Case Study: Ethics

by Sophia

WHAT'S COVERED

What does unethical behavior look like at a company-wide level? Can you think of any examples? What consequences does unethical behavior have for the employees or the stakeholders of the company? This tutorial will cover a case study on a classic business ethics situation, as well as a more modern one. Our discussion breaks down as follows:

1. Ethics

Recall that **ethics** comprises the principles of right and wrong and the morality of the choices we make in everyday life.

- **Business ethics** involves the principles of right and wrong and the morality of the choices made in the *business world*, which is a narrowing down of the overall view of ethics.
- **Managerial ethics** involves the principles of right and wrong and of the morality of the choices made in the context of *management*.

Let's explore two different case studies that serve as examples of unethical behavior at the company-wide level.

TERMS TO KNOW

Ethics
The principles of right and wrong and of the morality of the choices.

Business Ethics
The principles of right and wrong and of the morality of the choices made in the business world.

Managerial Ethics
The principles of right and wrong and of the morality of the choices made in the context of management.

2. Classical Example: Enron

Suppose you are an investor in 1999, and your broker approaches you with a great deal that you want to get in on. So far this year, the stock for this company has gone up 56%, beating the market by 36%. You think that

is rather impressive, so you go ahead and buy it, putting all the money that you have into it.

The next year, in 2000, that stock goes up 87%. At this point, the sky's the limit.

Well, that company was Enron, and it made a lot of people very wealthy for a while. The problem was that they weren't doing it ethically.

Enron was an energy, commodities, and service business. They were in the business of providing, selling, and transmitting electricity and natural gas, among other things. The problems began when they started using something called mark-to-market accounting in the early 1990s. Mark-to-market accounting is an accounting practice that--while perfectly legal at the time--had never been used for Enron's particular sector.

HINT

Suppose, for instance, you have a security, bond, or stock. Using mark-to-market accounting, you can account for the entire future value of that stock on today's financials. Meaning, all the future value of that stock, you would count *today*. However, this is the only time you can take that income; you can't use it again in the future.

Well, Enron was using mark-to-market accounting to hide the failures in their business. They were hiding the debt they had incurred. This created a huge problem for them. As a matter of fact, in 2000, the press finally started to notice and began to dig deeper into Enron's books. Suddenly people realized that they had no idea how Enron was making their money.

At this point in the story, Arthur Andersen enters the picture. Arthur Andersen was the accounting firm that did the books for Enron. Not only did they do the books for Enron, but they also consulted. This created a conflict of interest for Arthur Andersen. You see, having the same firm advise you on how to do your accounting and then turn around and audit those very same practices is probably not a good idea.

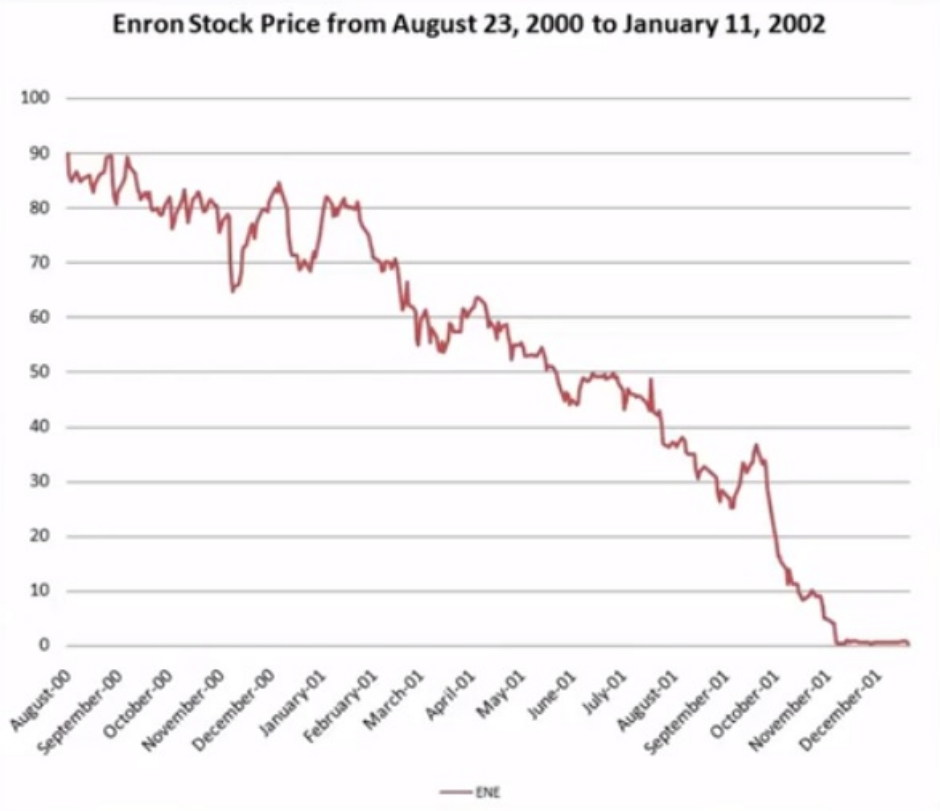
At this point, Enron was pressuring the CEO of Arthur Andersen to make their calculations work and to hide things from the general public on their annual statements.

After Enron collapsed in 2000, the CEO of Enron, Jeffrey Skilling, and a few other people from that company went to jail. The company went into bankruptcy, and the stockholders were devastated.

DID YOU KNOW

The demise of Enron also resulted in the creation of the Sarbanes-Oxley Act. This act requires company executives of any publicly-traded company to personally sign the annual statements to the stockholders, certifying them as true under penalty of law. Therefore, if something is amiss in the financials, and the CEO knows about it and signs his or her name, he or she is automatically going to jail. This act cracked down on conflict of interest situations like the one that happened with Arthur Andersen.

So, circling back to the fall of Enron, suppose, once again, that it's 2000, you own that stock, and you're up 100+ percent. Then, the collapse occurs. The beginning of the graph below shows August of 2000. The end of the graph is January 2002. Enron lost $90.00 and change in a two-year period.



Everybody who owned stock, every retirement account that had stock, suffered a complete loss. This devastated people's retirement programs, not to mention putting 30,000 people who worked for Enron out of a job.

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3. Modern Example: Rana Plaza

The Rana Plaza building in Bangladesh was owned by a man named Sohel Rana, who was an international shirt manufacturer, among other things. This was the business he owned in this particular building--manufacturing shirts to be sold on a worldwide stage.

So, Rana would make the shirts there, taking advantage of the country's cheap labor, and crank out shirts at a ridiculously low price in order to undersell the competition internationally. Of course, this attracted buyers from all over the world.

In April of 2013, people ran from the building in terror after hearing explosion-like sounds inside. An evacuation was ordered after an engineer inspected the building and deemed it unsafe. Now, the problem with the building was that it was never engineered or designed to house a factory. In addition, it was illegally raised from one story to five stories a few years earlier. Do you see an issue yet?

The Rana employees were forced to return to work, despite the building being unsafe. Mr. Rana himself had a press conference on the bottom floor of the building on April 24, 2013. He assured everyone that everything was fine, that it was just the plaster cracking. He claimed that the engineers had no idea what they were talking about.

On April 24, everyone went back to work. A generator on the roof started, which sent vibrations through the building, and the building collapsed. Over 1,100 people lost their lives in that collapse. Not only did all of these people perish, but there were 2,500 injured, and it sent the global market into disarray for shirt manufacturers.

The stakeholders were devastated. Now their names were tied to this tragedy which cost 1,100 lives. There was an alliance called for to improve the working conditions within Bangladesh. Mr. Rana was arrested, and the stakeholders were permanently tarnished for doing nothing else but seeking the best price they could get on shirts, and assuming that the company that was making the shirts would take care of their employees.

3. Case Study Similarities

What are the overarching similarities between these two case studies?

- *Focus on the short term:* Enron was worried about year to year, or how to make it look better year after year. Rana was focused on the immediate result of having to produce the shirts *now*.
- *Shortcuts:* To reach their goals, both companies took shortcuts to get there. They didn't do it by the rules, even though Enron, in most cases, never broke a law as far as the SEC (Securities and Exchange Commission) was concerned. The SEC gave them a pass.
- *Disregard for stakeholders:* There was disregard in both counts for stakeholders. They were so focused on short term gains and short term improvements in their bottom line that they forgot why they were really there--to continue the business. They didn't care how this would affect the workers or the stakeholders. All they cared about was making money *now* and using any means to do so.
- *Ruined lives/lost lives:* The collapse of Enron ruined thousands of lives financially, and in the case of Rana, the choice to be unethical at a company-wide level ultimately cost 1,100 lives.

SUMMARY

Today we explored two case studies illustrating unethical behavior at a company-wide level: the

classical example of **Enron** and the more **modern example** of the **Rana Plaza** collapse in Bangladesh in 2013. We also examined the **case study similarities**--the focus on the short term, the tendency to take shortcuts, a disregard for the stakeholders, and the cost of ruined or lost lives.

Good luck!

Source: adapted from sophia instructor james howard

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