The belief that the ethical standards of one's own country can be applied universally
 - Foreign Corrupt Practices Act – makes it illegal for U.S. businesses to use bribery elsewhere in the world
- Ethical relativism
 - The belief that ethical standards are subject to local interpretation
 - Training is necessary to ensure employees understand the firm's commitment to integrity
 - One-time practices may set a pattern for future behavior

5 Building a Business with Integrity

5. Building a Business with Integrity

Suggest practical approaches for building a business with integrity

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➤ The Foundations of Integrity

- Underlying values

Have students discuss a difficult ethical dilemma faced at work or at school

- Unarticulated ethical beliefs that provide a foundation for ethical behavior in a firm
- “Actions speak louder than words” – behavior reflects the level of a person’s commitment to honesty, respect, truthfulness, etc.

➤ Leading with Integrity

- Establishing high standards of integrity is more apparent in small firms than in large ones
- Personal integrity of the founder or owner is the key to a firm’s ethical performance

➤ An Ethical Organizational Culture

- Ideally the instinctive resolution of every ethical issue is doing what is right
 - Kenneth Blanchard and Norman Vincent Peale (*The Power of Ethical Management*) suggest five fundamental principles:
 - Purpose – the vision for the company and your core values will guide business conduct
 - Pride – when employees take pride in their work and their company, they are much more likely to be ethical in their dealings
 - Patience – if you push too hard for short-term results, sooner or later acting unethically will seem to be the only way to achieve the outcomes you seek
 - Persistence – stand by your work, which is the foundation of trust
 - Perspective – stop from time to time to reflect on where the business is going, why it is going that way, and how to plan to get there to assure you are on the right track
 - Code of ethics – official standards of employee behavior formulated by a firm
- Ask students about Codes of Ethics they have come into contact with and have them discuss what those Codes included*

➤ Better Business Bureaus

- Encourages ethical practices
- See Exhibit 2-3, The Ethical Code of the Dwyer Group

➤ The Ethical Decision-Making Process

- Step 1: Define the Problem
- Step 2: Identify Alternative Solutions to the Problem
- Step 3: Evaluate the Identified Alternatives
 - Rotary Club International suggests
 - ◆ Is it the truth?
 - ◆ Is it fair to all concerned?
 - ◆ Will it build goodwill and better friendships?
 - ◆ Will it be beneficial to all concerned?
 - Golden Rule

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- ◆ Treat others as you would want to be treated
- Separate what you think is the case from what you know to be true
- Step 4: Make the Decision
- Step 5: Implement the Decision
- Step 6: Evaluate the Decision

6 Small Business and the Natural Environment

Describe sustainable small business, and describe the influence it has on small firms.

➤ Sustainability Matters

Have students discuss environmentalism concepts.

- The effort to protect and preserve the environment
- Cost to business of environmentalism may be prohibitive to small business however win-win solutions are possible

➤ Green Opportunities for Small Business

- Adds to cost for some small companies, opens opportunities for others (may even create startups)

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.

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- 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

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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 a single person—or a small group of investors—who can legitimately decide to spend their resources in any way they choose, usually owns them.

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 15 percent to the company's cost of producing the product?*

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Before we think about costs, the answer is an easy “yes.” If it costs 15 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. *What are the advantages and possible drawbacks to Wilson's title-transfer scheme?*

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The only false advantage here is the increase in revenue for Darryl. Darryl believes he is profitable because he's able to skim money that is owed to the state of Texas. The drawbacks to this indiscretion are many. Darryl's integrity is in jeopardy. He runs the risk of getting caught and losing his business, going to jail, and being unable to provide for his family. If caught, his reputation will be tarnished, he'll incur legal costs in trying to defend himself, he will have embarrassed himself and his family, and he will have a very hard time recovering from this indiscretion.

2. Which stakeholders are affected by this approach, either positively or negatively? How great are their gains/losses?

Assuming Darryl doesn't get caught, the primary stakeholders that are affected negatively by this are: the State of Texas, private sellers, private buyers. Primary stakeholders that are affected positively by this are: Darryl, his family, the company business. However, the losses far outweigh the gains. The gains are small- roughly \$250 per car. If caught, the private sellers and private buyers could be impacted by this as they may be questioned by police officials during the investigation. Moreover, if caught, Darryl will lose his business and will incur a significant cost in trying to defend himself. He will also likely have to pay a fine for this theft. His family may disown him and he may serve time in jail. The IRS will also file charges and fine him for tax evasion. The costs far outweigh the benefits. Overall this is a bad decision by Darryl.

3. Wilson finds it hard to identify a downside to his approach, and so far it is working like a charm. What risks might he be overlooking?

It's only a matter of time before Darryl gets caught. He may get caught during an audit. He may get caught because a wise private seller may be astute enough to fill in the property transfer paperwork correctly or pick up on Darryl's evasive tactics (and report Darryl to the authorities). Darryl may get caught in an undercover investigation, perhaps even a public investigation which would be hugely embarrassing to he and his family. Darryl may be turned into the Better Business Bureau for unethical conduct. His lapse of judgment, also impinges on the qualities of social responsibility. Darryl has an obligation to conduct himself in an ethical way within his community. Should his community find out about his governmental violations, there will surely be varying degrees of response among the citizens- largely negative.

4. What would you do if you were in Wilson's shoes? If his competitors are following the same practice (and some of them surely are), would that make any difference to you?

Darryl has adopted an ethical philosophy of ethical relativism- whereby he is acting the way others may be acting in his industry because no one has been caught (yet). He has found a "loophole" and is exploiting it. This doesn't make this act right nor is it right even if others in his industry are behaving the same way. Rather, Darryl should think about adopting an attitude of ethical imperialism whereby his standards

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(high standards) are the ones that should guide him, regardless of others lower ethical standards. Darryl needs to evaluate his values and commit his decision making towards these values.

Situation 3

1. *Is this a customer relations problem or an ethics problem?*

This actually could involve both a customer relations problem and an ethics problem. However, customer relations would be the larger issue since it could involve a decision about future business from this client. Because the client approved the artwork and the missing period apparently was not noticed by either the client or WizeGuyz it doesn't appear to be an ethics problem. Had WizeGuyz noticed the missing period, not mentioned it to the client, and continued with producing the key chains the issue would have been an ethical situation.

2. *Is Whitaker's request reasonable?*

Since the client approved the artwork before the imprinting was completed, the request causes an inequity. Although WizeGuyz may respond with a price adjustment 65 percent of the total cost appears inequitable. Most such price adjustments would be closer to 10 percent of the total cost.

3. *Should WizeGuyz accept the proposed settlement?*

WizeGuyz should negotiate for a lower discount. The determination is whether the acceptance of this discount could lead to additional business from this client as well as whether WizeGuyz would feel comfortable dealing with this client in the future. Sixty-five percent appears to be an inequitable price adjustment.

SUGGESTED SOLUTION TO CASE 2: PORTIONPAC CHEMICALS

1. *Based on what you have learned about PortionPac, what do you think the owners would claim to be the most important features of doing business with integrity? Do you agree? Why or why not?*

The owners' sense of integrity refers to the honesty and reliability in their strong commitment to doing the right thing. They have always considered the "triple bottom line" of social, environmental, and economic balance while growing operations. They made the conscientious decision before starting the company to

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continually improve environmental standards and the human condition. This honesty, reliability, and accountability are PortionPac's claim to running a business with integrity.

- 2. Who are the most important stakeholders for PortionPac? What is the order of emphasis on the interests for these stakeholders—from most important and influential to least important and influential--on the company's decision-making processes? In your opinion, does this represent a wise ordering of stakeholder interests?**

PortionPac's most important stakeholders are their employees and clients. It's difficult to separate stakeholders from most important/most influential to least important/least influential because the company is founded on sustainability and the environment, external and human. This doggedness to their goal is apparent when considering the history of the company, and how it took so many years of sticking to their goals before achieving financial success. Their concern has been for the maximum safety for their employees to produce their products and for their clients to use them. The company holds itself accountable to the end-user and recognizes its role in health and safety, and these tenets have been behind the company's decision-making process.

- 2. PortionPac is very concerned about the environment. Is the company's environmental focus good for the company? Why or why not? 4. Would you want to work for a company that operates according to the goals discussed in the case? What would be the pros and cons of working there?**

Although it took PortionPac many years to achieve success, their commitment to the environment has proved invaluable for the company in terms of financial success and their leadership role in the industry.