CHAPTER 2

# Integrity and Ethics: Foundations for Success in Small Business

**In the SPOTLIGHT**
**PortionPac Chemical**
**http://www.portionpaccorp.com**

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PortionPac Chemical stands alone in its class. After nearly half a century in existence, the Chicago-based company remains a small business (especially when compared to the industry giants against which it competes), but it is doing just fine with 84 employees and increasing sales. And because of the way PortionPac puts people first, Winning Workplaces (a national nonprofit organization) and *Inc.* magazine named it a "2010 Top Small Company Workplace." The recognition was clearly deserved.

PortionPac specializes in what the company calls Sustainable Solutions®, providing a complete system of safe, effective, and environmentally friendly cleaning products—but that is only a small part of its business formula. When it comes to working with its employees and customers, the company is clearly exemplary. Who would have guessed that a chemical company would get the "people side" of its business so right?

The company's culture emphasizes three things—trust, satisfaction, and good relationships—and this shows up in the satisfaction and loyalty of its employees. (In 2009, the company's turnover was a mere 2 percent, with average employee tenure of 13 years.) Out of respect for family life, PortionPac never runs a third

## LOOKING AHEAD

*After studying this chapter, you should be able to ...*

1. Define *integrity*, and understand its importance to small businesses.
2. Explain how integrity applies to various stakeholder groups, including owners, customers, employees, the community, and the government.
3. Identify challenges to integrity that arise in small businesses, and explain the benefits of integrity to small firms.
4. Describe the impact of the Internet and globalization on the integrity of small businesses.
5. Suggest practical approaches for building a business with integrity.
6. Define *sustainable small business*, and describe the influence this trend is having on the management of small companies and startup opportunities.


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shift, and it has been known to change work schedules so that employees could spend more time with their kids. The factory floor is more like an atrium than a place to mix chemicals, with natural light pouring in through skylights to bathe a thriving assortment of plants. To help with the long hours the employees spend working together, the machines on the floor were designed to produce less noise, which encourages conversation. Warren Weisberg, co-owner and vice president of the company, spends a lot of time in the factory, learning from the employees and soliciting opinions about their work. When employees request personal time, it is usually granted, and their special needs are always given serious consideration. It figures that the company's workers feel they are very well cared for.

But PortionPac's concern for people does not end with its employees—the company also takes care of its customers, with a special focus on janitors, who are the ultimate users of the company's products. To make their work more manageable, the firm has narrowed the range of products it sells from the dozens that typically clutter supply closets to a few color-coded basics that come in portion-controlled packages. Beyond this, PortionPac offers innovative safety and effective cleaning classes for janitors, and was the first in the industry to hire a national education director to address their needs. These actions reinforce the message that custodians are part of a modern-day, chemical-wielding nobility—an honorable occupation that is more of a calling than a ho-hum job.

Marvin Klein, the company's chairman and co-founder, actually thinks beyond the custodial staff when he points out that a clean building can lead to improved student performance and increased office productivity. But the firm's concerns are even more far-ranging—PortionPac is very concerned about the impact of harmful chemicals on the environment. To help with this, the company's products come in premeasured packages to reduce waste. And because they are sold as concentrates that take up only one-tenth the volume of products in their final mix, packaging and shipping require far less energy. Janitors are also encouraged to ease the burden on landfills by reusing the spray bottles and mixing containers for products. Taken together, these features of PortionPac's strategy underscore the firm's uncommon respect for other people and its robust commitment to the well-being of the planet—all without hindering its financial performance. Despite the slow economy, the company's revenue increased by 8 percent in 2009, with annual sales approaching $20 million.

So, what should be the focus of a well-managed firm? People or profits? PortionPac proves that a company may not have to choose between the two, and that's good news for everyone involved.

*Sources:* Leigh Buchanan, "The Un-Factory," *Inc.* Vol. 32, No. 5 (June 2010), pp. 63–67; "PortionPac," http://www.portionpaccorp.com, accessed October 14, 2010; and "RedOrbit," http://www.redorbit.com/modules/news/tools.php?tool=print&id=1877240, accessed October 14, 2010.



Even a casual scan of this chapter's opening Spotlight reveals that the company profiled, PortionPac Chemical, is a unique small business. Its leadership is intensely interested in financial performance, but they also pay very careful attention to the crucial relationships (especially those involving employees and customers) that make the business tick.

Some would say that it is precisely because of this emphasis on the people part of the puzzle that PortionPac performs so well. This may very well be the case. Others will claim that the company's emphasis on the environment is also important and plays a key role in generating positive results. This may also be true. The most important point, however, is that the leadership of PortionPac has the freedom to emphasize important relationships as they see fit. And consistent with the values of the company's founders, they have chosen to give serious consideration to the needs and interests of those who impact or are impacted by the firm's operations. They see this as a matter of integrity—of being true to the character of the enterprise and those who run it—and the emphasis seems to be paying off in many ways.

But what is integrity, anyway? That's a very important question. And in this chapter, we define and discuss this fundamental concept, recognizing that it is the foundation for ethical behavior in small businesses. We also provide frameworks to guide you toward the principled management of such enterprises.

## What Is Integrity?

**1**
Define *integrity*, and understand its importance to small businesses.

**integrity**
An uncompromising adherence to the lofty values, beliefs, and principles that an individual claims to hold.

The seeds of business misdeeds are sown when individuals compromise their personal **integrity**—that is, they do not behave in a way that is consistent with the noble values, beliefs, and principles they claim to hold. According to Karl Eller—the highly successful entrepreneur who turned the business of outdoor advertising into the revenue powerhouse that it is today—a person has integrity if his or her character remains whole, despite the pressure and circumstances of the worst of situations. In his words,

> *[A person of integrity] doesn't fold in a crunch; doesn't lie, cheat, flatter; doesn't fake credentials or keep two sets of books. He doesn't blame others for his mistakes or steal credit for their work. She never goes back on a deal: her handshake matches the tightest contract drawn up by the fanciest law firm in town.*[1]

In other words, integrity refers to a general sense of honesty and reliability that is expressed in a strong commitment to doing the right thing, regardless of the circumstances. Some acts, such as cheating on taxes, clearly violate this standard, while others are less obvious but just as inappropriate. For example, one entrepreneur who owned a flooring sales business often sold sheets of linoleum at first-quality prices, even though they were graded as "seconds" by the factory. To hide his deception, he developed an ink roller that changed the factory stamp from "SECONDS" to read "SECONDS TO NONE!" Those who caught the inaccuracy probably figured it was a typo and gave it no more thought, but unsuspecting customers were paying for first-quality flooring, only to receive imperfect goods. By any measure, this shady business practice reveals a lack of integrity on the part of the entrepreneur.

> **START UP TOOLS**
>
> **Perceiving Integrity**
>
> The integrity of a small business is determined mostly by the nature and quality of its relationships. However, *perceptions* of integrity also make a difference. As strange as it sounds, researchers Niels van Quaquebeke and Steffen Giessner found that people associate symmetrical company logos with more ethical, socially responsible behavior.

As discussed in Chapter 1, a successful entrepreneur seeks financially rewarding opportunities while creating value, first and foremost, for prospective customers and the firm's owners. This perspective makes clear that relationships are critical and integrity is essential to success. Financial gain is important, but it cannot be the only goal of interest. In fact, "doing anything for money" can quickly lead to distortions in business behavior. There are numerous motivations for misconduct in companies, but inappropriate acts such as price fixing, overcharging customers, using pirated software in the business, and a host of others are driven primarily by financial motives. To act with integrity, however, requires an individual to think differently by considering the welfare of others.

Fortunately, many small business owners strive to achieve the highest standards of honesty, fairness, and respect in their business relationships. Although unethical practices receive extensive attention in the news, most entrepreneurs and other business leaders are people of principle whose integrity regulates their quest for profits.

## Integrity and the Interests of Major Stakeholders

2 Explain how integrity applies to various stakeholder groups.

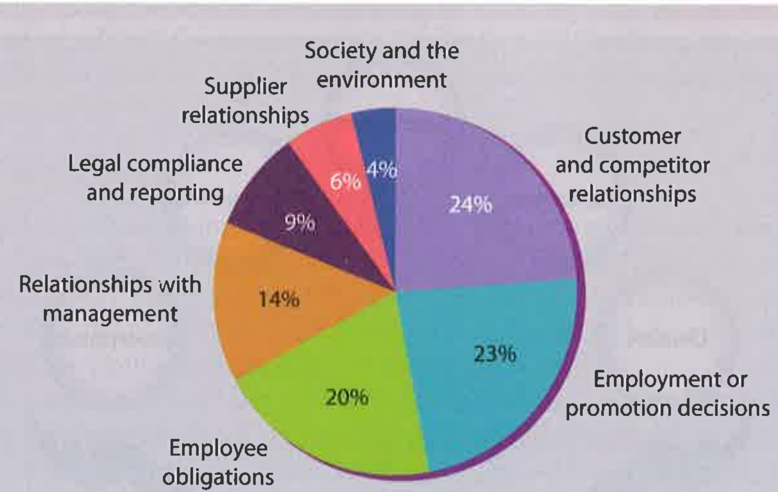
It is probably evident by now that the notion of integrity is closely tied to **ethical issues**, which involve questions of right and wrong.[2] Such questions go far beyond what is legal or illegal; entrepreneurs often must make decisions regarding what is honest, fair, and respectful.

In order to pinpoint the types of ethical issues that are most troublesome for small companies, a group of researchers from Baylor University asked small business owners nationwide the following question: "What is the most difficult ethical issue that you have faced in your work?" As might be expected, the question yielded a wide variety of responses, which have been grouped into the categories shown in Exhibit 2.1.

These responses provide a general idea of the issues that challenge the integrity of small business owners. As you can see in the exhibit, the issues mentioned most often are related to customers and competitors, such as failing to disclose conflicts of interest when representing clients in the same field, selling defective products, or misrepresenting unfavorable test results. However, the second most common category is concerned with the way a company treats its employees, including decisions about layoffs, workplace discrimination, and fairness in promotions. That this set of issues received almost as many responses as the first should not be surprising, given the challenges of the current business

**ethical issues**
Issues that involve questions of right and wrong.

**EXHIBIT 2.1 The Most Challenging Ethical Issues for Small Businesses**



environment. In fact, this category was near the bottom of the list when entrepreneurs responded to the same survey six years earlier.[3] Times are definitely changing.

The third category is related to the obligations of employees to their employers, focusing on the actions of personnel that may not align with the best interests of their companies—for example, accepting kickbacks, taking supplies for personal use, or loafing on the job. Fourth on the list are management processes and relationships, which can be put at risk when an employee must report to an unethical supervisor, cover for a superior's lies, or face other such uncomfortable situations. Management relationship issues can be especially disturbing because they reflect the moral fiber or culture of the firm, including weaknesses in managerial actions and commitments. Other issues—legal compliance and reporting, supplier relationships, and social and environmental responsibilities—received less attention in the survey than the other categories.

The results of this survey reveal that entrepreneurs must consider the interests of a number of groups when making decisions—owners (or stockholders), customers, employees, the community, and the government. The individuals in these groups are sometimes referred to as stakeholders, indicating that they have a "stake" in the operation of the business. Though definitions vary, **stakeholders** are typically described as those individuals or groups who either can affect the performance of the company or are affected by it.

**stakeholders**
Individuals or groups who either can affect or are affected by the performance of the company.

Because the interests of various stakeholder groups are different, they sometimes conflict; thus, decisions can be very difficult to make. And because there may not be one completely right or wrong position to take, managing the process can be extremely complicated.[4]

One executive observed that running a business is sometimes like juggling (see Exhibit 2.2). In his words, "I am given four balls to balance: the customers', the employees', the community's, and the stockholders', by which I mean profit. It's never made clear to me how I am to keep them all going, but I know for certain that there is one that I'd better not drop, and that's profit."[5]

As if the job were not already difficult enough, we must add one more ball to the mix—government.[6] Wandering beyond the limits of the law can quickly land a company in hot water, and there is no more certain way to compromise its integrity and its reputation.

**EXHIBIT 2.2** **Juggling the Interests of Stakeholder Groups and the Government**

However, the concerns of all of these groups are fundamental to the management of the business. If neglected, any one group can use its influence to negatively affect the performance of the company.

## PROMOTING THE OWNERS' INTERESTS

Nobel Prize–winning economist Milton Friedman outlined the responsibilities of businesses to society in very focused terms: "There is only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."[7]

Friedman argued that businesses should be expected simply to earn profits honestly; any other use of the firm's resources is justified only if it enhances the firm's value. Though we believe there is adequate room for entrepreneurs to adopt a broader view of their social responsibilities, it is undeniable that owners have a clear and legitimate right to benefit from the financial performance of the company.

Many businesses, even small ones, have more than one owner. When this is the case, high standards of integrity require an honest attempt to promote the interests of all the owners, which include a commitment to financial performance and protection of the firm's reputation. But this does not always happen, which Jeff Dennis learned the hard way. In 1989, he and three co-founders started a financial investment company called Ashton-Royce Capital Corporation. When the venture started to take off, two of the partners decided to "check out" and spend a good part of their time in California in semiretirement. This left the two remaining co-founders with more of the day-to-day work of the business and a growing resentment about the unfairness of the situation. In time, the conflict led to the dissolution of what had been a very profitable business.[8] Though entrepreneurs should be able to make their own decisions about personal matters, they have an obligation to make choices that protect the financial investment that others have in the company.

In many small businesses, a number of people own a small part of the enterprise but have no direct involvement in its operation. When this is the case, questions concerning proper conduct can show up in a number of areas. For example, entrepreneurs sometimes face ethical issues when reporting financial information. They must decide the extent to which they will be honest and candid. Because a firm has considerable discretion in reporting performance results, financial reports can sometimes be misleading without technically being illegal. But providing misleading financial information could easily persuade owners to make poor decisions regarding their investment in the company. The same could also be said for some who do not have ownership, outsiders such as bankers and suppliers who depend on a firm's financial reports to be accurate. It is always best to err on the side of honest disclosures that do not tend to mislead; doing so protects critical relationships and the reputation of the firm.

## CARING ABOUT CUSTOMERS

What do you call a business without customers? *Bankrupt!* Customers are obviously one of the most important stakeholder groups that a company must please. The fact that they are central to the purpose of any business has implications for integrity. Entrepreneurs who take customers seriously and care about them as individuals are apt to have more of them. And those they have are likely to return often because of that attitude.

It is easy to fall into the habit of seeing every client as merely a dollar sign, but this narrow and self-serving view can lead to a wide range of questionable practices. For example, entrepreneurs are often tempted to take advantage of customers by being less than honest with them. And marketing decisions can be particularly complicated when it comes to ethical issues. Advertising content must sell the product or service but also tell "the truth, the whole truth, and nothing but the truth." Salespeople often must

Photo courtesy of Steelcase, Inc.

walk a fine line between persuasion and deception. In some businesses, a sales representative might obtain contracts more easily by offering improper incentives to buyers or by joining with competitors to rig bids. This is clearly illegal and eventually may result in damage to the company's reputation, which will affect relationships with existing and potential customers.

Caring for customers is always important, but in some cases it can lead to life-or-death consequences. Steelcase, Inc., an office furnishings maker, is explicit about its commitment to integrity and customer care, but this was tested when the company started selling panels that could be used for waist-high office cubicles or be stacked to form floor-to-ceiling walls. Building managers loved them because they offered great flexibility, but there was a problem: The fire standards for full-length walls were more demanding than those for cubicle panels. Many wanted to ignore the oversight—including some very satisfied customers—but Steelcase's CEO, Jim Hackett, recognized that the company's commitment to integrity would require him to recall the defective panels from dealers and replace them with an improved, more fire-retardant product. This was very costly, and Hackett and his executive team lost their bonuses that year. But following the terrorist attacks that destroyed a part of the Pentagon building on 9/11, authorities found that some of the walls installed in that part of the complex were from Steelcase—and fortunately they were made of panels with the added fire-retardant materials. It was determined that these reduced the spread of burning jet fuel, saving many lives and no telling how much pain and suffering.[9] It also allowed Steelcase to avoid some very expensive lawsuits. The company has grown tremendously since it was a small office furnishings startup, but its high standards of integrity and deep concern for customers, as illustrated here, helped to fuel this growth. Though this situation is clearly unique, it shows that a firm's guiding principles sometimes can have a very serious impact on a business and its customers.

Companies with integrity recognize the importance of treating their customers with care, but it should be clear by now that this also just makes good sense. At its core, the formula for business success is actually quite simple: When a company delivers an excellent product with excellent service, customer satisfaction and healthy sales are almost certain to follow. Mike Jacobs, owner of two Wetzel's Pretzels franchises in California, believes his success in the marketplace has come from building employee teams that make things happen. With virtually no turnover since launching his businesses, Jacobs has communicated to his employees how important they are and how their performance impacts the business. In fact, their service orientation generates well over $1.1 million in annual sales.[10] The returns from high-quality customer care are apparent.

## VALUING EMPLOYEES

A firm's level of integrity is also expressed by the value it places on employees. Through management decisions, an owner affects employees' personal and family lives. Issues of fairness, honesty, and impartiality are inherent in decisions and practices regarding hiring, promotions, salary increases, dismissals, layoffs, and work assignments. Employees are also concerned about privacy, safety, and health issues, and these should not be ignored.

In communicating with employees, an owner may be truthful and fair, vague and misleading, or totally dishonest. Some entrepreneurs treat outsiders with great courtesy but display demeaning behavior or attitudes toward subordinates, whom they regard as mere pawns in the game of business. Showing proper appreciation for subordinates as human beings and as valuable members of the team is an essential ingredient of managerial integrity. It is also wise, since employees are a firm's most important resource.

Many entrepreneurs recognize the great importance of looking after the needs of their employees, creating a positive work environment and rewarding them generously for their contribution. Tom Rath, a researcher with The Gallup Organization and co-author of the book, *Wellbeing: The Five Essential Elements*, found that workers in well-managed workplaces actually *want* to spend time with their bosses, if those bosses truly care about the individuals they lead and are interested in what's going on in their lives. And when employees feel socially connected at work, they tend to be highly engaged and much more productive.[11] To complete the picture, employees who are loyal to the business naturally want to pour themselves into their work, which leads to high-quality service, very loyal customers, and ultimately, repeat business.[12] Once again, managing with integrity is the right thing to do, but it can also be very good for business.

Tony Hsieh recognized the virtuous cycle involved, a guiding concept that helped him lead online shoe store Zappos from a struggling startup in 1999 to a colossal category superstar worth $1.2 billion just a decade later. In his words,

> *We'd bet that by being good to our employees—for instance by paying for 100 percent of health care premiums, spending heavily on personal development, and giving customer service reps more freedom than at a typical call center—we would be able to offer better service than our competitors. Better service would translate to lots of repeat customers, which would mean lower marketing expenses, long-term profits, and fast growth.*[13]

Hsieh is so committed to supporting his people and protecting interactions with customers that he actually established a policy of paying employees $2,000 to quit if they were unhappy with their jobs. In his mind, forming strong personal and emotional bonds with customers is the surest way to provide unbeatable service, and from there, sales results will naturally follow. Zappos certainly generated plenty of sales, which is why Amazon.com decided to acquire the company on November 1, 2009. Signaling the importance of Hsieh's employee-centered philosophy to the company's success, Amazon asked him to stay on as CEO of the enterprise.[14]

To be sure, small businesses do not always show the level of concern for employees that Zappos expresses—not even within the limits of their resources—and we do not intend to imply that Hsieh's way of taking care of employees is right for every company. But there are many ways that companies can stray from the integrity track. For example, some small business owners give little thought to the standards of conduct that guide everyday behavior, thinking that a shortcut here and there won't hurt anything. But lapses in integrity can easily be passed down from superiors to subordinates, replicating like a life-threatening virus that spreads throughout the organization. As this influence expands, employees of small firms are likely to face pressure from various sources to act in ways that conflict with their own sense of what is right and wrong. For example, a salesperson may be pushed to compromise personal ethical standards in order to make a sale. Or an office employee may feel forced by her or his boss to act unethically, perhaps by destroying documents or misrepresenting production data. Such situations are guaranteed to spawn an organizational culture that erodes integrity.

Ronda Churchill/Bloomberg via Getty Images

Fortunately, most employees of small firms do not face such expectations, as was discovered by a research team at Baylor University.[15] In a nationwide survey of individuals holding managerial and professional positions in small firms, nearly three-fourths of the respondents (72.3 percent) reported an absence of pressure to compromise personal standards. This is encouraging, but the study also revealed that more than one-fourth of the respondents experienced either slight (24.1 percent) or extreme pressure (3.6 percent) to give in, which leaves room for improvement. The ideal is to develop a business environment in which the best ethical practices are consistently and uniformly encouraged, where employees feel completely free to do what they know is right.

Sometimes, employees may engage in unethical behavior at their employer's expense. They may fail in their ethical obligation to do "an honest day's work." Loafing on the job, working too slowly, and taking unjustified sick leave are all examples of such failure. Some employees even feign injury and draw fraudulent workers' compensation checks, thereby inflating the company's insurance costs.

According to FBI statistics, employees who steal supplies, merchandise, tools, or equipment from work cost employers as much as $150 billion dollars each year,[16] a figure that does not even include losses from embezzlement (that is, when an employee steals money from the firm). These problems are serious, with some experts estimating that one-third of all new businesses fail because of employee theft of one kind or another.[17]

## SOCIAL RESPONSIBILITY AND SMALL BUSINESS

To most people, an ethical business is one that not only treats customers and employees honestly but also acts as a good citizen in its community. These broader obligations of citizenship are called **social responsibilities**.

**social responsibilities**
A company's ethical obligations to the community.

Some regard social responsibility as a price of freedom to operate independently in a free economy. They believe that the public has certain social expectations regarding business behavior, not all of which are required by law. Accordingly, they regard some expenditures on social responsibilities as proper, even when they are costly.

To varying degrees, companies have increasingly accepted responsibility to the communities where they do business. Their contribution starts with creating jobs and adding to local tax revenues, but many entrepreneurs feel a duty to give back even more to the community in return for the local support they enjoy—and they usually benefit from increased goodwill as a result. It is important to recognize that opinions differ as to the extent to which businesses are obligated to engage in socially desirable activities, and the response of small businesses to those obligations also varies. Some emphasize environmentalism, minority contracting, or regional economic development, while others focus their attention on volunteerism, philanthropy, or day care for employees' dependents. Still others give only minimal attention to peripheral social issues.

### Examples of Citizenship in the Community

Contributions to the community can take many different forms. Ryan Allis and Aaron Houghton met when they were still students at the University of North Carolina. With combined experience in Web marketing, Web design, and software development, they soon joined forces and started a new company to sell an innovative Web-based e-mail list management tool that Houghton had developed. They called their new venture iContact Corp., and the market loved their product. Because the venture was profitable from its second year in business, Allis and Houghton chose to support charitable enterprises very early on. They established a social responsibility policy called the "4-1s" program. Under the program, iContact gives away 1 percent of its employee time, 1 percent of its payroll, 1 percent of its product, and 1 percent of its equity to worthy nonprofit organizations. In raw numbers, for 2009 alone iContact gave away 475 days of employee time to 63 organizations, contributed $109,000 in cash donations, and allowed 700 nonprofits to use its product free of charge. And with projections for continued growth, these numbers are very likely to increase in the years ahead.

In 1998, David Shapiro and Andrew Sherman started Fluid, an original music, sound design, and visual effects studio located in New York City. Today, the company has more than 20 employees, a growing list of very high-profile clients, and more than $6 million in annual revenues, but the company also does a great deal of pro bono work—that is, free service to the community. Many small businesses encourage their employees to make a difference in the community by donating their time to worthwhile causes, but companies like Fluid want more than just good PR from employee contributions of time and talent—they want maximum impact, which happens best when specific job skills are put to use.[18]

This trend toward "skills-based volunteering" is growing rapidly; in fact, recent research shows that around 40 percent of volunteers look for opportunities to put their specific skill sets to use. The bottom line for Fluid: Nonprofit organizations receive services for free that they would otherwise not be able to afford, and the company's employees give back to their community by doing what they love to do. Now they are all making beautiful music together.[19]

Entrepreneurs should think carefully about their community commitments, because building a business on the foundation of "doing good" may add to a small company's financial burden. However, this is often more than offset by increased loyalty among customers and employees who buy into the mission, which leads to improved productivity and morale. It can also help to set a company apart from competitors that offer similar products or services but make no charitable contributions. Perhaps most important, this commitment is often rewarded by customers in two ways—repeat sales and a willingness to pay a little more for what they get. These are strong incentives for a company to give serious consideration to its dedication to the community.[20]

### Differing Views on Social Responsibility

How do small business owners compare with big-business CEOs in their view of social responsibility? The evidence is limited, but research suggests that entrepreneurs who head small, growth-oriented companies may be more narrowly focused on profits and therefore less socially sensitive than CEOs of large corporations. Because simple survival may be the most pressing priority, many small, growing firms see social responsibility as a luxury they simply cannot afford. And in defense of small firm owners, we note that they usually spend their own money rather than corporate funds—it is much easier to be generous when someone else is footing the bill. Small business philanthropy often takes place anyway, but in the form of personal contributions by business owners.

Entrepreneurs must reconcile their social obligations with the need to earn profits. Earning a profit is absolutely essential. Without profits, a firm will not be in a position to recognize its social responsibilities for very long. But meeting the expectations of society can be expensive. For example, small firms must sometimes make expensive changes to conserve energy or emphasize recycling, and auto repair shops incur additional costs when they dispose of hazardous waste responsibly. It is evident that acting in the public interest often requires spending money, which reduces profits. There are limits to what particular businesses can afford.

Fortunately, many types of socially responsible actions can be consistent with a firm's long-term profit objective.[21] Some degree of goodwill is earned by such behavior. A firm that consistently fulfills its social obligations makes itself a desirable member of the community and may attract customers because of that image. Conversely, a firm that refuses its social responsibilities may find itself the target of restrictive legislation or local protests and discover that its customers and employees lack loyalty to the business.

Research conducted by Cone, Inc., a Boston-based strategic marketing firm, revealed that eight out of ten Americans claim corporate support of causes earns their trust in that firm. Eighty-six percent of respondents said they would be very or somewhat likely to switch brands based on corporate citizenship commitments. Carol Cone, CEO of the research firm, concludes, "It's clear from our research that the public wants to know . . . what a company is doing in the community—good and bad."[22] Small businesses seem to be responding to this message. A National Federation of Independent Business study found that 91 percent of small businesses made contributions to their communities through volunteering, in-kind assistance, and/or direct cash donations. The same study reported 74 percent of all small business owners volunteered for community and charitable activities, and the average commitment was just over 12 hours per month (which translates to 18 working days per year).[23] Overall, the evidence on performance impact is far from certain, but it suggests that commitment to the community may very well be good for business.

## GOVERNMENTAL LAWS AND REGULATIONS

Government at all levels serves a purpose, though there is room to debate whether it has too much power or too little. It intervenes directly in the economy when it establishes laws to ensure healthy competition. But its reach extends into other business matters as well—workplace safety, equal employment opportunities, fair pay, clean air, and safe products, to name a few. Entrepreneurs must comply with governmental laws and regulations if they are to maintain integrity, and avoid spending time behind bars.

One glaring example of unethical behavior by small firm management is fraudulent reporting of income and expenses for income tax purposes. This conduct includes *skimming*—that is, concealing some income—as well as improperly claiming personal expenses as business expenses. We do not mean to imply that all or even most small companies engage in such practices. However, tax evasion does occur within some of these firms, and the practice is common enough to be recognized as a general problem.

Tax avoidance can be flagrant and very intentional, but entrepreneurs often come up short on their tax commitments because of casual accounting systems, single-minded focus on their product or service, or both. One student entrepreneur confesses that he had a close brush with the law because he and his friends were creating clothing in his dorm room and selling it on his campus, but the company did not legally exist and he was not keeping track of sales and expenses because he didn't take seriously the obligations and advantages of keeping good records. But after a close encounter with Internal Revenue Service (IRS) agents, this young entrepreneur learned that accurate recordkeeping and legal formalities are necessary to ethical practice and, just as important, to peace of mind.[24]

When the topic of tax avoidance comes up, most people think of income taxes, but employee payroll tax—local, state, and federal obligations such as Social Security, Medicare, and unemployment—and other taxes must also be withheld. These often present the biggest tax burden on small businesses because they are owed regardless of whether the company makes a profit or not. And because tax authorities like the IRS do not always push hard enough to collect these taxes, small businesses can easily fall behind.[25]

This is what got Gus Rancatore into trouble. As co-owner of Toscanini's, a popular ice cream shop in Cambridge, Massachusetts, he sometimes struggled just to stay one step ahead of the business. As Rancatore puts it,

> *The bottom line is that, in the day-to-day craziness of running a business that was in danger of going off the rails, I missed tax payments—both employment taxes and my state meals tax. When it came to paying the state on time or making payroll and paying the milkman, I felt I had to worry about taxes second.*[26]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START UP

R E S O U R C E S

### Getting Assistance from the SBA

If all this talk of laws and regulation and compliance seems daunting, take heart! The Small Business Administration can help (go to http://www.sba.gov and choose the "Starting and Managing a Business" option). The information provided there can help small businesses understand their legal requirements and lead them to helpful government services from federal, state, and local agencies.

This financial neglect went on for some time—but it could not go on forever. Eventually, Rancatore owed the government a crippling $177,000, and there was no way he could come up with that kind of cash on demand. So, on the morning of January 17, 2008, state authorities showed up at the shop, padlocked the door, and put a bright orange "seized" sticker on the window. It was only with the support of friends and loyal customers that Rancatore was able to convince officials to allow him to reopen, and it was a long and painful road back from the financial abyss into which the business had descended.[27] And the damage to Rancatore's reputation is irreversible. Regardless of the circumstances, entrepreneurs must meet *all* tax obligations to preserve their integrity—or even to stay in business.

## The Challenges and Benefits of Acting with Integrity

**3**
Identify challenges and benefits to integrity that arise in small businesses.

Small companies sometimes face unique challenges to maintaining integrity, but the benefits of integrity are real and can offer small businesses a distinct advantage in the marketplace. However, small companies are often vulnerable because of their size and their desire to succeed. We'll discuss how the payoff from managing with integrity can make a small business, and how lack of it can break one.

### SMALL COMPANIES AND THE LEGITIMACY LIE

Walking the straight and narrow may be more difficult and costly on Main Street than it is on Wall Street. That is, small, privately held firms that are not part of the corporate world epitomized by Wall Street may face greater pressures than large businesses do to act unethically. Indeed, because small firms usually do not have the deep pockets and superior resources of their larger competitors, entrepreneurs may find it easier to rationalize, say, inappropriate gift giving or bribery as a way of offsetting what seem to be unfair limitations in order to establish a level playing field. And at times it may seem that a "little white lie" is justified when the life and future of the company are at risk. It's easy to cave in to the pressure when your back is against the wall.

Because startups do not have a history and a reputation to lean on when trying to sell customers on their new product or service or to impress other important stakeholders, entrepreneurs often are uniquely tempted to resort to telling what some researchers call "legitimacy lies."[28] That is, they sometimes misrepresent the facts to mislead others intentionally and earn their confidence. How do you feel about the following situations (which actually took place)?

- An entrepreneur launched his own fundraising business in South Carolina with only a few local projects to work on. Profits were slim, but that didn't stop him from telling everyone that business was great. Consistent with this false storyline, he set up an 800 number and launched a website to create an image of greater scale.[29]

- A small business owner who had just started a trucking company in Michigan sometimes used the phone in "creative ways" to shade customer impressions about the business. For example, "she pretended to transfer customers to different lines and used phony voices to make the company seem bigger."[30]

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- Partners in an auto sales startup rented a large lot for their business but could afford only four cars for inventory—a turn-off for would-be buyers. To adapt, the partners offered free parking in their lot to any employee of the big firm next door who would allow them to put a false price tag on their car during the day as if it were for sale. Many accepted, and soon the lot was full every morning and mostly empty by late afternoon. Passersby figured the company must be doing a booming business, and predictably, actual sales soon followed.[31]

When small business owners create false impressions to make their companies look good, are they being dishonest or simply resourceful? While there is nothing wrong with setting up an 800 number or establishing a Web presence to gain scale advantages to compete better against larger competitors, pretending to be something he or she is not is less than forthright and can lead a small business owner into what is, at best, a gray area. The drive and ingenuity of these entrepreneurs is certainly impressive, but their behavior raises questions about ethical standards. Such moves may save companies, but how would customers feel if they knew they were being manipulated in this way?

Telling legitimacy lies threatens the reputation of the business. If (when) the truth is revealed, the news could spread like wildfire and future sales or support could very well be compromised. It would be better—and much more honest—to understand the levers that move customers to confidence in a purchase and provide honest information that backs up your appeal. Research has shown that customers are less likely to decide to purchase if they have significant questions about three features of a new venture—the product or service that it offers, those who represent and/or run the business, and the organization itself.[32] (We call these features PRO factors—standing for *P*roducts, *R*epresentatives, and the *O*rganization—to emphasize that they can promote firm performance when customers are satisfied with them.) Prospective customers may have many different doubts and concerns about these factors, including the following:

- Will the *product* (or *service*) serve my needs better than alternatives, and will it be a hassle to change over from the brand I currently buy? (Research indicates that product/service knowledge is the most important of the three factors when customers make purchase decisions.[33])

- Do the company's *representatives* know what they are talking about, and will they (can they) live up to their assurances?

- Will the *organization* still be around to stand behind its product or service if I have a problem with it six months from now?

Considered in light of your own purchasing decisions, it should be clear that these are all reasonable concerns, and it is important that the new venture find a way to address them. For example, advertising can help to get product or service information out to prospective customers, but this can be expensive, so many new ventures choose to lean on a well-crafted publicity program, social media tools, or other promotional strategies instead (more on these in Chapter 17).

Often a small firm's legitimacy is staked on the reputation of its owner, but it is important to highlight and honestly bolster the credibility of anyone who represents the venture. It is best to make the credentials (educational background, expertise, industry experience, etc.) of key employees known, as well as to encourage the participation of those employees in trade, business, and community organizations where they can build important relationships and associations. The business itself can establish legitimacy by setting up a high-quality website, insisting on professional behavior from all customer-contact employees, forming strategic alliances with well-respected partner firms, and taking other, similar measures. The point is that a new venture or small company may be at a legitimacy disadvantage when compared to established competitors, but there are ways to close the gap. And while the research and our discussion above is concerned specifically with the reactions of customers, many of these principles clearly apply to relationships with investors, suppliers, and other important stakeholders as well.

## THE INTEGRITY EDGE

The price of integrity is high, but the potential payoff is incalculable. For example, it is impossible to compute the value of a clear conscience. The entrepreneur who makes honorable decisions, even when it comes to the smallest of details, can take satisfaction in knowing that she or he did what was right, even if things do not turn out as planned.

But integrity yields other important benefits as well. In his book *Integrity Is All You've Got,* Karl Eller observes that through his long career as a successful entrepreneur, he has seen one constant: the crucial role of integrity to achievement in business. As he puts it, "Those who have [integrity] usually succeed; those who don't have it usually fail."[34] Eller suggests that integrity lubricates the important traits of an entrepreneur so that they work harmoniously together, which can give a company an enormous advantage over competitors. Entrepreneurs with integrity are aware of the importance of the bottom line, but this is not their singular focus; nonetheless, extraordinary financial performance often follows their efforts.

A growing body of research supports the notion that ethical business practices are good for business, pure and simple. Citing specific studies, the advocacy group Business for Social Responsibility contends that there are numerous long-term benefits to adopting ethical and responsible business practices. These benefits include the following:[35]

- Improved financial performance
- Enhanced brand image and reputation
- Increased sales and customer loyalty
- Improved productivity and quality
- Better recruitment and reduced employee turnover
- Fewer regulatory inspections and less paperwork
- Improved access to capital

This is consistent with research conducted by the Institute of Business Ethics, which found that firms operating according to a "clear commitment to ethical conduct" consistently outperform those companies that do not. These findings prompted Philippa Foster Black, director of the institute, to declare, "Not only is ethical behavior in the business world the right and principled thing to do, but it has been proven that ethical behavior pays off in financial returns."[36]

Perhaps the greatest benefit of integrity in business is the *trust* it generates. Trust results only when the stated values of a company and its behavior in the marketplace match. When a small business owner looks to the needs of others and follows through on her or his promises, stakeholders notice. Customers buy more of what a firm sells when they realize that the company is doing its best to make sure that its products are of high quality and its customer service is excellent. Employees are much more likely to "go the extra mile" for a small company when it is clear that they are more than simply replaceable parts in an impersonal machine.

And members of the community also respond positively to business integrity. When they are convinced that a firm is living up to its commitments to protect the environment and pay its fair share of taxes, their support can keep the company going even if it falls on hard times. It all comes down to trust. If they conclude that the business is simply taking advantage of them, then all bets are off. There is no substitute for trust, and there is little hope for trust without integrity.

# Integrity and the New Economy

4
Describe the impact of the Internet and globalization on the integrity of small businesses.

For the entrepreneur with integrity, decisions are often complicated by developments in the world economy. Businesses that operate across national boundaries must consider the ethical standards that exist in other cultures, which often differ from those of their own country. And firms using the Internet face a host of ethical issues that have arisen in the online marketplace. As small firms move toward international commerce and harness the power of the Internet to launch and sustain their enterprises, these issues become all the more important.

## INTEGRITY AND THE ONLINE WORLD

It is not surprising that issues of honesty, deception, and fraud have affected Internet-based businesses, just as they have traditional commerce. It simply follows from the fact that those who buy and sell on the Internet are the same people who participate in all other arenas of the marketplace. One quickly encounters questions of right and wrong in business relationships in every venue.

An issue of great concern to Internet users is personal privacy. Businesses and consumers often disagree about how private the identity of visitors to websites should be. For example, businesses can use cookies (digital "ID tags" that track online activity) to collect data on patterns of usage related to a particular Internet address. In this way, a business may create a detailed profile of customers, which it may then sell to other parties for profit. Internet businesses—and even many of their customers—see the collection of personal information as helpful. A bookseller might, for example, welcome a customer back by name and tell him or her about a special book similar to those the customer ordered previously. To address customer concerns, a number of firms have developed privacy policies—they either will not share personal data or will not share it if the customer requests privacy.

The extent to which an employer may monitor an employee's Internet activity is also hotly debated. Many workers believe it is inappropriate for employers to monitor their e-mail, a practice they consider to be an invasion of privacy. Employers, on the other hand, are concerned that employees may be wasting company time dealing with personal e-mail, shopping online, and surfing the Internet. And it appears there is reason for concern. Business journalist David Freedman reviewed research indicating that accessing the Internet at work for personal reasons is escalating rapidly. In an *Inc.* article, he states,

> *American workers spent the equivalent of 2.3 million years' worth of 40-hour work-weeks reading nonwork-related blogs while at work, according to a study by* Advertising Age *magazine. And that's just blogs. Millions more work years were spent shopping online, checking eBay listings, cruising social networks, looking for vacation deals, Googling old flames, and, of course, ogling porn. [This research indicates that] employers spend nearly $760 billion a year paying employees to goof off on the Web.*[37]

Freedman concluded that this Internet activity is not all bad (for example, everyone needs a break now and then,[38] and an employee who spends time on the Internet can spot emerging trends and bring that insight to his or her work). But many employers are convinced such activity hinders workplace productivity and thus are taking steps to do something about it.[39]

An increasing number of small businesses are installing software to monitor Internet use, and one study found that 38 percent of firms go so far as hiring staff to read or otherwise analyze employees' e-mail.[40] Beyond productivity concerns, companies are very worried these days about deliberate or accidental leaks of sensitive information, employee access to inappropriate content, and system exposure to risky viruses and malware. But these must be balanced against respect for employee privacy. In the past, the courts tended to give firms great freedom to monitor personal e-mail accounts accessed from company networks, but that is quickly changing. In a number of cases, the courts have ruled that a firm does not have a legal right to monitor personal e-mail at work unless it has explicitly informed employees that it may do so.[41] Most small companies choose not to monitor workers' Internet use, but those that do should be sure to develop a carefully worded and legally sound policy first, and then ensure that all employees are aware of it.[42] Taking such measures is very practical—it helps head off costly legal challenges—and it also communicates that the firm respects its employees and signals sound commitment to high standards of integrity.

**intellectual property**
Original intellectual creations, including inventions, literary creations, and works of art, that are protected by patents or copyrights.

Widespread use of the Internet has also focused attention on the issue of protecting **intellectual property**. Traditionally, protection has been granted to original intellectual creations—whether inventions, literary works, or artistic products such as music—in the form of patents, copyrights, trademarks, design rights, and trade secrets. The law allows originators of such intellectual property to require compensation for its use. However, the Internet has made it easy for millions of users to copy intellectual property free of charge.

Protection of intellectual property is a political as well as an ethical issue. Recent congressional hearings, lawsuits, and proposed legislation suggest that additions or changes to current laws are likely, and international enforcement continues to be a major problem. As Internet use continues to grow and practices such as online selling and file sharing are made increasingly easier, it is safe to assume that property rights will become more difficult to protect. Therefore, content providers and other intellectual property owners will have to take stronger measures to guard what is legally theirs.

The problem of intellectual property rights violations was highlighted recently when accusations were leveled against eBay Inc., claiming that the online auction powerhouse was materially responsible for the rise in the sale of counterfeit goods (that is, unauthorized

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### Managing Your Online Reputation

Contrary to the old saying, what you don't know *can* hurt you! With the rising popularity of social media, the chances are good that someone is trashing your company's reputation online. And if they are, it's important that you know about it so you can deal with the potential fallout. Many firms are using tools like Google Alerts, Yext Rep, Viralheat, and Trackur to keep tabs on competitors and scan online customer comments about their business. You can, too, and for some of these tools there is no charge. For more on managing your online reputation, see April Joyner, "Who's Talking about You?" *Inc.*, Vol. 32, No. 7 (September 2010), pp. 63–64.

copies of a legitimate product). *The Economist* provides an idea of how widespread the problem has become:

> *A few years ago sellers on eBay were mostly private individuals flogging second-hand goods. But now eBay is increasingly used by professional retailers selling new items. Many of them sell fakes. [The French company] LVMH claims that out of 300,000 products [labeled] Dior and 150,000 Louis Vuitton handbags offered on eBay in the second quarter of 2006, fully 90% were fake.*[43]

Despite its aggressive fight against counterfeiting, the problem continues to dog the Internet icon. In fact, eBay has already lost lawsuits in Europe to luxury goods makers, though the online company's legal efforts have been more successful in the United States.[44] Regardless of eBay's legal liabilities, it is clear that the sale of counterfeit goods, though increasing, is a violation of the law and a breach of integrity. The practice cannot be defended.

## INTERNATIONAL BUSINESS AND INTEGRITY

Every country faces questionable business behavior within its borders, but some must deal with very serious forms of illegal business activity. For example, Italian police raided a Chinese-owned counterfeiting factory in the Tuscan town of Prato and confiscated more than 650,000 fake Gucci and Louis Vuitton handbags and accessories. Many such factories are setting up shop in Tuscany to be close to European consumers and to be able to add a "Made in Italy" label to their goods.[45] Other rogue businesses—some located in the United States—routinely exploit the weak and vulnerable in ways that stray far from ethical practice. For example, some companies exploit labor in countries with weak labor laws in order to procure products at low costs. Though practices of this kind may be tolerated (even encouraged) by local governments, labor activists and human rights organizations have condemned them, and they are increasingly targeted by law enforcement authorities.

In operating abroad, U.S. businesspeople often encounter ethical issues that are clouded by cultural differences. So what are entrepreneurs to do? Frequently, they simply apply U.S. standards to the situation. In some cases, however, this approach has been criticized for resulting in **ethical imperialism**, an arrogant attempt to impose American perspectives on other societies. Some guidance is provided by restrictions specified in the Foreign Corrupt Practices Act, which makes it illegal for U.S. businesses to use bribery in their dealings anywhere in the world. Regardless of local practices, American firms must comply with these laws, even though "gray areas" exist in which there are no definite answers.

**ethical imperialism** The belief that the ethical standards of one's own country can be applied universally.

Another viewpoint is embodied in the saying "When in Rome, do as the Romans do." This philosophy, sometimes called **ethical relativism**, is troublesome, because it implies that anything goes if the local culture accepts it. To define its ethical landscape and work out its position on difficult issues, a small business must consider the nuances of its particular international environment. Training is also needed to ensure that each

**ethical relativism** The belief that ethical standards are subject to local interpretation.

employee understands the firm's commitment to integrity, and consulting an attorney in the United States with appropriate expertise is highly recommended.

Also, bear in mind that one-time practices may set a pattern for future behavior. Some business owners have observed that offering a bribe to make a business deal possible often creates expectations for more of the same in the future. Owners who refuse to pay these "fees" say that they may have to deal with frustrating inconveniences in the short term (for example, shipped products being held up by customs), but it is likely to discourage such demands in the future. This is one of the ways in which integrity in business may offer unanticipated rewards.

# Building a Business with Integrity

**5**
Suggest practical approaches for building a business with integrity.

The goal of an entrepreneur with integrity is to have a business that operates honorably in all areas, which sets the entrepreneur on the path toward crafting a worthy legacy, as discussed in Chapter 1. This goal is not reached automatically, however. To build a business with integrity, management must provide the leadership, culture, and instruction that support ethical perspectives and appropriate behavior.

## THE FOUNDATIONS OF INTEGRITY

**underlying values**
Unarticulated ethical beliefs that provide a foundation for ethical behavior in a firm.

The business practices that a firm's leaders or employees view as right or wrong reflect their **underlying values**. An individual's beliefs affect what that person does on the job and how she or he acts toward customers and others. Talk is cheap (that is, *anyone* can *sound* ethical), but actual behavior provides the best clues to a person's true underlying system of basic values. Business behavior generally reflects the level of a person's commitment to honesty, respect, truthfulness, and so forth—in other words, to integrity in all of its dimensions. Such values are often organized into the business enterprise's mission statement.

Values that serve as a foundation for integrity in business are based on personal views of the role of humankind in the universe and, naturally, are part of basic philosophical and/or religious convictions.[46] In the United States, Judeo-Christian ideals have traditionally served as the general body of beliefs underlying business behavior, although there are plenty of examples of honorable behavior based on principles derived from other religions. Since religious and/or philosophical principles are reflected in the business practices of firms of all sizes, a leader's personal commitment to certain basic values is an important determinant of a small firm's commitment to business integrity.

Entrepreneurs who are deeply committed to underlying standards of integrity operate their businesses in ways that reflect their personal values and ideals. One business that places the entrepreneur's personal values above dollars is Ukrop's Super Markets, a Richmond, Virginia–based grocery chain that does not sell alcohol, closes every Sunday, and donates 10 percent of its profits to charity. Several times, *Fortune* magazine has named Ukrop's in its list of the 100 best companies to work for. And customers are happy with the company's policies, such as having staff carry and load groceries and refusing to take tips for this service.[47]

Steadfast devotion to integrity can lead to many other positive outcomes, as well. For example, a long-time observer of high-tech startups commented on the significance of an entrepreneur's personal standards to investment decisions:

> *I can tell you, even with the smallest high-technology companies, the product had to be good, the market had to be good, the people had to be good. But the one thing that was checked out most extensively by venture capitalists was the integrity of the management*