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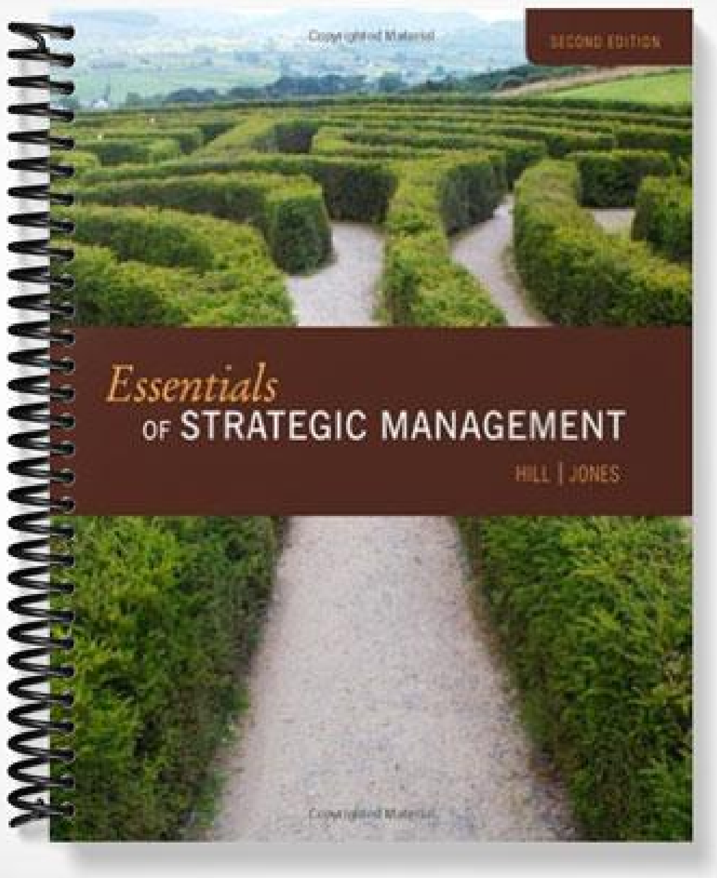
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CHAPTER 2

Stakeholders, the Mission, Corporate Governance, and Ethics

Name: ___________________________ Date: _____________

1. T F Stockholders are important external claimants on a company.
Ans: False Obj.: 1 Page: 27

2. T F The general public is not a stakeholder for a company.
Ans: False Obj.: 1 Page: 26

3. T F Examples of external stakeholders are the members of the board of directors.
Ans: False Obj.: 1 Page: 27

4. T F A national union is an example of an external stakeholder.
Ans: True Obj.: 1 Page: 27

5. T F All stakeholders are in an exchange relationship with the company.
Ans: True Obj.: 1 Page: 27

6. T F Different stakeholders supply different resources to the company, and in exchange they expect their interests to be satisfied.
Ans: True Obj.: 1 Page: 27

7. T F If a company fails to take stakeholder claims into account, stakeholders may withdraw their support.
Ans: True Obj.: 1 Page: 27

8. T F The goals of all stakeholder groups are generally aligned.
Ans: False Obj.: 1 Page: 28

9. T F The mission statement is a key indicator of how an organization views the claims of its stakeholders.
Ans: True Obj.: 2 Page: 28

10. T F **The mission is what it is that the company exists to to.**
Ans: True Obj.: 2 Page: 28

11. T F **Values of a company state how managers and employees should conduct themselves, how they should do business, and what kind of organization they should build to help a company achieve its mission.**
Ans: True Obj.: 2 Page: 30

12. T F The vision of a company lays out some desired future state and articulates what the company would like to achieve.
Ans: True Obj.: 2 Page: 30

13. T F **Organizational culture is the set of values, norms, and standards that control how employees work to achieve an organization's mission and goals.**
Ans: True Obj.: 2 Page: 30

14. T F **A goal is a precise and measurable desired future state that a company attempts to realize.**
Ans: True Obj.: 2 Page: 30

15. T F **Equity capital for which there is a guarantee that stockholders will recoup their investment and earn a decent return is call risk capital.**
Ans: False Obj.: 2 Page: 32

16. T F **As the agents of stockholders, managers should pursue strategies that maximize short-term returns to stockholders because this increases the value of their shares.**
Ans: False Obj.: 3 Page: 32

17. T F The agency problem occurs when managers pursue strategies that are not in the interests of stockholders.
Ans: True Obj.: 3 Page: 32

18. T F **The term principle refers to the person delegating authority to an agent, who acts on the principle's behalf in an agency relationship.**
Ans: True Obj.: 3 Page: 32

19. T F **The agency relationship arises whenever one party delegates decision-making authority or control over resources to another.**
Ans: True Obj.: 3 Page: 32

20. T F **Information asymmetry is a situation in which both parties have the same information about the exchange.**
Ans: False Obj.: 3 Page: 32

21. T F **Despite the existence of governance mechanisms and comprehensive measurement and control systems, a degree of information asymmetry will always remain between principles and agents.**
Ans: True Obj.: 3 Page: 33

22. T F **Critics of U.S. industry claim that extraordinary pay has now become an endemic problem and that senior managers are enriching themselves at the expense of stockholders and other employees.**
Ans: True Obj.: 3 Page: 33

23. T F **In 1980, the average CEO in Business Week's survey of CEO's of the largest 500 American companies earned seventy-two times what the average blue-collar worker earned.**
Ans: False Obj.: 3 Page: 33-34

24. T F **Today, the average CEO in the Business Week survey earns more than 350 times the pay of the average blue-collar worker.**
Ans: True Obj.: 3 Page: 34

25. T F **The typical board of directors is composed of a mix of inside and outside directors.**
Ans: True Obj.: 3 Page: 36

26. T F **The board of directors is the centerpiece of the corporate governance system in the United States and the Federal Republic of Germany.**
Ans: False Obj.: 3 Page: 36

27. T F **Outside directors are full-time employees of the company.**
Ans: False Obj.: 3 Page: 36

28. T F **Critics of the existing governance system charge that inside directors often dominate the outsiders on the board.**
Ans: True Obj.: 3 Page: 36

29. T F **The typical inside director is subordinate to the CEO in the company's hierarchy and therefore unlikely to criticize the boss.**
Ans: True Obj.: 3 Page: 36

30. T F **The most common pay-for-performance system has been to give managers stock options: the right to buy the company's shares at a predetermined (strike) price at some point in the future, usually within ten years of the grant date.**

Ans: True Obj.: 3 Page: 37

31. T F **The risk of being acquired by another company is known as the takeover constraint.**
Ans: True Obj.: 3 Page: 39

32. T F Governance mechanisms help align the incentives between principals and agents, and monitor and control agents.
Ans: True Obj.: 3 Page: 36

33. T F **Publicly trading companies in the United States are required to file quarterly and semi-annual reports with the SEC that are prepared according to GAAP.**
Ans: False Obj.: 3 Page: 38

34. T F **Business ethics are the accepted principles of right or wrong governing the conduct of business people.**
Ans: True Obj.: 3 Page: 49

35. T F **Ethical Dilemmas are situations were there is no agreement over exactly what the accepted principles of right and wrong are, or where none of the available alternatives seems ethically acceptable.**
Ans: True Obj.: 3 Page: 40

36. T F **Self-Dealing occurs when managers find a way to feather their own nests with corporate monies.**
Ans: True Obj.: 4 Page: 41

37. T F **Information manipulation occurs when managers use their control over corporate data to distort or hide information in order to enhance their own financial situation of the competitive position of the firm.**
Ans: True Obj.: 4 Page: 41

38. T F In reality, there is a clear and distinct line between business ethics and personal ethics.
Ans: False Obj.: 4 Page: 40

39. T F **Environmental degradation occurs when a firm takes actions that directly or indirectly result in pollution or other forms of environmental harm.**
Ans: True Obj.: 4 Page: 44

40. T F **To foster ethical behavior, businesses need to build an organization culture that places a high value on ethical behavior,**
Ans: True Obj.: 4 Page: 45

41. **Which of the following would not be considered a company stakeholder?**
a) **Employee**
b) **Customer**
c) **Supplier**
d) **Competitor**
e) **Shareholder**
Ans: d Obj.: 1 Page: 26

42. **Internal stakeholders of a company include**
a) **the board of directors**
b) **customers.**
c) **unions**
d) **suppliers.**
e) **local communities.**
Ans: a Obj.: 1 Page: 27

43. **External stakeholders of a company include**
    a) **stockholders**
    b) **the board of directors.**
    c) **executive officers.**
    d) **unions**
    e) **employees.**
    Ans: d Obj.: 1 Page: 27

44. **Which of the following groups is *not* among the external claimants on a company?**
    a) **Customers**
    b) **General public**
    c) **Unions**
    d) **Governments**
    e) **Stockholders**
    Ans: e Obj.: 1 Page: 27

45. **Typically, the third step in the stakeholder impact analysis is________________________.**
    a) **Identify the resulting strategic challenges.**
    b) **Identify the stakeholders.**
    c) **Identify what claims stakeholders are likely to make on the organization.**
    d) **Identify stakeholders' interests and concerns.**
    e) **None of the above**
    Ans: c Obj.: 2 Page: 28

46. **The ___________ of a company lay(s) out some desired future state.**
    a) **vision**
    b) **values**
    c) **goals**
    d) **mission statement**
    e) **stakeholders**
    Ans: a Obj.: 2 Page: 30

47. **Which of the following is *not* a characteristic of well-constructed goals?**
    a) **They are precise and measurable.**
    b) **They are challenging but realistic**
    c) **They specify a time period.**
    d) **They are the result of a group decision process.**
    e) **They address crucial issues.**
    Ans: d Obj.: 2 Page: 30-31

48. **The capital that stockholders provide to a company is seen as**
    a) **play money.**
    b) **risk capital**
    c) **contractual capital.**
    d) **guaranteed capital.**
    e) **agency capital**
    Ans: b Obj.: 3 Page: 32

49. **The _________________ statement describes what it is that the company does.**
    a) **vision**
    b) **values**
    c) **mission**
    d) **cultural**
    e) **major goals**
    Ans: c Obj.: 3 Page: 28

50. **______________________ is the set of values, norms, and standards that control how employees work to achieve an organization's mission and goals**
a) **The vision**
b) **The mission**
c) **The organizational culture**
d) **The goals**
e) **The corporate governance**
Ans: c Obj.: 3 Page: 30

51. **Equity capital for which there is no guarantee that stockholders will ever recoup their investment or earn a decent return is called _________________________.**
a) **capital**
b) **investments**
c) **risk capital**
d) **stock options**
e) **none of the above**
Ans: c Obj.: 3 Page: 32

52. **When managers pursue strategies that are not in the interests of stockholders, this is call _________________.**
a) **empire building**
b) **agency problem**
c) **unauthorized acquisitions**
d) **strategic incoherence**
e) **a corporate scandal**
Ans: b Obj.: 3 Page: 32

53. **Dennis Kozlowski was the CEO of _______________.**
a) **Red Hat**
b) **IBM**
c) **Tyco**
d) **Microsoft**
e) **Netscape**
Ans: c Obj.: 3 Page: 35

54. **Which of the following is *not* a type of governance mechanism?**
a) **Business ethics**
b) **The takeover constraint**
c) **The board of directors**
d) **Stock-based compensation**
e) **Financial statements**
Ans: a Obj.: 3 Page: 36

55. **The centerpiece of the corporate governance system in the United States and the United Kingdom is__________________.**
a) **stock-based compensation**
b) **the takeover constraint**
c) **financial statements**
d) **cultural leadership**
e) **the board of directors**
Ans: e Obj.: 3 Page: 36

56. __________________ **are senior employees of the company, such as the CEO.**
   a) **Stockholders**
   b) **Outside directors**
   c) **Inside directors**
   d) **Business-level managers**
   e) **None of the above**
   Ans: c Obj.: 3 Page: 36

57. **Why are managers thought to engage in empire building?**
   a) **Companies that do not grow stagnate**
   b) **The pursuit of growth represents the best way of maximizing the long-run profitability of the company.**
   c) **Growth is designed to increase market share, which in turn increases company profits.**
   d) **Growth results in large company size, and large size satisfies managers' needs for power, status, income, and job security.**
   e) **Stockholders would rather invest in large companies than in small ones.**
   Ans: d Obj.: 3 Page: 34

58. **The most common pay-for-performance system have been to give managers ________________.**
   a) **semi-annual bonuses**
   b) **annual pay increases**
   c) **capital increases**
   d) **stock options.**
   e) **none of the above**
   Ans: d Obj.: 3 Page: 37

59. **Publicly trading companies in the United States are required to file quarterly and __________ reports with the SEC that are prepared according to GAAP**
   a) **semi-annual**
   b) **monthly**
   c) **annual**
   d) **by-monthly**
   e) **detailed**
   Ans: c Obj.: 3 Page: 38

60. **Which of the following is *not* a responsibility of the board of directors?**
   a) **Monitor corporate strategy decisions and ensure that they are consistent with stockholder interests**
   b) **Develop the company's competitive strategy**
   c) **Hire, fire, and compensate the CEO**
   d) **Apply sanctions on management when appropriate**
   e) **Make sure the audited financial statements present a true picture of the company's financial situation**
   Ans: b Obj.: 3 Page: 36

61. **Members of the board of directors are supposed to be agents for**
   a) **executive officers**
   b) **employees.**
   c) **stockholders**
   d) **customers.**
   e) **suppliers.**
   Ans: c Obj.: 3 Page: 36

62. **Which of the following statements about the board of directors is *false*?**
    a) **Board members are elected by stockholders.**
    b) **All directors are full-time employees of the company.**
    c) **The board has the legal authority to hire, fire, and compensate the CEO.**
    d) **The board can be held legally accountable for a company's actions.**
    e) **Outside directors help perform the monitoring function of the board.**
    Ans: b Obj.: 3 Page: 36

63. **Which of the following statements about the takeover constraint is *false?***
    a) **Limits the extent to which managers can pursue strategies.**
    b) **Limits the actions that put the managers own interests above those of the stockholders.**
    c) **Limits situations where there is no agreement about acceptable principles.**
    d) **Managers could lose their independence and probably their jobs.**
    e) **Limits the worst excesses of the agency problem.**
    Ans: c Obj.: 3 Page: 39

64. **Which of the following statements about the Sarbanes-Oxley bill is false?**
    a) **It represents the biggest overhaul of accounting rules.**
    b) **It represents the biggest overhaul of corporate governance since the 1930s**
    c) **It set-up a new oversight board for accounting firms.**
    d) **It requires CEOs and CFOs to endorse their company's financial statements.**
    e) **It outlines acceptable principles of right and wrong.**
    Ans: e Obj.: 3 Page: 39

65. **When are the interests of stockholders and senior managers likely to be most closely aligned?**
    a) **When the board of directors is dominated by insiders**
    b) **When managers receive most of their compensation in the form of a regular salary**
    c) **When managers receive most of their compensation in the form of stock options**
    d) **When stockholders are weak**
    e) **When corporate raiders are unable to mount a takeover bid**
    Ans: d Obj.: 3 Page: 38

66. **Which one of the following about business ethics is *true?***
    a) **Business ethics are the accepted principles of right or wrong governing the conduct of business people.**
    b) **Business ethics are accepted principles of right or wrong that govern a person.**
    c) **Business ethics govern the behavior of members of a profession.**
    d) **Business ethics is selecting the correct alternative to solve a problem.**
    e) **Business ethics govern the actions of an organization.**
    Ans: a Obj.: 3 Page: 40

67. **In the business arena the laws that govern product liability are called __________________.**
    a) **contract laws**
    b) **intellectual laws**
    c) **tort laws.**
    d) **securities laws**
    e) **none of the above**
    Ans: c Obj.: 3 Page: 40

68. **A takeover constraint**
    a) **uses the threat of a takeover to cause the CEO to fear the loss of his or her job.**
    b) **prevents a company from being taken over.**
    c) **limits the extent to which managers can pursue strategies that are inconsistent with shareholder interest.**
    d) **is reduced by corporate raiders.**
    e) **is greatest when a company's stock price is significantly higher than book value.**
    Ans: c Obj.: 3 Page: 39

69. **Business ethics is primarily concerned with**
   a) **teaching people the difference between right and wrong.**
   b) **replacing economics with social responsibility in the decision-making process**
   c) **ensuring that employees are experts in laws related to business ethics.**
   d) **ensuring managers weigh the ethical implications of their decisions.**
   e) **increasing profits.**

   Ans: d Obj.: 4 Page: 40

70. **The most common examples of unethical behavior include all of the following *except*______________.**
   a) **information manipulation**
   b) **self-dealing**
   c) **annual reports**
   d) **anti-competitive behavior**
   e) **the maintenance of substandard working conditions**

   Ans: c Obj.: 4 Page: 41

71. **Which of the following is *not* a potential cause of unethical behavior in organizations?**
   a) **Failure to examine the ethical dimensions of a decision**
   b) **An organizational culture that de-emphasizes ethical behavior**
   c) **Dynamic competitive environment**
   d) **Management pressure to meet organizational objectives by "cutting corners"**
   e) **Weak ethical leadership**

   Ans: d Obj.: 4 Page: 41

72. **When managers of a firm seek to unilaterally rewrite the terms of a contract with suppliers, buyers, or complement providers in a way that is more favorable to their firm they are engaging in**
   a) **corruption**
   b) **ethical behavior.**
   c) **opportunistic exploitation.**
   d) **philosophical ethics.**
   e) **self-dealing.**

   Ans: c Obj.: 4 Page: 42-43

73. **When managers pay bribes to gain access to lucrative business contracts they are engaging in**
   a) **opportunistic exploitation.**
   b) **corruption**
   c) **self-dealing.**
   d) **information manipulation.**
   e) **utilitarian ethics**

   Ans: b Obj.: 4 Page: 44

74. **To make sure that ethical issues are considered in business decisions**
   a) **a company should use a bottom-up approach.**
   b) **top managers should articulate and model ethical behaviors.**
   c) **a company should have a no-layoff policy**
   d) **a company should spend the majority of its operating budget to teach people what is legal and not legal.**
   e) **a company should hire and promote employees that do whatever it takes to achieve organizational objectives.**

   Ans: b Obj.: 4 Page: 41

75. ______________________ covers a range of actions aimed at harming actual or potential competitors, most often by using monopoly power, thereby enhancing the long-run prospects of the firm.
a) **Self-dealing**
b) **Information manipulation**
c) **Anti-competitive behavior**
d) **Opportunistic exploitation**
e) **Corruption**
Ans: c Obj.: 4 Page: 41

76. **Which of the following statements about opportunistic exploitation is *true?***
a) **When managers find a way to feather their own nests with corporate monies.**
b) **When managers use their control over corporate data to distort or hide information.**
c) **When managers aim at harming actual or potential competitors.**
d) **Managers unilaterally rewrite the terms of a contract with suppliers, buyers, or complement providers in a way that is more favorable to the firm.**
e) **None of the above**
Ans: d Obj.: 4 Page: 42-43

77. _______________ **are individuals who are responsible for making sure that all employees are trained to be ethically aware, that ethical considerations enter the business decision-making process, and that the company code of ethics is adhered to.**
a) **CEOs**
b) **Corporate attorneys**
c) **The board of directors**
d) **Ethics officers**
e) **Stakeholders**
Ans: d Obj.: 4 Page: 46

78. **Which of the following statements about moral courage is *false?***
a) **It enables managers to walk away from a decision that is profitable.**
b) **It gives the employee the strength to say no to a superior that instructs her to pursue actions that are unethical.**
c) **Moral courage is important to maximize long-term profits in order to maximize returns to stockholders.**
d) **It gives employees the integrity to go public to the media and blow the whistle on persistent unethical behavior in a company.**
e) **Moral courage does not come easily.**
Ans: c Obj.: 4 Page: 47

79. **Identify and discuss the governance mechanisms that help align the incentives of stockholders and managers and monitor and control management.**
Ans: ***The board of directors is the first governance mechanism. As board members are elected by shareholders and have specific statutory responsibility, this mechanism may break down, primarily because of the structure of the board. First, boards are often dominated by insiders who often have position authority and access to information that outside directors do not have. In addition, many boards are chaired by the CEO—the ultimate insider. A second governance mechanism is stock-based compensation. The idea behind this mechanism is that it helps align the financial interests of shareholders and managers. When share price rises, both benefit and when it falls, they both suffer. A problem with stock-based compensation is that many companies have used stock options that distort their real cost and dilute the value of shareholders' holdings. A third mechanism is financial statements and auditors. Good governance relies on accurate and timely information about company performance. Transparency is the cornerstone of financial reporting. Unfortunately, recent high-profile examples (Enron, Computer Associates) of companies that have falsified reports to present an inaccurate picture of company performance indicate that this mechanism is not without problems. A final governance mechanism is the takeover constraint. When companies are mismanaged and not creating the value that they should, the possibility of an outside party coming in, taking over control (through a hostile raid), replacing existing management, and then turning the company around may be the ultimate management***

punishment for poor performance. A problem with this is that many companies (and states) have put in place takeover defenses that make it much more difficult to take over a company. *Page: 36*

80. **Discuss the best ways for managers to make sure that the ethical considerations are taken into account when making business decisions.**
Ans: ***There are a number of things that managers can do: 1. Businesses should strive to hire people who have a strong sense of personal ethics, and would not engage in unethical or illegal behavior. Businesses should not promote people, and perhaps fire people whose behavior does not match generally accepted ethical standards. Businesses can give potential employees psychological tests to try and discern their ethical predisposition, and they can check with prior employees regarding someone's reputation by asking for letters of reference, and talking to people who have worked with the prospective employee. 2. Businesses need to build an organizational culture the places a high value on ethical behavior. Three things are important: a. the business must explicitly articulate values that place a strong emphasis on ethical behavior by having a code of ethics. 3. It is important that leaders in the business give life and meaning to those words repeatedly emphasizing their importance, and then acting on them. This means using every relevant opportunity to stress the importance of business ethics and making sure that key business decisions not only make good economic sense, but also are ethical. 4. The organizational culture must have incentive and promotional systems that reward people who engage in ethical behavior and sanction those who do not.*** *Page: 45-47*

81. Explain the principles of agency theory, including the issues it addresses. What are some effective ways to deal with agency problems, as implied or stated by agency theory?
Ans: Agency theory addresses situations where one individual or group (the principals) relies on another individual or group (the agents) to make decisions and take actions on their behalf. In many of these situations, there are opportunities for mutual gain, but there are also opportunities for the agents to act in their own best interests, to the detriment of the principals. Opportunities for exploitation exist because agents have more access to information about the situation and to other resources than do the principals. Therefore, the principals cannot fully monitor the actions of the agents, and must trust the agents to some extent. One way to manage agency problems is to align the two parties' goals—that is, to create opportunities for mutual gain and reduce opportunities for one-sided gain. For example, if corporate managers are compensated based on stock price, then they are more likely to work toward that goal, which would also benefit stockholders. If managers are compensated based on the size of the firm, then they will work toward that goal, which may not be beneficial for stockholders. Another tactic is to reduce information asymmetry to the extent possible by overseeing or monitoring the principal's actions closely. However, there will always be a need for the principal to trust the agent to some extent. Page: 32

82. Business ethics are concerned with accepted principles of right or wrong governing the conduct of business people. Identify and discuss the common examples of unethical decisions that business people have made.
Ans: Unethical behavior often occurs when people decide to put their own interests ahead of those of the firm and its stakeholders. Common examples of unethical behavior include: Self-dealing—pursuing personal enhancements with company funds. Information manipulation—hiding or distorting information (usually negative) that would show how the company is really performing. Information is usually financial but may be nonfinancial (data that a company's products are harmful). Anticompetitive behavior—concerns a broad range of behaviors that limit competition and may harm customers. Opportunistic exploitation—occurs when managers of a company seek to unilaterally rewrite the terms of a contract with suppliers, buyers, or complement providers. Substandard working conditions—paying below market rates or under-investing in working conditions to reduce costs. Important issue in international operations. Environmental degradation—actions that directly result in pollution or other forms of environmental harm. Corruption—paying bribes to gain access to lucrative contracts or personal gain. Page: 44-45

83. **Discuss the ethical decision-making process.**
Ans: A decision is acceptable on ethical grounds if a business person can answer "yes" to each of the following questions: 1. Does my decision fall within the accepted values or standards that typically apply in the organizational environment? 2. Am I willing to see the decision communicated to all stakeholders affected by it - for example, by having it reported in newspapers or on television? 3. Would the people with whom I have a significant personal relationship, such as family members, friends, or even managers in other businesses, approve of the decision? Page: 46